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STRUCTURED JUDICIAL DECISION-MAKING AND MINORITY PROTECTION

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A corporation controlled by a majority shareholder may engage in self-dealings that harm the interests of the minority shareholders. If a minority shareholder challenges the decision in court, what should be the appropriate methods for judicial decision-making? Theoretically, courts can choose between balancing or structured decision-making. Existing studies show that balancing has significant advantages over structured decision procedures in antitrust, discrimination law, and constitutional law. This article develops an economic theory to illustrate the advantages of structured decision-making in the context of corporate law. In Delaware, courts have adopted the structured decision-making method in the protection of minority shareholders. The underlying rationale for Delaware courts' approach can be illustrated using the law and economics theory of property rule and liability rule protection for minority rights. Delaware courts have essentially applied a combination of property rules and liability rules, an approach that this article refers to as "structured pliability rules," to protect minority shareholders. Courts can incorporate the consent of minority shareholders into their judicial rulings through the implementation of structured decision-making approaches, thereby altering the probabilities of success for various parties depending on whether the decision has received approval from a majority of minority shareholders.

The theory of structured pliability rules presented in this article has significant explanatory and normative implications. It explains the underlying rationale of Delaware law regarding self-dealings, offers normative guidance for the design of judicial decision-making methods in appraisal actions, and provides insights on enhancing corporate law in other jurisdictions.

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Furthermore, this article contends that structured pliability rules should extend beyond corporate self-dealings and be applied in other scenarios involving majority-minority conflicts. It further explores the potential application of structured pliability rules in the judicial review of constitutional law pertaining to takings. In cases where a government intends to expropriate private lands, courts should employ distinct decision-making rules based on the level of approval among the affected landowners.

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Introduction

In a business corporation where the majority shareholders can make a decision on a one-share-one-vote basis, a general concern is that the corporation may engage in self-dealing transactions that benefit the majority at the expense of the interest of the minority.[1] For example, a majority shareholder or group of shareholders may try to sell company assets to themselves at prices far below market value. Such actions enable the majority to profit from the transaction while adversely affecting the minority shareholders. Scholars have consistently highlighted the importance of legal safeguards that protect minority shareholders from tunneling practices, as these protections foster investment and contribute to the development of a robust capital market.[2] Four economists, Rafael La Porta, Florencio

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1. *See* Johnson Simon et al., *Tunneling*, 90 Am. Econ. Rev. 22 (2000). Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 Colum. L. Rev. 941, 949 (2020). ("cash-flow rights conflicts involve either *a transaction* in which the controller stands on one side and the controlled corporation on the other or *an action* taken by the corporation that results in reallocation of discernible economic value from the minority to the controller (both cases are commonly referred to as self-dealing)"). For cases in which courts review self-dealings, *see, e.g.*, Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994) (merger between a controlling shareholder and the company); Levien v. Sinclair Oil Corp., 261 A.2d 911 (Del. Ch. 1969) (a dividend distribution decision relating to conflicted parent-subsidiary relationships). Another classical example is the so-called "opportunistic amendment hypothesis"—the majority or supermajority members of a corporation may amend the corporate charter in the midstream that harms the interests of the minority shareholders. *See, e.g.*, Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 Colum. L. Rev. 1549, 1573 (1989); Lucian Arye Bebchuk, *Foreword: The Debate on Contractual Freedom in Corporate Law*, 89 Colum. L. Rev. 1401 (1989). While I use "majority shareholders" for the sake of simplicity in this article, it should be noted that it sometimes also refers to "controlling shareholders" who hold a special class of shares that grant them additional voting rights and hence control of the corporation. Similarly, I use minority shareholders to refer to those shareholders that do not exercise meaningful control of the corporation, even though they may in fact hold a large proportion of shares.

2. American corporate law has long been regarded as exceptionally successful in protecting minority shareholders and has contributed immensely to the capital market in the United States. Erica Gorga & Michael Halberstam,

Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, collectively known by their acronyms as "LLSV," published a series of articles on law and finance, arguing that common law countries are superior in their protection of minority shareholders and thus have stronger capital markets.[3] It has been noted that courts in civil law jurisdictions, especially the French law jurisdictions, are constrained by more rigid rules and cannot effectively curb tunnelings by the majority shareholders or insiders of corporations.[4] Meanwhile, scholars have found that compared with other common law jurisdictions such as the United Kingdom (UK), courts in the United States, especially in Delaware, assume a notably pronounced role in safeguarding the rights of minority shareholders.[5] The thriving state of

Litigation Discovery and Corporate Governance: The Missing Story about the Genius of American Corporate Law, 63 EMORY L.J. 1383, 1386 (2013) ("This comparative enterprise has been highly consequential in that the legal variables so identified have, in turn, been deemed 'preconditions' to the highly developed capital markets in the United States that other nations across Europe, Asia, and Latin America ought to emulate."); Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 783 (2001) (stating that the article seeks to "explain the complex network of interrelated legal and market institutions that supports strong markets in countries, like the United States and the United Kingdom."). In business corporations, minority shareholders' interests may be harmed by those in control, including the directors and the majority shareholders. John Armour et al., *Agency Problems and Legal Strategies, in* ANATOMY OF CORPORATE LAW 36 (Kraakman et al. eds, Oxford University Press 2009). This article focuses solely on the conflicts between the majority and minority shareholders and does not consider directors' misconduct. Many corporate decisions may harm the interests of minority shareholders. This article will focus mainly on self-dealing transactions, which more directly affect the minority's rights. For other types of corporate decisions that might adversely affect minority shareholders, *see, e.g.*, Gordon, *supra* note 1; Bebchuk, *supra* note 1.

3. *See, e.g.*, Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285, 286 (2008) ("LLSV documented empirically that legal rules protecting investors vary systematically among legal traditions or origins, with the laws of common law countries (originating in English law) being more protective of outside investors than the laws of civil law (originating in Roman law), and particularly French civil law, countries."); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998)

4. Simon et al., *Tunneling*, *supra* note 1.

5. *See* BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE, AND OPERATION 309, 333 (Oxford Univ. Press 1997) ("Ideally, judges will have sufficient awareness of key commercial dynamics to evaluate in a well-informed fashion the conduct of those involved in companies. There is some reason, however, that English judges are not particularly well-qualified on this count. . . English judges usually eschew judicial activism. As well, they are strongly inclined to follow rules set down in previous cases."); John Armour

the U.S. capital market has prompted scholars to investigate the legal factors that contribute to its success.[6] Some attribute this success to the inter-state competition within the federal system, which is considered a distinguishing characteristic of American corporate law, [7] while others attribute it to the civil procedures within the American legal framework.[8]

This article identifies another important feature of courts in the protection of minority rights in the United States—the mode of judicial decision-making. In Delaware, where most corporations are incorporated, courts have adopted structured decision-making methods and developed different decision-making rules in different circumstances.[9] By contrast, many other states have adopted a balancing approach.[10] The

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et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 688-90 (2009); CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 29 (Univ. of Chicago Press 2008) ("Despite its small size and diminutive stature in virtually all other areas of the U.S. political economy, it is the most attractive jurisdiction for incorporation among Fortune 500 companies").

6. *See, e.g.*, MILHAUPT & PISTOR, *supra* note 5, at 17–20; Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1234 (2002).

7. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14–15, 118 (AEI Press 1993).

8. *See* Gorga & Halberstam, *supra* note 2. For other explanations, see John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2151–52, 2171–75 (2001); Mark J. Roe, *Can Culture Constrain the Economic Model of Corporate Law?*, 69 U. CHI. L. REV. 1251, 1262–64 (2002); MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 1–5, 49–51, 201–04 (Oxford Univ. Press 2003).

9. See Louis Kaplow, *Balancing Versus Structured Decision Procedures: Antitrust, Title VII Disparate Impact, and Constitutional Law Strict Scrutiny*, 167 U. PA. L. REV. 1375, 1440 (2019) [hereinafter Kaplow, *Balancing Versus Structured Decision Procedures*]. Louis Kaplow, *On the Design of Legal Rules: Balancing Versus Structured Decision Procedures*, 132 HARV. L. REV. 992, 997 (2019) [hereinafter Kaplow, *On the Design of Legal Rules*].

10. Courts in Germany, for example, have not adopted structured decision procedures. *See* Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393, 435 (2003) ("German law mandates liability-rule protection and leaves no freedom for the parties to contract for property-rule protection."). In the UK, courts sometimes review corporate decisions to protect minority shareholders in unfair prejudicial actions. However, courts have not developed similar standards that take into account the approval from the majority of minority shareholders. UK courts largely choose balancing rather than structured decision-making in these types of

utilization of structured decision-making within the United States legal framework has garnered significant scholarly attention in recent years. The most vocal critic has been Louis Kaplow, who argues that unconstrained balancing is more efficient than structured decision-making.[11] Kaplow's analysis focuses on constitutional law and antitrust law. It remains an interesting and important question whether the judicial decision-making methods are crucial to the success of Delaware law, and whether other jurisdictions should emulate this method of reviewing corporate decisions.[12]

This article endeavors to provide a novel perspective on the superiority of structured decision-making over unconstrained balancing when it comes to safeguarding the rights of minority shareholders from a law and economics perspective.[13] Law and economics scholars have long recognized the distinction between property rule and liability rule protection of a legal entitlement.[14] According to Calabresi and Melamed, if a legal entitlement is protected by property rules, it cannot be transferred without the consent of the owner of the entitlement.[15] If, however, a legal entitlement is protected by liability rules, it may be transferred as long as a court ensures that the owner has been awarded just compensation. This theoretical framework has also been employed to analyze the protection of minority shareholders under corporate law.[16] In a business corporation

cases. PAUL L. DAVIES & SARAH WORTHINGTON, GOWERS AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 681-83 (Sweet & Maxwell 9th ed. 2012)

11. *See generally* Kaplow, *On the Design of Legal Rules*.

12. Courts in Germany, for example, have not adopted structured decision procedures. See Goshen, *supra* note 10, at 435 ("German law mandates liability-rule protection and leaves no freedom for the parties to contract for property-rule protection.").

13. In recent years, the use of structured decision-making is under attack. *See, e.g.*, Kaplow, *On the Design of Legal Rules*.

14. *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). A legal entitlement confers interests to its owner and is a concept broader than a "right" since it may not have been formally recognized as a right.

15. *Id.* at 1092.

16. Many studies consider the protection of the entitlement to be a choice between these two rules. *See, e.g.*, IAN AYRES, OPTIONAL LAW: THE STRUCTURE OF LEGAL ENTITLEMENTS (Univ. of Chicago Press 2005); Ian Ayres & J.M. Balkin, *Legal Entitlements as Auctions: Property Rules, Liability Rules, and Beyond*, 106 YALE L.J. 703, 704 (1996); *see generally* Ian Ayres, *Protecting Property with Puts*, 32 VAL. U. L. REV. 793 (1998); *cf.* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE

where the majority shareholder can make a decision on a one-share-one-vote basis, a general concern is that the decision may harm the property interests of the minority shareholders.[17] The minority members can be protected by property rules. In that case, any changes to their interests must be approved by each of the minority members or a majority of the minority members. The second approach is for courts to review majority decisions to ensure the fairness of these decisions, which is considered as a form of *liability rules* protection.[18] This approach can overcome the problem of opportunistic holdouts by minority shareholders. However, liability rules face the challenge that judges may not have the necessary information and expertise to determine what is fair to the minority shareholders.[19] Due to this difficulty,

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L.J. 1027 (1995); Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713 (1996).

17. One classical example is the so-called "opportunistic amendment hypothesis"—a majority or supermajority of shareholders of a corporation may amend the corporate charter in the midstream that harms the interests of the minority shareholders. *See, e.g.*, Gordon, *supra* note 2, at 1573, 1574; *see generally* Bebchuk, *supra* note 1. This is similar to the "tyranny-of-the-majority" problem. *See* ALEXANDER M. BICKEL, THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS 27 (Yale Univ. Press 1962).

18. For instance, let's consider a scenario where a majority shareholder intends to sell a valuable company asset to themselves at a significantly lower price than its market value. This self-dealing transaction could potentially benefit the majority shareholder while causing financial harm to the minority shareholders. Under a property rule approach, the minority shareholders' interests would be protected, and their approval would be required for such a transaction to take place. This ensures that any changes affecting their property rights are subject to their consent or the agreement of a majority of the minority shareholders. Alternatively, courts can play a crucial role in safeguarding minority shareholders' rights through a liability rule approach. In this case, the court would carefully examine the fairness and adequacy of the transaction, ensuring that the minority shareholders receive just compensation for any potential harm or loss resulting from the transaction.

19. Goshen, *infra* note 25, at 431 ("The vast majority of judges lack any expertise with the realities of the corporate world."); John C. Coffee Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1620 (1989); Lucian Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1855 (1989). Courts often need to rely on conflicting expert opinions, which gives rise to doubts as to whether courts are capable of adjudicating such disputes. Recent studies show that certain shareholder rights are impossible to evaluate, rendering it difficult for courts to determine whether a decision made by a corporation is fair to the minority or not. James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 461 (1995) ("[T]hese very same multiple-party cases entail high assessment costs as well as high transaction costs, and

courts in many jurisdictions do not actively review corporate decisions.[20] A widely shared belief is that property rules should be preferred when transaction costs are low, and liability rules are necessary when transaction costs are high.[21]

While current studies largely consider judicial review as simply offering liability rule protection,[22] this article argues that Delaware courts can be viewed as offering a combination of property rules and liability rules protection, which this article refers to as "structured pliability rules."[23] Within this approach, when a corporate decision obtains the backing of a majority of the affected minority members, courts invoke a specific set of rules that limit the scope of scrutiny and afford the corporation

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this might regularly be the case."). Eugene Kontorovich, *The Constitution in Two Dimensions: A Transaction Cost Analysis of Constitutional Remedies*, 91 VA. L. REV. 1135, 1147 (2005) ("When an entitlement is not traded in thick markets, or possesses elements of idiosyncratic value, it becomes more difficult to get an accurate judicial valuation."). Moreover, some collective rights, such as control rights, cannot be easily evaluated. *See generally* Goshen & Hamdani, *supra* note 1. Some members may hold the belief that their shares are worth more than the market price, as it does not reflect the intrinsic value of shares. When there is a market price for the rights, such as the price of a share in a stock market, the price only reflects the value at the margin to people who buy and sell shares. Meanwhile, some members may claim that their collective rights are worth more than the market price, only to hold out the decision for more compensation, which may delay the decisions that might benefit the members as a whole. Krier & Schwab, *supra* ("If parties can hide their valuations from each other, they can hide them from a judge.").

20. *See* CHEFFINS, *supra* note 5, at 309, 333; Goshen, *supra* note 10, at 431.

21. Krier & Schwab, *supra* note 19, at 450 ("Let the parties trade by themselves when they are able; presumably they can establish the relevant values by bargaining more cheaply and more accurately than can the judge by weighing the evidence.").

22. Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 74 (1986) ("From this perspective, eminent domain provides a mechanism that allows government to convert property rules into liability rules. This model presumes that property rules work well where low transaction costs make consensual exchange of resources practical. Liability rules, on the other hand, are necessary where high transaction costs render consensual exchange difficult."); *See* Daniel Markovits & Alan Schwartz, *Who Owns What? Re-Thinking Remedies in Private Law* 36-37, (Working Paper, Jan. 17, 2019), https://economix.fr/uploads/source/doc/workshops/2019_6th_imle/Schwartz%20%20%26%20Markovits%20IML%26E%202019.pdf ("Productive property... is thus subject to what is commonly called liability rule protection").

23. The concept of structured pliability rules is new, while the idea of pliability rules was proposed by Bell and Parchomovsky. *See generally* Abraham Bell & Gideon Parchomovsky, *Pliability Rules*, 101 MICH. L. REV. 1, 6 (2002).

greater deference.[24] Conversely, if a decision lacks such support, courts undertake a comprehensive review to assess the fairness of the transaction.[25] Courts employ different *rules* and *standards*,[26] following structured decision-making procedures based on whether the corporate decision has been approved by the majority of minority shareholders.

This article further argues that structured pliability rules are superior to liability rules under two assumptions that normally hold. First, courts generally face limitations in their access to information and expertise, making it more challenging to ascertain the fairness of organizational decisions, as compared

24. In Delaware, when a corporation enters into a self-dealing transaction, the court will first consider whether the corporate decision has been approved by a majority of minority shareholders and an independent committee of directors. Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014); *In re* MFW S'holders Litig., 67 A.3d 496, 502, 536 (Del. Ch. 2013). If so, the court will grant a motion to dismiss based on the business judgment rule and will not proceed any further. Louis Kaplow, *Multistage Adjudication*, 126 Harv. L. Rev. 1179, 1180 (2013) ("U.S. civil litigation allows motions to dismiss and for summary judgment prior to trial."). Aronson v. Lewis, 473 A.2d 805, 812 ("The business judgment rule . . . [carries] a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").

25. Similar standards of review are not seen in other jurisdictions. *See* Goshen, *supra* note 10, at 435 ("German law mandates liability-rule protection and leaves no freedom for the parties to contract for property-rule protection."). In the UK, courts sometimes review corporate decisions in unfair prejudicial actions. However, courts have not developed similar standards that take into account the approval from the majority of minority shareholders. *See* Davies & Worthington, *supra* note 10 at 681-83 (Sweet & Maxwell 9th ed. 2012). In Germany, shareholders can file a lawsuit based on Sec. 243 of the German Stock Corporation Act (AktG) to void the resolution, which creates a holdout leverage for the minority shareholder since it can delay the execution of the corporate decision. Due to the concern about frivolous lawsuits, Germany has developed a "fast-track" procedure that enables courts to deal with disputes quickly when evidence shows that the action is without merits or that the suit is merely used as a holdout. However, German courts do not consider the same factors as the Delaware courts. *See* Christian A. Krebs, *Freeze-Out Transactions in Germany and the U.S.: A Comparative Analysis*, 13 Ger. L.J. 941, 966 (2012) ("As long as an action to enjoin is pending, the squeeze-out cannot be registered with the commercial register, and therefore the transaction cannot become legally effective.").

26. For the distinction between the two, see Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 621 (1992). Scholars have noted that discovery imposes significant costs on the parties. *See* Gorga & Halberstam, *supra* note 2.

to the investors themselves.[27] Second, the approval by a majority of minority shareholders can significantly enhance the probability that the decision aligns with the interests of the shareholders as a collective.[28] In light of these assumptions, structured pliability rules can integrate the parties' autonomy within judicial proceedings, thereby mitigating concerns regarding the institutional competence of the court.

The theory proposed in this article carries significant policy ramifications for comparative corporate law, providing insight into the underappreciated role of structured decision-making as a crucial element contributing to the success of American corporate law.[29] Notably, this approach has not received adequate recognition in current studies. For instance, German courts have yet to embrace this approach, resulting in challenges when it comes to regulating self-dealings.[30] Meanwhile, courts in the United Kingdom (UK) have adopted an approach that is functionally similar to that in Delaware.[31]

This article also contributes to the literature on comparative civil procedure law. Scholars have identified a tradeoff between procedural costs and the costs of error in the design of civil procedure rules.[32] Scholars have recognized that as procedures become more intricate, the associated procedural costs increase, while the costs of error generally decrease.[33] Various jurisdictions have adopted different approaches: some, like the

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27. The determination of the fairness of a transaction is usually recognized to be difficult even with the tools of modern corporate finance. Courts may need to rely on the opinions of investment bankers that are problematic. *See* Lucian Arye Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can be Done About It?*, 1989 DUKE L.J. 27, 37-46 (1989). Investment banks could choose among various justifiable estimates of share value to reach disparate conclusions. Ted. J. Fiflis, *Responsibility of Investment Bankers to Shareholders*, 70 WASH. U. L.Q. 497, 518 (1992). William J. Carney, *Fairness Opinions: How Fair Are They and Why We Should Do Nothing About It*, 70 WASH. U. L.Q. 523, 533 (1992).

28. Goshen, *supra* note 10, at 410 n.53.

29. For a discussion of the genius of American corporate law, *see generally* ROMANO, *supra* note 7; *see also generally* Gorga & Halberstam, *supra* note 2.

30. *See infra* Section II.C.1.

31. *See infra* Section II.C.2.

32. Geoffrey P. Miller, *The Legal-Economic Analysis of Comparative Civil Procedure*, 45 AM. J. COMP. L. 905 (1997).

33. *Id.* at 906–07. One example is the rule of discovery, which enables the court to collect information about the background of the corporate decision and identify wrongdoings while also incurring significant costs for the parties involved.

United States, have implemented complex procedural rules with relatively low costs of error, whereas others, like France, have opted for less costly procedural rules but with higher costs of errors.[34] In light of corporate litigation, this article argues for the adoption of dual sets of rules by courts, as opposed to a singular approach. The court should adopt procedural rules that are more complicated and costly when offering liability rules protection but can be changed if there is approval by the majority of minority shareholders. Consequently, the theory proposed in this article lends support to the employment of intricate judicial procedures, as the drawbacks associated with costly procedures can be significantly mitigated through the implementation of structured pliability rules.[35]

Structured pliability rules can be applied beyond the realm of corporate law. In line with this perspective, the article posits that courts should contemplate the application of structured pliability rules when evaluating eminent domain decisions, much like the review of self-dealing within corporate law. Specifically, when a government intends to acquire and assemble parcels of land in a given area, the collective approval of the majority of residents facing similar circumstances could be considered in determining the appropriate standard of review.[36] By adopting this approach, the article aims to demonstrate the superiority of structured pliability rules over current proposals addressing the safeguarding of individual property rights in eminent domain cases.

This article proceeds as follows. Part I develops the theory of how courts can combine property and liability rules in the protection of minority shareholder rights. Parts II further applies this theory to corporate fiduciary litigation and appraisal actions in Delaware in detail, explains its internal logics, and compares Delaware's approach with those of Germany and the United Kingdom. Part III applies this theory to judicial review in the areas of constitutional law. Part IV concludes.

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34. *Id.* at 907.
35. *See infra* Section II.A.-B. for a detailed discussion.
36. This proposal is similar to the "Land Assembly District" (LADs) proposed by Heller and Hills. Michael Heller & Rick Hills, *Land Assembly Districts*, 121 HARV. L. REV. 1467, 1469 (2008). For a discussion of the similarities and differences between my proposal and LADs, see *infra* Section III.B.2.

I. JUDICIAL REVIEW AND MINORITY SHAREHOLDER PROTECTION

Collective decision-making inherently possesses coercive qualities, as the actions taken by the majority can often result in harm to the interests of the minority within any large-scale organization. Scholars have long observed the problem of the "tyranny of the majority."[37] In a democratic society, the majority's decisions typically prevail due to the principle of majority rule. While majority rule is a fundamental aspect of democracy, the concept of the tyranny of the majority highlights its potential pitfalls. It emphasizes the need to protect the rights and interests of minorities, ensuring that they are not unfairly subjected to the decisions and actions of the majority. Similarly, when a corporation is controlled by a majority shareholder, there persists an ongoing risk that corporate decisions will unjustly prejudice the rights of the minority shareholders.

Law and economics scholars have applied the theoretical frameworks of property rules and liability rules to analyze different approaches to protecting minority rights. This part of the article considers these approaches and proposes that another approach—the application of structured pliability rules—can be employed to protect minority rights. The discussion primarily centers on corporate law, elucidating the notion of structured pliability rules through its application. In Part III, the theory will be extended to the realm of constitutional law.

A. *Property Rules, Liability Rules, and the Protection of Minority Rights*

In one of the most-frequently cited articles, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral,* Calabresi and Melamed propose a theoretical distinction between property rule and liability rule protection of legal entitlements.[38] Property rule protection ensures that an entitlement

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37. *See generally* BICKEL, *supra* note 17.

38. Calabresi & Melamed, *supra* note 14, at 1090. This distinction has become the foundation of numerous subsequent studies. *See, e.g.*, Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 YALE L.J. 2149 (1997); Ian Ayres & Paul M. Goldbart, *Optimal Delegation and Decoupling in the Design of Liability Rules*, 100 MICH. L. REV. 1 (2001); Richard Craswell, *Property Rules and Liability Rules in Unconscionability and*

cannot be transferred, limited, or modified without the consent of the right-holders.[39] Under liability rules, by contrast, the transfer of an entitlement can be forced without the consent of the right-holders as long as they have been justly compensated.[40] The theoretical framework of property rules and liability rules can also be employed to analyze collective rights.[41]

1. *Property Rule Protection of Minority Rights*

In the context of collective decision-making, members of a particular group or organization can agree to a rule of unanimity, which can be viewed as a *strong form* of property rule protection for minority rights. Under this approach, decisions must receive the approval of the right-holders whose collective rights will be impacted. For instance, in a corporation, when the majority shareholder proposes a merger transaction, each minority shareholder could be granted a veto right, ensuring their consent is required for the decision to proceed.[42] This, however, would lead to an opportunistic holdout problem in collective decision-making when there are many members.[43]

Related Doctrines, 60 U. Chi. L. Rev. 1 (1993); Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. Chi. L. Rev. 681 (1973); Ward Farnsworth, *Do Parties to Nuisance Cases Bargain After Judgment? A Glimpse Inside the Cathedral*, 66 U. Chi. L. Rev. 373 (1999); Zohar Goshen, *Controlling Strategic Voting: Property Rule or Liability Rule?*, 70 S. Cal. L. Rev. 741 (1997); Kaplow & Shavell, *supra* note 16. This article has been widely cited. *See, e.g.*, Fred R. Shapiro, *The Most-Cited Law Review Articles*, 73 Cal. L. Rev. 1540, 1550 (1985).

39. Calabresi & Melamed, *supra* note 14, at 1092. Richard A. Epstein, *The Supreme Court, 1987 Term—Foreword: Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 Harv. L. Rev. 4, 19 n.36 (1988) ("'Property protection' means that control over the asset can only be lost by consent . . . .").

40. Calabresi and Melamed also considered the rule of inalienability, which means that an entitlement cannot be transferred even if the entitlement holder agrees. Calabresi & Melamed, *supra* note 14, at 1092. This rule is not widely used in the context of collective decision-making. I thus do not consider it in this article. *See e.g.*, Luca Enriques et al., *Related-Party Transactions*, *in* Anatomy of Corporate Law 145 (Kraakman et al. eds., 2017).

41. *See generally* Goshen, *supra* note 10.

42. Goshen, *supra* note 10, at 410–11 n.53 (arguing that in the context of a self-dealing transaction entered into by a corporation, "a property rule conditioning a self-dealing transaction upon the unanimous consent of all voters protects each and every member of the minority on an individual basis, such that no voter can be coerced.").

43. Krier & Schwab, *supra* note 19, at 460 ("There are the special problems that arise when an exchange will necessarily benefit many people at once (giving rise to free rider problems) or when many people have to agree

Each member is likely to have an incentive to hold out on the decision in order to seek personal gain, even when the decision benefits all members as a whole.[44] To mitigate the challenge of minority holdouts, members often establish collective decision-making rules that permit decisions to be made based on criteria that do not require unanimous agreement. These rules, such as majority rule, majority of minority ("MoM") rule, or supermajority rule, can be seen as weaker forms of property rules.[45] In the context of corporate law, some corporations seek the approval of MoM shareholders when the majority shareholder has a conflict of interest.[46] A MoM rule or a supermajority rule can partially alleviate the opportunistic holdout problem arising from the requirement of unanimous consent. Even if some minority members oppose a decision, their votes alone cannot veto the outcome, ensuring a more balanced decision-making process.

The approval of MoM shareholders can significantly contribute to the fairness of a corporate decision, particularly when compared to a majority rule that permits conflicted shareholders to vote.[47] When a majority of minority shareholders vote in favor of a decision, it is likely to reflect the collective interests of the minority shareholders as a whole. This is because if the corporate decision proves detrimental to the minority shareholders, those who hold a majority of the minority shares would bear a substantial portion of the resulting losses.

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to an exchange in order for it to be consummated (giving rise to holdout problems).").

44. The majority and minority are locked into a "bilateral monopoly" situation. *Id.* at 461.

45. One may also consider this as a property rule if all minority shareholders can be considered as acting in a group. The majority of the minority then can be viewed as representing the collective will of all minorities. *See* Goshen, *supra* note 10, at 408 ("The fairness-test solution to self-dealing is best understood as a liability rule, and the majority-of-the-minority solution is best understood as a property rule . . . the majority-of-the-minority rule employs a subjective valuation and enables the minority to capture a greater part of the surplus."). For the opinion that collective decision-making should be considered as liability rule, see Markovits & Schwartz, *supra* note 22, at 36–37 ("Productive property . . . is thus subject to what is commonly called liability rule protection.").

46. Goshen, *supra* note 10, at 410–11 n.53. *See, e.g.*, *MFW*, 67 A.3d at 516.

47. James Si Zeng, *The Calculus of Shareholders' Consent: A Constitutional Economics Theory of Corporate Charter Amendment Rules*, 41 U. PA. J. INT'L L. 429, 460 (2019).

However, the MoM approval is still subject to two major problems: free-riders and holdouts.[48] First, the minority shareholders may only hold a small proportion of interests and thus lack incentives to participate in the decision-making process, which creates the free-rider problem.[49] This problem becomes more pronounced when minority shareholders are dispersed and have limited coordination. Second, the MoM shareholders may hold out the decision, which sometimes over-regulate transactions beneficial to the corporation.[50] The MoM shareholders may hold out to seek private gains from the majority shareholder since they can decide whether to approve a self-dealing transaction.[51] They may hold out the decision for too much personal benefits or for too long and may eventually thwart the transaction even if the decision is beneficial for the corporation.[52] Therefore, entrusting the decision-making power solely to the MoM shareholders can sometimes lead to inefficiencies in corporate decision-making.

Whether the MoM approval indicates fairness of the corporate decision depends on the ownership structure of a corporation. When the minority shareholders' shares are held by institutional investors, known for their astute judgment in evaluating the equity of decisions, the MoM approval is more likely to serve as a reliable indicator of the decision's fairness.[53] Conversely, if the minority shareholders are retail investors prone to relying on others' decisions, a small group of minority shareholders could exert disproportionate influence. These shareholders may collude with the majority or engage in holdouts, thereby jeopardizing the interests of other minority shareholders.[54] Even though structured pliability rules

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48. Goshen, *supra* note 38, at 751.
49. *Id.* at 751.
50. *Id.* at 753–54.
51. *Id.* at 756.
52. *Id.*
53. Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. Rev. 263, 270-71 (2019). ("When the principal has relatively low competence (as with retail investors) the parties are more likely to rely on a court for dispute resolution. By contrast, when the principal has relatively high competence (as with institutional investors), the parties are more likely to resolve these issues on their own through the use of discretionary control rights." (footnote omitted)).
54. Goshen, *supra* note 10, at 416 ("[A]t times these investors act, directly or indirectly, in collusion with management or the controlling owner against the remaining shareholders.").

encompass elements of property rules protection in the judicial review process, they are not immune to the challenges posed by free-riding and holdout behavior.

To illustrate, suppose a corporation enters into a freeze-out merger transaction that offers minority shareholders ten dollars per share. Suppose all shareholders value their shares at nine dollars. The transaction is beneficial to all shareholders. Suppose that one shareholder holds 0.01% of the shares and effectively controls the MoM vote while the rest of the shares are held by retail investors who do not participate in voting. She may hold out the approval for personal gain, given her disproportionate voting power.[55] If the corporation fails to gain the MoM approval, it would incur high litigation costs in courts, which may deter some transactions beneficial to all shareholders.

2. *Liability Rule Protection of Minority Rights*

Given that a rule of unanimity is rarely adopted, a collective decision is inevitably coercive. Majority or supermajority members may coerce minority members into accepting a collective decision. To counteract this inherent coerciveness, judicial review assumes a crucial role. Particularly within the domain of corporate law, judicial review serves as a vital mechanism for curbing self-dealing transactions that unjustly favor majority shareholders while adversely impacting the interests of the minority shareholders.

Many scholars view judicial review as offering liability rules to protect minority members against the tyranny of the majority (or the supermajority).[56] To do so, courts often review decisions to ensure that they are fair to minority members, which is often viewed as a liability rule approach.[57] For example, under corporate law, courts review whether majority decisions constitute self-dealing and, if so, whether the transactions are entirely fair. Moreover, they afford minority shareholders the opportunity to exercise the appraisal remedy in instances where they dissent

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55. This situation is similar to what Berle and Means described as the separation of ownership and control. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 66 (1933).

56. Goshen, *supra* note 10, at 430("Given these characteristics, one would expect that, like the United States, the United Kingdom would adopt a fairness-test approach to self dealing transactions. Indeed, the default rule followed in the United Kingdom is a liability rule.").

57. *Id.* at 430; Bell & Parchomovsky, *supra* note 23, at 5.

from substantial alterations in the corporation's business trajectory.[58] While the majority is typically empowered to implement coercive collective decisions that bind all members, courts possess the authority to overturn such decisions if they are found to be unfair towards the minority.[59] Liability rules enable courts to foster efficiency by nullifying decisions that unfairly disadvantage the minority, while concurrently upholding decisions that enhance the welfare of shareholders.

Liability rules give rise to the concern that judges lack capacity in adjudicating decisions involving majority-minority conflicts. To tell whether a corporate decision is fair or not, courts often need to rely on expert opinions on the fair value of certain assets.[60] For example, to tell whether minority shareholders are to receive fair consideration in a freeze-out merger, the court would need to assess the fair value of a share. One possible approach of evaluating a share is the discounted cash flow (DCF) method.[61] Applying this method entails an analyst making estimations regarding the future cash flow that a shareholder could potentially obtain by incorporating assumptions regarding the corporation's costs, revenues, taxes, as well as macroeconomic factors such as inflation.[62] The analyst must also estimate the discount rate for future profit, which depends on the risks of the corporation.[63] Two analysts relying on justifiable assumptions often reach drastically different opinions about the fair value of a share.[64]

Another major challenge to valuation is that courts lack information about the subjective value of shares.[65] Shareholders often attribute different subjective values to their rights,

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58. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 241–244 (1962).

59. Calabresi & Melamed, *supra* note 14, at 1119-21; Goshen, *supra* note 10, at 408 ("The fairness-test solution to self-dealing is best understood as a liability rule, and the majority-of-the-minority solution is best understood as a property rule.").

60. *See generally* Bebchuk & Kahan, *supra* note 27.

61. *See id.* at 35.

62. *Id.* at 35.

63. *Id.*

64. *Id.*

65. If a shareholder consents to a transfer of assets, it indicates that the transaction is efficient. Without such consent, however, it would be difficult to determine the subjective value. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 13, 89, 99 (4th ed. 1992). *See also* Lucian A. Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEG. STUD. 197, 201–03 (1988).

making it difficult to ascertain the precise subjective value of property rights. When there is a market price for shares in a stock market, the price only reflects the value at the margin to people who buy and sell shares. Some shareholders may perceive their shares to be worth more, asserting that the market price fails to capture the intrinsic value of their shares. This discrepancy may stem from differing perspectives on factors such as future cash flow potential, influenced by varying profits, tax rates, or macroeconomic conditions. Meanwhile, certain shareholders may overstate the value of their shares solely to delay decision-making in pursuit of greater compensation.[66] While scholars have proposed various valuation methods for use by courts in the United States, evaluating the worth of corporations and their shares remains a difficult task that necessitates courts possessing advanced expertise.[67]

More importantly, liability rules inherently entail coercion. One of the primary distinctions between liability rules and property rules lies in the fact that the former permits alterations to collective rights to occur without the agreement of the right-holders. This becomes evident in scenarios where a corporation, under the control of a majority shareholder, can freeze out minority shareholders without their consent.

3. *Choosing between Property Rules and Liability Rules*

Given the inherent limitations of both property rules and liability rules, numerous scholarly investigations approach the selection between these two frameworks as a delicate balance between transaction costs and assessment costs.[68] Property rules should be preferred when transaction costs are low, since property rules protect the subjective value of legal entitlements and

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66. Manning, *supra* note 58, at 238 ("He can abuse the procedural process under the appraisal statute to the cost and disruption of the enterprise.").

67. Krier & Schwab, *supra* note 19, at 462 ("If parties can hide their valuations from each other, they can hide them from a judge."). *See* William A. Groll & David Leinwand, *Judge and Banker—Valuation Analyses in the Delaware Courts*, 116 Dick. L. Rev. 957, 959 (2012) ("The plaintiffs' bar and the Delaware courts have become quite sophisticated in reviewing valuation analyses and are thoroughly conversant in the related, highly technical financial arcana."). *See* Goshen & Hamdani, *supra* note 1, at 951 ("Entire fairness review is fundamentally reliant upon the ability and competence of a third party—in this case, the Delaware courts—to perform an objective valuation of the disputed transaction.").

68. Assessment costs are sometimes referred to as the litigation costs. Ayres & Talley, *supra* note 16, at 1037.

respect the will and autonomy of the holders of entitlements, whereas liability rules override the market mechanism and use coercive means to force transfers of entitlements, offering only objective compensation to the entitlement holders.[69] This perspective finds endorsement from Richard Posner, who espouses in his seminal textbook on law and economics that in settings characterized by high transaction costs, the optimal allocation of property rights should be achieved through legal mechanisms rather than relying solely on market forces.[70] Zohar Goshen extends this analytical framework to the protection of minority rights against self-dealing within the domain of corporate law, positing that "the choice between the two types of rules—property or liability—is a function of the total transaction costs in a particular legal system."[71]

This view, however, has been questioned by some scholars.[72] Krier and Schwab raise a valid point that in situations characterized by high transaction costs, assessment costs may also escalate, particularly in the context of multi-party bargaining.[73] The involvement of numerous participants can amplify transaction costs due to two significant challenges: free-riders and holdouts.[74] In the context of collective decision-making, members of an organization may free-ride on the negotiation efforts of others, leading to underinvestment in negotiations, which may produce results that are less than efficient. Meanwhile, some members may hold out on decisions for personal gains, which may also lead to high transaction costs and lower the likelihood of reaching socially desirable agreements. In scenarios where transaction costs are substantial, the assessment costs associated with bargaining among multiple parties can similarly surge.[75] A court may need to assess the value of the entitlement to each member, who may hold an opinion different from the opinions of the other members. Such circumstances pose

69. Calabresi & Melamed, *supra* note 14, at 1107-08. For criticisms, see Krier & Schwab, *supra* note 19, at 453 n.44.

70. Richard A. Posner, Economic Analysis of Law 29 (Little, Brown, and Co., 1st ed. 1972).

71. Goshen, *supra* note 10, at 395.

72. *See generally* Krier & Schwab, *supra* note 19.

73. *Id.* at 461.

74. *Id.* at 460–61.

75. *Id.* at 461.

greater complexities compared to cases where the assessment of the value of a single property right suffices.[76]

In summary, when transaction costs are high, liability rules are not necessarily superior to property rules because assessment costs may also be high. Scholars disagree as to whether property rules or liability rules should be applied—some suggest that courts should intervene to adjudicate disputes when voluntary exchange is difficult to achieve, while others point out that liability rule protection also generates high assessment costs under such circumstances. [77]

4. *Pliability Rules*

Subsequent studies have offered other alternative approaches.[78] Scholars have noted that property rules and liability rules can be combined. Bell and Parchomovsky argue that in practice, legal entitlements are often protected by dynamic rules called *pliability rules*.[79] According to Bell and Parchomovsky, pliability rules are "contingent rules that provide an entitlement owner with property rule or liability rule protection as long as some specified condition obtains; however, once the relevant condition changes, a different rule protects the entitlement."[80]

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76. *Id.*

77. *See generally* Goshen, *supra* note 10, at 395; Krier & Schwab, *supra* note 19, at 461–62.

78. Ayres and Talley argue that liability rules may be more efficient in thin markets when divided entitlements can generate information. However, they acknowledge that such an approach may be efficient only when the "transactional barriers to trade can at least be surmounted." Ayres & Talley, *supra* note 16 at 1083. In collective decision-making, the major problem is that multiple parties may hold out, and the divided entitlement may exacerbate the holdout problem. *Id.* Krier and Schwab argue that even when transaction costs are high, liability rules may also be inefficient because assessment costs might be high. Krier & Schwab, *supra* note 21, at 455. They point out that many factors that lead to high transaction costs also give rise to high assessment costs. For example, in disputes involving multiple parties or bilateral monopoly, negotiation costs are usually high. However, courts may also find it difficult to assess damages. Similarly, in a monopoly situation where there is a lack of market price, both transaction costs and assessment costs would be high.

79. Bell & Parchomovsky, *supra* note 23, at 5.

80. *Id.* Bell and Parchomovsky distinguish different types of pliability rules. These rules include classic pliability rules, zero-order pliability rules, simultaneous pliability rules, loperty rules, title-shifting pliability rules, and multiple-stage pliability rules. Classical pliability rules involve "property rules that are transformed into liability rules." Zero order pliability rules are "property rules that become liability rules where the compensation for breach of the rule is zero." Under simultaneous pliability rules, the same entitlement

One typical example of a pliability rule is the protection of share ownership in freeze-out mergers. Shares are normally protected by property rules because they cannot be transferred without the consent of the shareholders. However, once a corporation decides to enter into a freeze-out merger, the minority shareholders may be forced to give up their shares; in a judicial review of the corporate decision, the court is to ensure the fairness of the compensation offered to the minority shareholders. According to Bell and Parchomovsky, the minority shareholders "lose the ability to refuse to part with their shares", and the legal protection of minority rights becomes a liability rule.[81]

B. *Structured Pliability Rules*

This article proposes that courts can combine property rules and liability rules even after a dispute has entered judicial proceedings rather than simply offering liability rules. This approach can be referred to as structured pliability rules. Analyzing the theoretical framework of property rules and liability rules in litigation sheds new light on the available choices for minority protection and highlights the importance of the structured decision-making method in corporate law that has largely been ignored in the literature. Courts can substantively review a corporate decision, imposing high litigation costs on parties when they seek to resolve their disputes via judicial review. However, courts can shift to a superficial substantive review or lower the litigation costs on the majority shareholders if the corporation has gone through MoM shareholder approval that alleviates the concern of minority protection. Under this

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holder holds "one type of rule protection with respect to some potential users" but a different rule applies with respect to different users. Loperty rules are rules in which liability rule protection "is transformed into property rule protection." Title shifting pliability rules "transform property rule protection in the hands of one entitlement holder into property rule protection in the hands of another entitlement holder." Multiple stage pliability rules change the rule protection more than once. *Id.* at 30–31.

81. Bell & Parchomovsky, *supra* note 23, at 31, 33 ("Classic pliability rules, as we noted, involve the transformation of an entitlement from property rule to liability rule protection. . . . [I]n most cases, a share is a property interest entitled to property rule protection, but the adoption of certain corporate decisions alters the nature of the shareholder's interest in his or her shares. The provision in state law requiring majority decisions to engage in a merger, freeze-out takeover or the like, should therefore be viewed as creating a classic pliability rule.").

approach, majority shareholders will be incentivized to seek the consent of minority members or disinterested directors to avoid high litigation costs. The majority shareholder may opt to offer a price that is sufficiently attractive to secure the agreement of a majority of the minority shareholders, thereby significantly reducing the risk of externalities. If the majority shareholder anticipates that a corporate decision would not gain the approval of MoM shareholders, it would expect to incur high litigation costs once the decision is challenged and is less likely to support such a decision unless it feels confident that it can demonstrate its fairness. Courts thus do not need to conduct an intensive substantive review when the corporate decision has been approved by the MoM shareholders, which significantly alleviates the concern for judicial capacity.

Structured pliability rules are superior to liability rules under two assumptions that normally hold. First, courts have an informational disadvantage compared with private parties. If courts could evaluate the fairness of a corporate decision with relatively low costs, they should provide liability rules by using an unconstrained balancing test to review corporate decisions rather than focusing on whether the decision has been approved by the MoM shareholders. However, as illustrated above, courts are subject to various informational and resource constraints and thus are at a comparative disadvantage compared with private parties.

Second, the MoM approval can to a great extent, improve the fairness of a corporate decision. For example, a MoM decision is likely to represent the interests of the minority shareholders as a whole because if the corporate decision is harmful to the minority shareholders, those who hold a majority of minority shares would bear a significant proportion of the losses.[82] The consent of MoM shareholders serves as a significant testament that a minority shareholder initiating a legal challenge might be pursuing self-interest through a frivolous lawsuit.

One may raise a challenge to the second assumption that going through the MoM approval procedure does not always guarantee that the corporate decision is fair. As illustrated

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82. For example, suppose a corporation has a controlling shareholder holding 51%. The controlling shareholder benefits from the deal, leaving the losses to be borne by the minority shareholders. Suppose a shareholder holds 26% and holds the majority of the minority votes. This shareholder would also bear a majority of the losses.

above, an MoM approval is subject to the problems of free-rider and holdouts.[83] Thus, relying on the MoM approval may cause two consequences: a decision backed by the MoM may be harmful to the minority shareholders but due to the free-rider problem, no shareholder acts to block the decision; a decision may be beneficial to the minority shareholders but because some minority shareholders hold out the decision for personal gains, the decision is not backed by the MoM.

Since structured pliability rules incorporate an element of property rules protection in the judicial review, they are also subject to the free-rider and holdout problems. To illustrate this point, consider a scenario where a corporation engages in a freeze-out merger, offering minority shareholders a price of ten dollars per share. Now, assume that all shareholders perceive the true value of their shares to be nine dollars, meaning the transaction is advantageous for all parties involved. However, there is one particular shareholder who holds a mere 0.01% of the shares yet possesses a significant degree of control over the MoM vote. This individual, driven by their disproportionate voting power, may deliberately withhold their approval in an attempt to extract personal gains from the situation. In this case, if the MoM approval is not obtained, the corporation would be compelled to enter into protracted and costly litigation proceedings. Such a predicament has the potential to discourage future transactions that would otherwise benefit all shareholders. The prospect of enduring substantial legal expenses acts as a deterrent, hindering the execution of transactions that could contribute to the collective interests of the shareholders.

Whether the second assumption holds depends on the ownership structure of a corporation. If the shares of the minority shareholders are held by institutional investors who can exercise good judgment on the fairness of the decision, the MoM approval is more likely to serve as a good indication of fairness of the corporate decision.[84] If, however, the shares held by minority shareholders are held by retail shareholders

83. *See* Zohar Goshen, *Voting (Insincerely) in Corporate Law*, 2 THEORETICAL INQUIRIES L. 815, 819 (2001).

84. Goshen & Hannes, *supra* note 53, at 270–71 ("When the principal has relatively low competence (as with retail investors) the parties are more likely to rely on a court for dispute resolution. By contrast, when the principal has relatively high competence (as with institutional investors), the parties are more likely to resolve these issues on their own through the use of discretionary control rights.").

who tend to free-ride on the decisions of others, a few minority shareholders may dictate the outcome. They may either collude with the majority shareholders or hold out the decision, which may harm the interests of the other minority shareholders.[85] Currently, studies have shown that institutional investors play a significant role in corporate governance in the United States.[86] Since they are largely sophisticated investors holding a significant proportion of shares, the MoM approval is likely to serve as an important indication of the fairness of a corporate decision.

Under the above assumptions, structured pliability rules are superior to liability rules. If courts are to offer liability rules protection to minority shareholders, they can either conduct an *intensive review* or a *superficial review* of the fairness of the decision. Structured pliability rules are superior to the intensive review approach because the court does not conduct an intensive review unless the corporation fails to obtain the MoM approval. Structured pliability rules thus lessen the litigation costs compared to an intensive substantive review approach, including the procedural costs incurred in the legal proceedings and the costs of error resulting from the court making a wrong judgment as to the fairness of the corporate decision.

Meanwhile, compared to the superficial review approach, structured pliability rules would raise litigation costs but alleviate the costs of error to some extent. Unlike an intensive review, which incurs high procedural costs and relatively low costs of error, a superficial review incurs lower procedural costs and relatively high costs of error. The court only considers little evidence and often approves an unfair corporate decision or blocks a fair one.[87] Structured pliability rules employ the corporate decision-making procedures to help courts review the fairness of a corporate decision, which has significant advantages over the superficial review approach.

Current studies on the economics of civil procedural law note that different jurisdictions have adopted different civil procedure rules that balance two costs—complicated procedures increase procedural costs and reduce the costs of error, whereas simple procedures involve lower procedural costs but

85. This situation is similar to what Berle and Means described as the separation of ownership and control. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 66 (1933).
86. Goshen & Hannes, *supra* note 53.
87. *See* Miller, *supra* note 32, at 907.

increase the costs of error.[88] This article suggests that complicated procedures also have an additional function—imposing litigation costs on the corporation so that corporations can be induced to follow a certain decision-making process that alleviates the concern of minority protection. To be sure, it is important for courts to consider the fairness of a corporate decision to the minority, thereby ensuring that they reach the correct conclusion. Many of the procedural rules aim at collecting evidence and clarifying facts, which certainly help courts make the "right" decisions.[89] However, some may believe that the procedures may be too costly and prefer less costly procedures even though they may generate a higher cost of error.[90] This article offers an additional supportive argument for costly judicial review— the disadvantages of such an approach can be alleviated through structured pliability rules, and the litigation costs can be reduced in many cases.

Courts can also adopt a complete deferential approach. This approach can be regarded as an extreme form of superficial review. It may lead to insufficient regulation over oppression by the majority shareholder. Compared to such a regime, structured pliability rules incur higher litigation costs. While it is also true that the corporation can adopt benign decisions beneficial to all shareholders with fewer judicial constraint, such a regime is not likely to be better since the majority shareholder is very likely to engage in tunneling decisions or other decisions that harm the interests of minority shareholders, assuming that it is rationally maximizing its own interests.

C. *Structured Pliability Rules and Structured Judicial Decision-Making*

If courts are to offer structured pliability rules, what judicial methods can be employed? This Section argues that courts can employ a structured decision-making method rather than an unconstrained balancing test. Courts can also use a combination

88. *Id.*

89. *See generally* Gorga & Halberstam, *supra* note 2.

90. *See* Miller, *supra* note 32, at 906 ("As the procedures involved in resolving a dispute become more and more summary, the probability that the finder of fact or law will make an error will usually increase."). *See* Joachim Zekoll, *Comparative Civil Procedure*, *in* THE OXFORD HANDBOOK OF COMPARATIVE LAW 1327, 1335 (Mathias Reimann & Reinhard Zimmermann eds., 2006).

of rules and standards and shift the burden of proof based on the presence or absence of MoM approval.

Courts in the United States have long utilized structured decision-making procedures in the process of judicial review. Louis Kaplow provides an analysis of the general procedures involved in structured decision-making.[91] Consider a scenario where Party A alleges that an action by Party B has caused harm and initiates a legal action against Party B. In response, Party B argues that the action has generated significant benefits. The court is tasked with determining whether liability should be assigned to Party B, either in the form of damages or injunctive relief, to deter or prevent the action in question. The court has two options: it can directly evaluate the benefits and harms through an unconstrained balancing test, or it can employ structured decision-making procedures to review the case. According to Kaplow, structured decision-making in a particular case involves three steps: first, the plaintiff must show that some harm exceeds a certain threshold; second, the defendant must show that the benefits of its actions exceed a certain threshold; third, the court considers the harm and the benefits.[92] Each step must be completed before the court proceeds to the next stage.[93] Structured decision-making is employed in the application of many doctrines in various areas of law, including corporate and constitutional law.[94]

In the context of corporate law, Delaware courts apply various standards of review, including the business judgment rule and entire fairness, to examine corporate decisions, which can be viewed as a structured decision-making approach. For example, in the context of a freeze-out merger, the court is faced with the decision of whether to block the merger from taking place. In theory, the court could utilize an unconstrained balancing

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91. *See* Kaplow, *On the Design of Legal Rules*, *supra* note 9, at 1382.

92. *Id.* ("Under a structured decision procedure, it will be assumed that liability is determined by the following three-step protocol: (1) If $H > H^*$, proceed to step 2. Otherwise, assign no liability and stop. (2) If $B > B^*$, proceed to step 3. Otherwise, assign liability and stop. (3) If $H > B$, assign liability. Otherwise, assign no liability. And stop.").

93. *Id.*

94. In practice, structured judicial decision-making in constitutional law and corporate law sometimes does not follow the three steps above. *See id.* at 1449 ("Viewed in its particulars and as a whole, strict scrutiny doctrine does depart importantly from the stylized structured decision procedure introduced in subsection I.A.1 and, in varying degrees, from the other applications considered earlier in this [a]rticle.").

test, weighing the benefits accruing to shareholders against the harm suffered by dissenting minority shareholders. If the benefits outweigh the harm, the freeze-out merger would be allowed to proceed without regulation, in order to promote social efficiency.[95] However, in practice, the approach taken by Delaware courts aligns more closely with structured decision-making.[96] The court will readily grant summary judgment if it determines that the challenged merger decision was approved by a majority of the minority shareholders and a committee of independent directors and hence falls under the protection of the business judgment rule.[97] Consideration of the approval by minority shareholders is not directly relevant to the fair value of shares. Thus, courts are directed to consider different facts in the two stages of reviewing this type of corporate decision, which is different from an unconstrained balancing method in which courts only consider the fairness of the corporate decision to the minority shareholders.

Structured decision-making can better enable courts to offer structured pliability rules. This theory explains courts' reluctance to adopt the mode of unconstrained balancing of costs and benefits. If a court simply balances the costs and benefits of a collective decision, it essentially offers liability rule protection to the parties, which gives rise to the concern of judicial capacity since courts often lack information and expertise in reviewing collective decisions. Moreover, majority members would likely be dragged into frivolous lawsuits because of this.

Structured decision-making essentially offers two sets of rules. One set of rules apply when the courts offer liability rules protection. Courts impose high litigation costs on the parties, which generates more information and hence reduces the costs of error. Another set of rules apply when the MoM shareholders have approved the corporate decision. In the second case, the corporate decision is more likely to benefit the corporation as

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95. The analysis here assumes that we do not consider distributive goals and focus mainly on efficiency. It has long been accepted that economic analysis of law focuses mainly on efficiency. For a challenge, see Zachary Liscow, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as well as Efficiency*, 123 Yale L.J. 2478 (2013). This article accepts this assumption because it intends to analyze the efficiency of structured decision-making in the context of corporate law.

96. *See, e.g.*, *M&F Worldwide Corp.*, 88 A.3d 635.

97. *See, e.g.*, *id.*

a whole.[98] Thus, the litigation costs can be lowered to incentivize consent. In the academic literature, scholars have noted that complicated procedures usually incur high litigation costs while reducing the costs of error.[99] Current studies have examined cross-country variance in the civil procedure rules.[100] This article suggests that in one particular state, courts can employ two sets of decision-making rules in different circumstances.

In employing the structured decision-making method, courts can use a combination of rules versus standards.[101] Theoretically, rules are proposed ex ante and can offer clear guidance to the relevant parties, while standards are left open to be applied by courts when disputes arise.[102] Rules are written in a way that enables parties in a dispute to easily predict the outcome of the case, whereas standards are applied by courts on a case-by-case basis. Scholars have long been interested in the advantages of rules and standards.[103] In the context of corporate law, the business judgment rule is a clear rule. If the court applies this rule, the corporate decision would be given deference and the court would not review it, which incurs low procedural costs and a high cost of error.[104] By contrast, the standard of entire fairness is a standard that needs to be applied in a trial, incurring high litigation cost.

This article posits that rules and standards should be employed in different circumstances. When a corporate decision has gained the consent of the majority of the minority

98. Goshen, *supra* note 10, at 410. ("Thus, a transaction will only transpire if the minority, or more precisely, a majority of the minority, has consented to it. This arrangement assures the minority more than a minimum fair price, however. It empowers the minority to look after its own interests and to strive to obtain the maximum price it can achieve. Placing the decision in the minority's hands maintains a regime of voluntary transactions and preserves the role of subjective valuations.").

99. *See generally* Miller, *supra* note 32.

100. *See, e.g.*, *id.*

101. *See* Kaplow, *supra* note 26, at 621.

102. *Id.* at 560 ("[T]he only distinction between rules and standards is the extent to which efforts to give content to the law are undertaken before or after individuals act.") (emphasis omitted).

103. *See* Kathleen M. Sullivan, *Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 62 (1992); Kaplow, *supra* note 26; Michael P. Dooley, *Rules, Standards, and the Model Business Corporation Act*, 74 L. & CONTEMP. PROBS. 45, 55 (2011) ("The great bulk of corporation law in the United States has been created by courts, not legislatures.").

104. The business judgment rule may block a challenge to a tunneling decision harmful to the minority shareholders, incurring the cost of error.

shareholders, rules should be employed to alleviate the litigation costs imposed on the parties. For example, the business judgment rule is a rule rather than a standard and can alleviate the procedural costs imposed on majority shareholder.[105] In *Kahn v. M&F Worldwide Corporation,* a Delaware court held that when a corporation enters into a freeze-out merger transaction with its controller, the business judgment rule applies if the majority shareholder has obtained the approval of a majority of the minority shareholders and a committee of independent directors.[106] This rule can incentivize majority shareholders to seek the consent from minority shareholders. Similarly, in appraisal actions where courts are to determine the fair value of shares that corporations should pay to dissenting shareholders in a merger, courts can make it a rule that they defer to the deal price when the transaction has been approved by a majority of the minority shareholders and a committee of independent directors.[107]

Standards should be used when a majority shareholder has failed to obtain consent from the minority shareholders because standards allow the court to conduct a more intensive review.[108] Using standards in this context encourages the majority shareholder to seek the MoM approval. By contrast, when a court employs rules to review a corporate decision, the litigation costs are significantly lower because parties can predict the outcome with ease.[109] Meanwhile, using rules in evaluating the fairness of corporate decision may incur high costs of error in the context of corporate law—using rules to adjudicate the fairness of a self-dealing transaction may either over-regulate or under-regulate the corporate decision. Thus, rules should only be employed when the MoM shareholders agree to the corporate decision.[110]

105. *See infra* Section II.A.1 for a detailed discussion.
106. *M&F Worldwide Corp.*, 88 A.3d 635.
107. *See infra* Section II.B. for a detailed discussion.
108. To be sure, not all standards are more complex than rules. See Kaplow, *supra* note 26, at 598. This article merely considers the comparison in the limited context of corporate law and later in constitutional law.
109. For detailed illustrations, see *infra* Section III.
110. It should be noted that I am comparing here rules and standards with an equal level of complexity. If one compares a simple rule with a complex standard, perhaps the answer is clear—a complex and well-designed standard may better cope with the majority decision-making. However, this article goes further to argue that even if the rules and standards are of equal complexity,

It should be noted that structured decision-making is not the only way to implement structured pliability rules. Another approach is through the shifting of the burden of proof. After a court has decided to substantially review a corporate decision, it may vary the costs imposed on the parties by changing the burden of proof based on the presence or absence of MoM approval. In civil litigation, parties with the burden of proof must prove their claims. The preponderance of the evidence standard generally requires claimants to prove that their story is more likely to be true than the alternative story proposed by their opponents.[111] The allocation of the burden of proof and the preponderance of the evidence standard presume that courts cannot be certain about the facts of a case. If courts had a strong capacity for fact-finding, the allocation of the burden of proof would matter less. By shifting the burden of proof in a case, the court can increase or reduce a party's likelihood to win the case and hence can manipulate the costs imposed on the parties when the facts are unclear or difficult to prove.[112] The party bearing the burden of proof is likely to bear a majority of the cost of error.[113] In the context of corporate law, if a decision has gained the MoM approval, courts can alleviate the litigation costs on the majority by requiring the minority shareholder challenging the decision to bear the burden of proof. This approach would encourage the majority to seek the consent from the minority shareholders. It also enables the court to take into account the presence or absence of the MoM approval, strengthening its capacity of reviewing the fairness of the corporation. The reallocation of the burden of proof can be perceived as a less intense variation of structured decision-making, as it continues to afford the court the opportunity to undertake substantive evaluations of the decision. In contrast, structured decision-making would completely foreclose judicial proceedings under specific circumstances.

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standards are preferable simply because they are promulgated ex post. *See* Kaplow, *supra* note 26, at 586–90.

111. Edward K. Cheng, *Reconceptualizing the Burden of Proof,* 122 YALE L.J. 1254, 1259 (2012).

112. Miller, *supra* note 32, at 907.

113. For instance, within the context of a criminal case, the responsibility of the prosecuting attorney to establish guilt "beyond a reasonable doubt" reduces the cost of error borne by the criminal suspect. Cheng, *supra* note 111, at 1275.

II.
Structured Decision-Making under Corporate Law

The above discussion illustrates the conceptual underpinnings of structured decision-making in safeguarding minority rights. This section endeavors to demonstrate the practical implementation of judicial review concerning corporate decisions in the United States, [114] with particular emphasis on Delaware law given its significance.

A. *Fiduciary Litigation in the Merger Context in Delaware*

The theoretical framework presented in this article provides a comprehensive understanding of the function of structured decision-making. Furthermore, it offers significant implications for the theory of property rules and liability rules, as well as judicial decision-making procedures.

1. *Standards of Review for Freeze-out Mergers in the United States*

One of the most dominant forms of corporate litigation in Delaware is class action lawsuits challenging corporate decisions in the context of mergers.[115] Judicial review of corporate decisions plays a more important role in the context of mergers than in ordinary transactions.[116] Among these cases, the duty of loyalty claim serves as the most common basis for challenging corporate decisions, primarily arising in friendly deals where the majority shareholder possesses a conflict of interest with

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114. Corporate law generally deals with two major problems: the conflicts between the directors and the shareholders, and the conflicts between shareholders. This article focuses on the conflicts between the controlling and minority shareholders.

115. Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 Vand. L. Rev. 133, 167 (2004) ("[T]he overwhelming[] majority of fiduciary litigation in Delaware is in the form of challenges to director actions taken in the context of the sale of a company.").

116. *See id.* at 137 ("[A]pproximately 80 percent of the breach of fiduciary duty claims, the vast bulk of state court representative litigation, are class actions against public companies challenging director action in an acquisition."); *id.* at 167–68 ("The vast majority of the fiduciary duty claims against public companies are class actions (85 percent: 808 of 952). . . . Almost all (94 percent: 772 of 824) class action suits arise in an acquisition setting whereas almost all (90 percent: 123 of 137) of the derivative suits arise in a non-acquisition setting.") (emphasis omitted).

the corporation.[117] A typical scenario is a freeze-out merger, in which the majority shareholder merges with the corporation and the minority shareholders are cashed out.[118] In this context, there exists a conflict between the majority shareholder and minority shareholders. Given that the majority shareholder typically exercises control over the board of directors, they possess the authority to dictate the terms of the merger transaction, thereby jeopardizing the interests of the minority shareholders.[119]

Since a self-dealing transaction is very likely to harm the interests of the corporation, courts usually review mergers with conflicts of interest under the standard of entire fairness, as set out in the case of *Weinberger v. UOP*.[120] When courts adopt the standard of entire fairness, they will not readily grant summary judgment, and majority shareholders must demonstrate both fair dealing and fair price.[121] Courts will consider the process of deal-making and examine "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[122] Courts will also consider the prices related to the proposed transactions, taking into account the "assets, market value, earnings, future prospects, and any other

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117. Thompson & Thomas, *supra* note 115, at 196.

118. *See* Goshen, *supra* note 10, at 413; Daniel Wilson, *Desirable Resistance: Kahn v. M&F Worldwide and the Fight for the Business Judgment Rule in Going-Private Mergers*, 17 U. PA. J. BUS. L. 643 (2015). *See also MFW*, 67 A.3d at 502, 536. For a discussion of the standards of review of non-freezeout self-dealings, see Itai Fiegenbaum, *The Controlling Shareholder Enforcement Gap*, 56 AM. BUS. L.J. 583, 589 (2019).

119. *See* Goshen, *supra* note 10, at 400 ("A self-dealing situation can thus neutralize the voting mechanism's ability to determine group preference."); Wilson, *supra* note 118. *See* Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter*, 75 OHIO ST. L.J. 829, 855 (2014) ("The risks of managerial opportunism are greater in the context of a sale of corporate control than in conventional corporate decisions.").

120. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983). *See* Thompson & Thomas, *supra* note 115, at 138. The Delaware court has exempted short-form mergers from the entire fairness review. Also, the majority shareholders can use a tender offer rather than a freeze-out merger to obtain the shares of the minority, which is also not reviewed based on the entire fairness standard. *See* Fernán Restrepo, *Do Different Standards of Judicial Review Affect the Gains of Minority Shareholders in Freeze-Out Transactions? A Re-examination of Siliconix*, 3 HARV. BUS. L. REV. 321 (2013); Glassman v. Unocal Expl. Corp., 777 A.2d 242 (Del. 2001).

121. Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985).

122. *Weinberger*, 457 A.2d at 711.

elements that affect the intrinsic or inherent value of a company's stock."[123] As a result, the majority shareholders not only face a higher risk of losing but also incur additional litigation costs, including attorney fees and time spent in the process of discovery and in coping with the litigation.

In *Kahn v. Lynch*, a Delaware court held that even when a merger transaction has been approved by a special committee consisting of independent directors, the decision will still be subject to judicial review under the entire fairness standard.[124] Under this approach, a court will examine all aspects of a merger transaction in terms of both the negotiation procedures and substance.[125] However, the court will mitigate the extent of scrutiny if the self-dealing decision was approved by the majority of the minority shareholders, since the court will then shift the burden of proof of the fairness of the transaction to the minority shareholders challenging the decision.[126]

The Delaware Supreme Court took a turn in *Kahn v. M&F Worldwide Corporation* in 2014.[127] The court held that if a freeze-out merger is approved by both a majority of the minority shareholders and a special committee consisting of independent directors (collectively known as the "MFW conditions"), the merger decision may be shielded by the business judgment rule.[128] More specifically, the court will scrutinize whether the special committee exhibited independence, possessed complete authority to select advisors and reject the majority shareholder's offer, fulfilled its duty of care during negotiations, and whether the minority shareholders voted freely and were adequately informed.[129] If a freeze-out merger has been approved in this manner, Delaware courts will not second-guess the decisions

123. *Id.*
124. Kahn v. Lynch Commc'n Sys., 638 A.2d 1117 (Del. 1994).
125. *Weinberger*, 457 A.2d at 711.
126. *See* Kahn v. Lynch Commc'n Sys., 638 A.2d at 1117. *See also* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. Rev. 1009, 1025–26 (1997) (discussing the unique style of Delaware courts' writings).
127. *M&F Worldwide Corp.*, 88 A.3d 635; *MFW*, 67 A.3d at 502, 536.
128. *M&F Worldwide Corp.*, 88 A.3d 635; *MFW*, 67 A.3d at 502, 536. Wilson, *supra* note 118, at 644.
129. *M&F Worldwide Corp.*, 88 A.3d at 645.

and will grant summary judgment, which significantly alleviates the costs incurred by the majority shareholder.[130]

While some scholars criticize this body of law as being incoherent and overly complicated,[131] this article argues that the use of different standards of review and the burden of proof in reviewing corporate decisions offer a combination of property and liability rules protection to minority shareholders. When a merger transaction garners approval from the MoM shareholders free from conflicts of interest, the probability of detrimental impact on the minority shareholders' interests diminishes. As a result, the imperative for meticulous scrutiny diminishes, enabling courts to adopt decision-making rules that incur lower costs. For example, in a corporation with a majority shareholder holding 51% of the voting rights, a decision approved by 80% of the votes cast by all shareholders is less likely to be harmful to the minority shareholders than a decision approved by only 51% of the votes cast by all shareholders, assuming that the minority shareholders who approve the transaction are not colluding with the majority shareholder.

It should be noted that even when a majority of the minority shareholders has endorsed a merger decision, there is still a possibility that the merger transaction harms the interests of the minority dissenters. This scenario could arise if the majority of the minority shareholders were swayed or coerced into colluding with the majority shareholders, resulting in adverse consequences for the remaining minority shareholders.[132] Thus, Delaware courts would still review the merger transaction based on the entire fairness standard. Only when a merger has been approved by both the majority of the minority shareholders and a special committee of directors who are disinterested and independent will the courts grant the protection of the business judgment rule to the decision and refrain from substantively reviewing the decision.[133] A recent case suggests that

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130. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

131. See Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1914 (1998) ("[I]n light of the importance of certainty in corporate law, Delaware law seems too indeterminate."). *See also* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 776 (1995) ("It is self-evident that the meaning and applicability of this language to specific factual settings is highly uncertain.").

132. Goshen, *supra* note 10, at 416.

133. *M&F Worldwide Corp.*, 88 A.3d at 645. Even then, the court may consider the fairness of the decision in appraisal actions. *See Infra* Section II.

majority shareholders are sometimes willing to seek the consent from the majority of the minority shareholders and the approval of a committee of independent directors to avoid litigation costs.[134]

It has been noted that Delaware courts are able to conduct an intensive review based on a set of procedural rules, including the rule on discovery.[135] Through discovery in corporate litigation, a plaintiff can investigate corporate affairs and uncover potential misconduct. The corporation "must search for, review, and produce almost all of the documents and witnesses," which generates significant assessment costs.[136] Additionally, such lawsuits have the potential to expose damaging information that could tarnish the reputation of the corporation and its insiders.[137] Structured decision-making, however, significantly limits the plaintiff's access to discovery since it allows the defendants to move to dismiss the lawsuit.[138] Under Delaware corporate

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B. for a detailed discussion. The rules in the United Kingdom in derivative actions are similar. *See* DAVIES & WORTHINGTON, *supra* note 10 at 686 PRINCIPLES OF MODERN COMPANY LAW 648 (Sweet & Maxwell 9th ed. 2012).

134. IRA Tr. FBO Bobbie Ahmed v. Crane, No. CV 12742-CB, 2017 WL 7053964, at *4 (Del. Ch. Dec. 11, 2017).

135. Gorga, *supra* note 2, at 1476. H.R. REP. NO. 104-369, at 37 (1995) (Conf. Rep.) ("[D]iscovery costs account for roughly 80% of total litigation costs in securities fraud cases"); Third Branch (Admin. Office U.S. Cts., D.C.), Judicial Conference Adopts Rules Changes, Confronts Projected Budget Shortfalls (Oct. 1999), https://www.uscourts.gov/news/1999/09/15/judicial-conference-adopts-rules-changes-confronts-projected-budget-shortfalls ("Discovery represents 50 percent of the litigation costs in the average case and up to 90 percent of the litigation costs in cases in which it is actively used.").

136. Gorga, *supra* note 2, at 1424.

137. M. Todd Henderson, *Impact of the Rakoff Ruling: Was the Judge's Scuttling of the SEC/BofA Settlement Legally Pointless or Incredibly Important-or Both?*, 13 WALL ST. LAW., 1, 6 (2009) ("[A] suit generates not only legal costs but also negative publicity and the potential that even more damning information will be revealed during discovery or the trial.").

138. Kaplow, *On the Design of Legal Rules*, *supra* note 9, at 1389-90 ("If a complaint's adequacy is challenged at a motion to dismiss, the only question before the court is whether the challenger has stated a plausible claim. Under a pure balancing test, the plaintiff must allege that H > B, whereas under the structured decision procedure the plaintiff must instead allege that H > H*. . . When a motion to dismiss is denied or none was filed, the case proceeds to discovery. Ordinarily, the scope of discovery covers all issues and all types of evidence, subject to limits regarding burdensomeness, what is now called 'proportional to the needs of the case.' The key point is that, unless a judge chooses to engage in substantial case management, the ordinary conduct of discovery does not involve sequencing.").

law, the business judgment rule establishes a "presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[139] This rule "operates as both a procedural guide for litigants and a substantive rule of law" in corporate litigation.[140] Defendants can file motions to dismiss based on the business judgment rule, thus limiting the adverse impacts caused by discovery and significantly reducing the litigation costs incurred by corporations.[141] Any shareholders challenging corporate

139. *Van Gorkom*, 488 A. 2d at 872.

140. *See* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989). Gorga, *supra* note 2, at 1394 ("[T]he twin hurdles of the demand requirement and the business judgment rule mean that most cases do not even go to discovery in the first place."); NCS Healthcare, Inc. v. Candlewood Partners, LLC, 827 N.E.2d 797, 803 n.3 (Ohio Ct. App. 2005) ("Delaware courts routinely dismiss complaints pursuant to Rule 12(b)(6) based on the business-judgment rule."); *see, e.g.*, *In re* Nat'l Auto Credit, Inc. S'holders Litig., 2003 WL 139768 (Del. Ch. Jan. 10, 2003).

141. Gorga & Halberstam, *supra* note 2, at 1394 ("[T]he twin hurdles of the demand requirement and the business judgment rule mean that most cases do not even go to discovery in the first place."); *Candlewood Partners, LLC*, 827 N.E.2d at 803 n.3 ("Delaware courts routinely dismiss complaints pursuant to Rule 12(b)(6) based on the business-judgment rule."); Fiegenbaum, *supra* note 118, at 586; Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. Corp. L. 597, 602 (2017); Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, 14 N.Y.U. J. L. & Bus. 27, 53-54 (2017) ("Duty of care claims that go beyond the judicially defined carve-out will quickly be dismissed without discovery even under the lenient standard of "reasonable conceivability," the standard of review that the Delaware courts use in determining whether a complaint will survive a defendant's motion to dismiss."); Lori McMillan, *The Business Judgment Rule as an Immunity Doctrine*, 4 William & Mary Bus. L. Rev. 521, 529 ("Realistically, it is difficult for a plaintiff to rebut the business judgment rule, given that, prior to discovery, the information needed might not be readily available."); Allison *ex rel.* Gen. Motors Corp. v. Gen. Motors Corp., 604 F. Supp. 1106, 1110 (D. Del. R), *aff'd*, 782 F.2d 1026 (3d Cir. 1985) (plaintiff initiating a shareholder litigation) ("Defendants. . . moved to dismiss and alternatively to obtain a stay of discovery pending resolution of the motions to dismiss and pending the GM Board's action on plaintiff's demand letter. On May 29, a stay was ordered except as to any discovery which might be relevant to the motions to dismiss."). Stoner v. Walsh, 772 F. Supp. 790, 800 (S.D.N.Y. 1991) ("At this time, the requested discovery will not be permitted. There is a presumption that a board's decision was the exercise of valid business judgment. As set forth below, because plaintiff's complaint fails to set forth facts leading to a reasonable inference that rebuts that presumption, her request for discovery should be denied."). Levine v. Smith, 591 A.2d 194, 199, 208 (Del. 1991), *overruled by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) ("When Levine initiated

decisions based on the fiduciary duty must plead "facts which if true would take defendants' actions outside the protection afforded by the business judgment rule" to survive a motion to dismiss.[142] The MFW conditions provide significant advantages for majority shareholders in the context of a freeze-out merger, as they can secure the protection of the business judgment rule. Consequently, this enables them to seek an early dismissal motion during the litigation process.[143]

While recent research indicates that an exhaustive discovery rule may impose excessive costs on the parties involved, this article proposes that structured pliability rules effectively mitigate this concern.[144] When litigation costs are high enough, the majority shareholder will be inclined to obtain consent from the majority of the minority shareholders to lower those costs, which offers *de facto* property rule protection to the minority shareholders even though the law does not mandate the majority-of-the-minority approval.

2. *Implications for the Theories of Property Rules and Liability Rules*

The aforementioned functional analysis of structured pliability rules introduces fresh insights into the theories of property rules and liability rules in the context of judicial review in the corporate law context. In the academic literature, Zohar Goshen was the first to employ the property rule and

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discovery, GM and its directors moved to dismiss the complaint under Rule 23.1 and for a protective order pending disposition of the motion. Following briefing, limited to defendants' motion for a protective order, the Court of Chancery, in December 1987, granted defendants' motion and stayed further discovery. . .The court held that a shareholder plaintiff, alleging that a pre-litigation demand has been wrongfully refused, is not entitled to discovery prior to responding to a Rule 23.1 motion to dismiss."); Lewis v. Hilton, 648 F. Supp. 725, n.1 (N.D. 111. 1986); Dennis J. Block et al., *The Role of the Business Judgment Rule in Shareholder Litigation at the Turn of the Decade*, 45 Bus. Law. 469, 497 ("[T]he three courts which have considered the issue under Delaware law - Levine v. Smith, Allison v. General Motors Corp. and Lewis v. Hilton - have held that a shareholder plaintiff may not take discovery in support of a claim that directors acted wrongfully in refusing a demand prior to responding to a motion to dismiss.").

142. Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 984 (Del. Ch. 2000).

143. Bernard S. Sharfman, *Kahn v. M&F Worldwide Corporation: A Small but Significant Step Forward in the War against Frivolous Shareholder Lawsuits*, 40 J. Corp. L. 197, 212-14 (2014).

144. *See generally* Miller, *supra* note 32.

liability rule frameworks to analyze collective decision-making by shareholders in the context of self-dealing transactions.[145] Goshen's argument aligns with the prevailing notion that the selection between property rules and liability rules hinges on the balance between transaction costs and assessment costs.[146] According to Goshen, when a self-dealing transaction necessitates approval from the MoM shareholders, it is tantamount to employing property rules to safeguard the entitlement of the minority shareholders in the decision.[147] The MoM approval is similar to the minority shareholders as a group "consenting" to the transfer of their entitlement in the transaction.[148] Property rules generate transaction costs since minority shareholders may hold out on decisions that could benefit the corporation as a whole just to obtain personal gains.[149] Meanwhile, due to the free-rider problem, the MoM shareholder may not represent the interests of all the minority shareholders.[150] As a result, a property rule that requires the approval of a corporate decision by the majority of the minority shareholders, may not be socially efficient in some circumstances. In line with this reasoning, courts should serve as impartial third-party institutions to evaluate the fairness of decisions, effectively providing liability rule protection to minority shareholders by enabling majority shareholders to make decisions while ensuring fair compensation for the minority shareholders. This approach entails assessment costs as courts may face limitations in reviewing these decisions, but it reduces the transaction costs associated with property rules.[151]

145. *See generally* Goshen, *supra* note 10.

146. *Id.* at 417–18 ("[W]hen there are more efficient transactions, the risk of approving inefficient transactions is small, and a liability rule is preferable to save the negotiation costs associated with the property rule.").

147. *Id.* at 410.

148. *Id.* at 410, n. 53 ("Minority protections can afford protection to either individuals in the minority group or to minority members as a group. A property rule conditioning a self-dealing transaction on the consent of the majority of the minority protects the minority as a group.").

149. *Id.* at 402.

150. *Id.*

151. *Id.* at 415 ("Where transaction costs are incurred, however, the choice between a liability rule and a property rule depends upon which rule better ensures the realization of efficient transactions and the avoidance of inefficient ones. Although negotiation costs are primarily responsible for the failure to bring about efficient transactions, they might still be preferable to adjudication costs.").

This article introduces a third perspective on the matter, challenging the notion that judicial review solely provides liability rule protection to safeguard minority rights. Instead, it argues for a hybrid approach that combines elements of property and liability rules to offer comprehensive protection.[152] The aforementioned analysis highlights the inadequacy of a straightforward shift to liability rules by governments in response to high transaction costs. Instead, it suggests the implementation of structured decision-making and the design of diverse decision-making rules that impose varying assessment costs contingent upon the approval of minority shareholders. The assessment costs associated with judicial review can be further delineated into two categories: procedural costs and costs of error. The article contends that courts should adopt intricate and resource-intensive legal procedures when providing liability rule protection as they serve two crucial functions: first, they reduce the costs of error; second, high procedural costs encourage parties to reach agreements. If the procedural costs are too low, such an incentive structure would not be possible.

It should also be noted that the size of litigation costs imposed on parties can be adjusted dynamically over time depending on the transaction costs between the majority and minority shareholders. Higher litigation costs will likely generate stronger incentives for the majority shareholders to seek the approval from the MoM shareholders, thereby augmenting the role of property rules protection. In this case, the resolution of most disputes would lie with the MoM shareholders, as those lacking approval would not progress further. Conversely, diminished litigation costs amplify the significance of courts and diminish the significance of MoM approval. This article does not seek to offer a perfect solution for finding the right balance. Its objective lies in demonstrating that courts can adopt a third approach, distinct from property and liability rules, which integrates the element of consent even after disputes have entered judicial proceedings. Assuming that courts know less about the subjective value of parties' rights than the parties themselves, it is better for courts to create incentives for parties to reach

152. *Id.* at 421 ("if the legal system generates prohibitive adjudication costs, these mechanisms are likely to produce less expensive means of enforcement or to reduce negotiation costs to a point where recourse to the courts is unnecessary.").

agreements and to respect parties' autonomy using structured decision-making procedures.

3. *Implications for Judicial Decision-Making*

The theory above also has important theoretical implications for the discussion of judicial decision-making. This article suggests that structured decision-making is crucial to judicial review of corporate decisions, which contradicts the belief that unconstrained balancing is generally superior.[153] In a recent article, Louis Kaplow examines the choice between the two judicial decision-making modes and advocates for unconstrained balancing.[154] While recognizing the screening effect offered by structured decision-making, which serves to deter frivolous lawsuits where plaintiffs fail to illustrate significant harm, Kaplow contends that it would be more advantageous to gather information concerning both the harms and benefits of the challenged action at the initial stage of case screening. He argues that this approach capitalizes on the existence of information synergies, as much of the relevant information holds relevance to both the harms and benefits at hand.[155]

Kaplow's analysis mainly focuses on constitutional law and antitrust law and does not involve corporate law. In the context of judicial review of freeze-out mergers, the use of different standards of review can be classified as structured decision-making rather than unconstrained balancing, given that courts often do not directly assess the value of shares or the fairness of corporate decisions at the initial stage. Instead, they focus on whether the transactions have been approved by the majority of the disinterested shareholders and directors.[156] This method is significantly different from unconstrained balancing since courts only consider a restricted range of information at the initial stage rather than assessing all the costs and benefits.

This article demonstrates that, especially concerning minority protection, the corporate decision-making process can serve as a suitable indicator of the overall fairness of those decisions. Assessing the decision-making process is much more

153. *See generally*, Kaplow, *Balancing versus Structured Decision Procedures*, *supra* note 9.
154. *Id.*
155. *Id.* at 1414.
156. *See, e.g.*, *MFW*, 67 A.3d at 502, 536.

straightforward compared to evaluating the substantive fairness of individual corporate choices. In the screening phase, applying liability rules without having access to all the essential information and expert opinions can lead to significant errors and costs. Consequently, employing structured decision-making is more suitable in the context of corporate law than in the tort context analyzed by Kaplow. Doing so alleviates the procedural costs imposed on parties and incentivizes majority shareholders to solicit the consent of minority shareholders.

B. *The Appraisal Remedy in Delaware*

The theory of structured pliability rules also has explanatory and normative implications for the appraisal remedy in Delaware. [157] Under Delaware law, subject to certain exceptions, shareholders may seek an appraisal from courts when their company engages in a merger transaction. [158] Currently, courts employ a variety of methods to determine the fair value of shares in appraisal actions, including using the pre-deal market price, the deal price, and the price determined by the discounted cash flow ("DCF") method.[159] Compared with the pre-deal market price and the deal price methods, the DCF method most resembles a "standard", rather than a "rule", that cannot be determined without going through litigation. Litigants usually provide opposing expert opinions as to the discounted future cash flows of the corporations at issue, [160] while the judges face the difficult burden of reaching a final determination of value.[161] It is widely accepted that the DCF method relies on subjective estimation of a set of factors that can lead

157. *See* Liz Hoffman, *Wall Street Law Firms Challenge Hedge-Fund Deal Tactic*, Wall St. J. (April 6, 2015, 8:53 PM), https://www.wsj.com/articles/wall-street-law-firms-challenge-hedge-fund-deal-tactic-1428362171.

158. Del. Code Ann. tit. 8, § 262 (2024).

159. Lawrence A. Hamermesh & Michael L. Wachter, *Finding the Right Balance in Appraisal Litigation: Deal Price, Deal Process, and Synergies*, 73 Bus. Law. 961, 962, 969, 977, fn.80 (2018).("[O]ne school of thought posits that the merger price (or deal price) should presumptively be taken to reflect fair value. . . .").

160. *See* Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 34 J. L. Econ. & Org. 543, 544 (2018).

161. *In re* Appraisal of Ancestry.com, C.A. No. 8173, 2015 WL 399726, at *16 (Del. Ch. Jan. 30, 2015).

different experts to arrive at drastically different conclusions.[162] With empirical studies showing that final awards usually fall somewhere between the values provided by the experts on the opposing sides,[163] the academic debate on how courts should determine the level of compensation for dissenting shareholders is far from settled.[164]

Currently, an influential view in the academic literature is that courts should use the market price to determine the fair value of shares. In a recent study, Macey and Mitts argue against using the DCF method in appraisal proceedings and that the

162. *Id.* at *1 ("I have commented elsewhere on the difficulties, if not outright incongruities, of a law-trained judge determining fair value of a company in light of an auction sale, aided by experts offering wildly different opinions on value."). Finkelstein v. Liberty Dig., Inc., No. Civ. A. 19598, 2005 WL 1074364, at *13 (Del. Ch. Apr. 25, 2005) ("[M]en and women who purport to be applying sound, academically-validated valuation techniques come to this court and, through the neutral application of their expertise to the facts, come to widely disparate results, even when applying the same methodology."). Choi & Talley, *supra* note 160, at 544; Prior to 1983, the Delaware court used the "Delaware block method" to evaluate stocks. The Delaware court considered the market price of the stock, the value of the assets of the corporation, and the value of its earnings. Later, the Delaware Supreme Court adopted finance theories such as discounted cash flow analysis to calculate the value. *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. Corp. L. 119 (2005).

163. *See* Charles R. Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 Del. J. Corp. L. 279, 298 (2017).

164. The Delaware statute has not provided a clear method for calculating the value. DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017); William J. Carney & Keith Sharfman, *Appraisal in Delaware: Possible Improvement from the Bottom Up?*, Emory Legal Stud. Rsch Paper, (2018), https://ssrn.com/abstract=3138251 [http://dx.doi.org/10.2139/ssrn.3138251]. Scholars have proposed various methods for valuing stocks. William J. Carney & Keith Sharfman, *The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters*, 43 Del. J. Corp. L. 61 (2018); Jonathan Kalodimos & Clark Lundberg, *Shareholder Rights in Mergers and Acquisitions: Are Appraisal Rights Being Abused?*, 22 Fin. Rsch. Letters 53 (2017); William J. Carney & Mark Heimendinger, *Appraising the Nonexistent: The Delaware Courts' Struggle with Control Premiums*, 152 U. Pa. L. Rev. 845, 847–48, 857–58, 861–66 (2003); Lawrence A. Hamermesh & Michael L. Wachter, *Rationalizing Appraisal Standards in Compulsory Buyouts*, 50 B.C. L. Rev. 1021, 1023–24, 1034–35, 1044, 1046–54, 1067 (2009) (hereinafter referred to as *Rationalizing Appraisal Standards*); Lawrence A. Hamermesh & Michael L. Wachter, *The Short and Puzzling Life of the "Implicit Minority Discount" in Delaware Appraisal Law*, 156 U. Penn. L. Rev. 1, 30–36, 49, 52, 60 (2007); Hamermesh & Wachter, *supra* note 162, at 128, 132–33, 139–42; Jonathan R. Macey & Joshua Mitts, *Asking the Right Question: The Statutory Right of Appraisal and Efficient Markets*, 74 Bus. Law. 1015 (2019); Choi & Talley, *supra* note 160.

market price should be used in the appraisal proceedings.[165] In freezeout mergers, where the deal price is reached through a flawed procedure, the deal price may be unfair. However, Macey and Mitts argue that based on the efficient capital market hypothesis ("ECMH"), the market price reflects the intrinsic value of shares.[166] Since the pre-deal market price is untainted, courts should use it to determine the fair value.[167] Meanwhile, the DCF method relies on subjective valuation and thus is not reliable.[168] To conduct a DCF analysis, the court must first estimate the future profits of a corporation, which depend on a set of factors, including the future costs, revenues, and tax rates of the corporation.[169] The court must then determine the discount rate,[170] which, under the capital asset pricing model, depends on the risk-free interest rate and the risk premium.[171] The risk premium depends on how sensitive the share price is to the market portfolio.[172] Any differences in the estimation of these factors may lead to drastically different evaluation.[173]

This article offers a more nuanced view. It suggests a structured pliability rules approach—courts should consider using different methods in different circumstances based on the decision-making procedures of the corporation. While the DCF method leads to uncertain outcomes and certain costs of error, these costs imposed discourage the controlling shareholder from setting the compensation too low for fear of the minority shareholders challenging the decision in court. Meanwhile, courts may consider alleviating the litigation costs imposed on controlling shareholders when the challenged

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165. *See* Macey & Mitts, *supra* note 164. Similar arguments have been made by other scholars. Benjamin Hermalin & Alan Schwartz, *Buyouts in Large Companies*, 25 J. Legal Stud. 351, 360 n. 26 (1996).

166. Macey & Mitts, *supra* note 164, at 1042.

167. *Id.* Macey and Mitts acknowledge that there are multiple criticisms of the ECMH. These criticisms include asset bubbles, manipulation, and challenges based on behavioral economics. However, most of these criticisms can be addressed. *See id.* at 1023–28.

168. Other scholars also regard the indeterminacy generated by the DCF analysis to be a weakness of this method. *See* Carney & Sharfman, *supra* note 165 ("Indeterminacy has been an ongoing problem in Delaware corporate law.").

169. Bebchuk & Kahan, *supra* note 27, at 35.

170. *Id.*

171. Stephen Ross et al., Corporate Finance, 357–60 (12th ed. 2018).

172. *Id.*

173. Bebchuk & Kahan, *supra* note 27, at 34–37.

merger transactions have gone through the MoM approval. While courts do not employ structured decision procedures in appraisal actions, they could decide to defer to the deal price or at least shift the burden of proof to the minority shareholders to prove that the deal price is unfair.

The proposed approach is preferable to exclusively relying on the pre-deal market price in appraisal proceedings for two major reasons. Firstly, the pre-deal market price primarily reflects the value of shares to buyers and sellers, failing to account for the subjective value individual shareholders place on their own shares. In theory, if a shareholder has no intention of selling their shares, the subjective value they attribute to those shares would be higher than the market price. Thus, compensating minority shareholders at the pre-deal market price would be inadequate.[174]

Second, and more importantly, this article argues that in a freeze-out merger where a controlling shareholder squeezes out minority shareholders, the pre-deal market price reflects the agency costs between the majority and minority shareholders. If the market anticipates that the majority shareholder may engage in acts of misappropriation or opportunism, thereby diverting corporate interests for its own gain, such concerns would be reflected in the market price of the shares.[175] In such instances, the rights and interests of minority shareholders are particularly vulnerable. Given the control wielded by the majority shareholder, the freeze-out merger can easily result in unfair treatment towards minority shareholders.

If courts accept the ECMH and always use the pre-deal market price to determine the fair value of shares, it would undermine the incentive for the controlling shareholder to offer prices that significantly exceed the pre-deal market price. Both the controlling shareholder and the minority shareholder can easily predict the decision of the court in appraisal litigation. As a result, minority shareholders would probably not exercise

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174. Macey and Mitts have also considered this. They argue, however, that no alternative can "operationalize this theoretical point in a manner that courts can utilize in an appraisal proceeding." Macey & Mitts, *supra* note 164, at 1053-1054.

175. To be sure, courts may impose restrictions on tunneling transactions. *See generally*, Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. CORP. L. 1 (2011). However, corporate litigation is not perfect and not all wrongdoings would receive judicial oversight. Hamermesh & Wachter, *Rationalizing Appraisal Standards*, *supra* note 164, at 1035.

the appraisal rights at all. Given that the pre-deal market price might already factor in agency costs, the appraisal right does not seem to provide extra safeguards for minority shareholders. If the company negatively impacts minority shareholders, the share value may decrease. Consequently, in appraisal actions, the minority shareholders would receive a lower amount of compensation. The superiority of the structured pliability rules approach over the court's reliance on the pre-deal market price hinges on whether the heightened litigation costs imposed by judicial review are outweighed by the reduction in agency costs. The validity of this assumption remains an empirical matter that warrants further investigation.

Delaware courts have embraced the notion that a certain level of judicial oversight is essential in appraisal proceedings, diverging from complete deference to the market price.[176] The preceding theoretical analysis provides a coherent rationale for the decisions rendered by Delaware courts in this regard. Delaware courts held in several cases in recent years that they will generally defer to the deal price of a transaction as long as the negotiation process was fair.[177] In *Highfields Capital, Ltd. v. AXA Fin., Inc.*, the court held that "a court may derive fair value in a Delaware appraisal action if the sale of the company in question resulted from an arm's-length bargaining process where no structural impediments existed that might prevent a topping bid."[178] By contrast, Delaware courts generally award a higher compensation to minority shareholders if conflicts of interest exist in the transactions at issue.[179] For example,

176. *See* Hamermesh & Wachter, *supra* note 159, at 977–981.

177. *DFC Glob. Corp.*, 172 A.3d at 349 ("[E]conomic principles suggest that the best evidence of fair value was the deal price."). Cede & Co. v. MedPointe Healthcare, Inc., No. 19354-NC, 2004 Del. Ch. LEXIS 124, at *1-2 (Aug. 16, 2004). Gholl v. eMachines, Inc., No. 19444-NC, 2004 Del. Ch. LEXIS 171 (Nov. 24, 2004), *aff'd*, 875 A.2d 632 (Del. 2005). *See* Hamermesh & Wachter, *supra* note 159, at 977-981. Desiree M. Baca, *Curbing Arbitrage: The Case for Reappraisal of Delaware's Appraisal Rights*, 13 N.Y.U. J. L. & Bus. 425, 440 (2017) (describing the "trend of deferral" to the deal price by courts).

178. Highfields Cap., Ltd. v. AXA Fin., Inc., 939 A.2d 34, 59 (Del. Ch. 2007).

179. *See, e.g.*, Pinson v. Campbell-Taggart, Inc., No. CIV.A. 7499, 1989 WL 17438, at *7 (Del. Ch. Feb. 28, 1989) ("It should not be concluded that in an appraisal the Court will blind itself to or ignore, the manner and procedures by which the merger price was arrived at. If corporate fiduciaries engage in self-dealing and fix the merger price by procedures not calculated to yield a fair price, those facts should, and will, be considered in assessing the credibility of the Respondent corporation's valuation contentions.").

in *In Re Appraisal of Dell Inc.*, the Supreme Court of Delaware decided that the deal price was the intrinsic value of the shares given that the deal process was fair.[180] In *Glob. GT LP v. Golden Telecom, Inc.*, the court found that the corporation did "not engage in any sales efforts at all and instead concentrated solely on getting as good a deal as it could from VimpelCom," which was partially owned by the largest shareholder of the corporation.[181] The court thus rejected the deal price as the fair value of shares.[182] As Hamermesh and Wachter note, Delaware courts have identified several factors to ascertain the fairness of the deal process, including competition among bidders prior to the deal and the absence of "any specter of self-interest or disloyalty."[183] Appraisal actions impose additional litigation costs on controlling shareholders by enhancing the likelihood that dissenting minority shareholders will obtain compensation in an amount greater than the deal price when negotiation processes cannot be shown to be fair. This heightened probability consequently motivates controlling shareholders to seek approval from impartial shareholders and directors, as well as conduct market checks while determining merger prices, thereby mitigating concerns of opportunistic conduct.[184] Structured pliability rules further serve as a deterrent against minority shareholders abusing their rights, as they too bear procedural costs if they choose to exercise their appraisal rights and may potentially obtain even lower compensation as a result. Consequently, the theoretical framework presented herein justifies Delaware law's approach of employing a combination of standards and rules contingent upon whether the decision has garnered approval from the disinterested shareholders and directors.

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180. Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 28 (Del. 2017) ("[A]ny interested parties would have approached the Company . . . if serious about pursuing a deal."). *See* Macey & Mitts, *supra* note 165.

181. Glob. GT LP v. Golden Telecom, Inc., 993 A.2d 497, 508 (Del. Ch. 2010), *aff'd*, 11 A.3d 214 (Del. 2010).

182. *Id.* at 499.

183. Hamermesh & Wachter, *supra* note 159, at 984.

184. Studies have shown that when the majority pays a higher premium, the likelihood of the transaction being challenged later would decline. Korsmo & Myers, *supra* note 119, at 887.

C. *Comparing Delaware's Approach with other Jurisdictions*

Given the essential role of corporate governance in the development of a strong capital market, the theory offered in this article may offer guidance to governments in other countries that would like to emulate American corporate law. Presently, scholars have put forth various theories to explain the success of American corporate law, with some attributing it to federalism and others highlighting the impact of rigorous discovery rules.[185] This article shows that structured pliability rule serves the important functions of encouraging consent and alleviating the concern for judicial capacity. It is thus superior to a litigation where the court adjudicates disputes with an unconstrained balancing test. In this Section, I will compare the approach by the United States with those in Germany and the United Kingdom to illustrate the advantages of structured pliability rules.[186]

1. *Germany*

Concentrated ownership structures are traditionally prevalent in Germany.[187] German law thus is particularly concerned with the protection of minority shareholders' interests from

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185. *See generally* Gorga & Halberstam, *supra* note 2.

186. Other developing countries, such as China, also fail to adopt structured liability rules. For a discussion of the judicial decision-making methods employed by Chinese courts, *see e.g.*, James Si Zeng, *The Effectiveness of Judicial and Public Enforcement of Regulation on Related-Party Transaction in China*, 22 J. Corp. L. Stud. 505 (2022); James Si Zeng, *Does Regulation of Defensive Tactics with Mandatory Rules Benefit Shareholders? Evidence from Event Studies in China*, 66 Int'l Rev. L. & Econ. 105988 (2021); James Si Zeng, *Rules versus Standards in Chinese Law on Minority Shareholder Protection: A New Taxonomy and Empirical Analysis*, Am. J. Compar. L. (forthcoming 2024); *See also*, Zeng Si(曾思), Shangshi Gongsi Guanlian Jiaoyi de Huiyingxing Guizhi(上市公司关联交易的回应型规制)[Responsive Regulation of Related-Party Transaction of Listed Corporations], 6 Zhong Wai Fa Xue(中外法学)[Peking University Law Journal] 1599 (2021); *See also*, Zeng Si(曾思), Fan Shougou Tiaokuan de Qiangzhixing Guifan Guizhi: Yi Haili Shengwuan Wei Zhongxin(反收购条款的强制性规范规制: 以海利生物案为中心)[Regulation of Takeover Defenses with Mandatory Rules: An Analysis of the Hile Bio-tech Case], 2 Beifang Faxue(北方法学)[Northern Law Review] 54 (2021). However, stock exchanges in China sometimes adopt more flexible regulatory measures to protect minority shareholders. James Si Zeng, *Regulating Draconian Takeover Defenses with Soft Law: Empirical Evidence from Event Studies in China*, 20 Euro. Bus. Org. L. Rev. 823 (2019).

187. John Armour et al., *What is Corporate Law*, *in* Anatomy of Corporate Law 30 (Kraakman et al. eds., 2009).

abuse of power by the majority shareholders.[188] In Germany, shareholder derivative lawsuits are relatively rare.[189] However, judicial review plays an important role in nullifying resolutions that benefit majority shareholders at the expense of minority shareholders.[190] Under German law, many decisions of the company need to take effect by being entered into the commercial register.[191] Minority shareholders can block a resolution from being registered, thus protecting their interest.[192] In the famous *Linotype* case, a shareholder holding 96% of the shares initiated a resolution to dissolve the firm so that the profitable business operated by the firm can be integrated into the business of the shareholder.[193] The court held that the majority shareholder violated its duty of loyalty, and as a result, the resolution was nullified.[194] If the shareholder resolution "conveys special advantages" on certain shareholders, which is most likely the case when there is a majority shareholder dominating the decision, minority shareholders may raise a challenge under Section 243 of the German Stock Corporation Act (Aktiengesetz, hereinafter referred to as the "AktG").[195] Any shareholders can bring litigation if they obtained the shares before the notice of the meeting, attended the meeting and voiced their dissent, or were wrongfully refused to attend or attended a meeting that was not duly held.[196]

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188. Armour et al., *supra* note 2.

189. *See* Pierre-Henri Conac et al., *Constraining Dominant Shareholders' Self-dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. CO. FIN. L.R. 491, 508 (2007) ("As a consequence of the threshold for standing to sue in derivative suits and other hurdles to shareholder litigation, in Germany and Italy liability suits against directors have always been rare (even in the case of corporate groups).").

190. *Id.* at 513. ("Challenges to the validity of shareholder resolutions have traditionally been used as a shareholder remedy in Italy and Germany, because it is an effective bargaining tool against the company and its dominant shareholders.").

191. ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW: TEXT AND CASES ON THE LAWS GOVERNING CORPORATIONS IN GERMANY, THE UK AND THE USA 745 (2010)

192. *See id.* at 749. This is mainly because German law does not recognize contingent fees. As a result, shareholders lack the incentives to bring derivative lawsuits, which benefits the company rather than shareholders directly.

193. *See* Conac et al., *supra* note 189, at 501. BGH 1.2.1988, II ZR 75/87, BGHZ 103, 185.

194. *Id.*

195. *See* CAHN & DONALD, *supra* note 191, at 750.

196. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBI at 1089, § 245, translation at https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/imported/german-stock-corporation-act.pdf.

German scholars have recognized the problem in using judicial review to curb the abusive actions of the majority shareholders and protect the interests of the minority shareholders.[197] On the one hand, judicial review is viewed as necessary to protect minority shareholders when the voting mechanism does not generate efficient outcomes. On the other hand, a minority shareholder may also abuse its power to bring frivolous lawsuits.[198] Certain professional litigation groups have incentives to file the litigation because they can obtain personal benefits in the form of settlement payment.[199] A minority shareholder may block a time-sensitive transaction and inflict harm on the majority shareholders by suing in court in the hope that the majority will offer some personal benefits to the minority.

To prevent the professional groups from abusing the litigation procedures, German law was amended in 2005 to allow corporations to sue in courts for registration of a resolution when a challenge is impermissible or unfounded, or when a delay would damage the company's interests.[200] Section 246(a) of the AktG provides that the court can, "at its discretion and conviction," hold that "the significant disadvantages for the company and its stockholders as presented by the petitioner outweigh the disadvantages the respondent stands to suffer."[201]

German law can be viewed as adopting liability rules protection to minority shareholders that focuses mainly on the fairness of corporate decisions rather than whether there is MoM approval. It imposed high litigation costs on the corporation prior to the 2005 amendment, especially when the transaction is time-sensitive, which can be regarded as an intensive substantive review approach that offers leverage to the minority members. However, such an approach allowed the minority shareholders to hold up the transaction by bringing frivolous lawsuits. Consequently, the 2005 amendment significantly reduced the litigation costs by restricting the rights of the minority shareholders, which can be regarded as a superficial substantive review approach. Following Section 246(a), courts are to substantially evaluate the damages caused to the company and the disadvantages of the shareholder, rather

197. *See* Cahn & Donald, *supra* note 191, at 744.
198. *Id.*
199. *Id.*
200. *Id.* at 751. AktG § 246(a).
201. AktG § 246(a).

than to consider the decision-making process. While such an approach significantly alleviated the concern of prolonged lawsuits and hence reduced the procedural costs of the companies, it increased the costs of error—courts may allow a frivolous lawsuit without merit to proceed to a further stage or allow a legitimate challenge to be blocked. It may thus either overprotect or under-protect minority shareholders. Germany has largely failed to vary the litigation costs based on the presence or absence of MoM approval.[202] As a result, courts are likely to bear a significant burden of reviewing corporate decisions, while the majority shareholder lacks incentives to seek the approval from a majority of the minority shareholders.

German law on the appraisal rights of shareholders also faces a similar problem. When a corporation enters into a merger transaction, German courts will appoint an independent auditor to evaluate the fairness of the transaction.[203] Shareholders of an acquired corporation have the right to appraisal proceedings if the consideration is insufficient.[204] A recent study shows, however, that courts often face difficulty in appraisal proceedings because of the inherent problems of valuation.[205] In addition, courts cannot award a compensation lower than the merger price, rendering the appraisal right an "option" for minority shareholders—the minority shareholders thus have nothing to lose and are incentivized to always initiate the appraisal proceedings.[206] Scholars have already proposed that German courts should learn from the Delaware courts and focus their inquiry more on the decision-making process of the merger to alleviate the concern of uncertainty in valuation.[207]

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202. *See* Conac et al., *supra* note 189, at 501. For a detailed discussion of how German courts adjudicate similar disputes, *See* David Cabrelli, *Shareholders' Rights and Litigation*, *in* COMPARATIVE COMPANY LAW: A CASE-BASED APPROACH 401–03 (Mathias Siems & David Cabrelli 2d ed. 2018) (discussing how German law deals with a related-party transaction).

203. Krebs, *supra* note 25, at 957.

204. Andreas Engert, *How (not) to Administer a Liability Rule—The German Appraisal Procedure for Corporate Restructurings* 5 (Freie Universität Empirical Legal Stud., Working Paper No. 6, 2020), https://www.jura.fu-berlin.de/en/forschung/fuels/Output/Working-Papers/FUELS_WP-How-not-to-administer-a-liability-rule-2020.pdf.

205. *Id.* at 7.

206. *Id.*

207. Scholars have also proposed shifting the court's inquiry to the process. *Id.* at 13 ("Putting greater weight on a fair bargaining process in corporate

2. *United Kingdom*

The UK can be viewed as having adopted a similar approach of structured pliability rules to protect minority shareholders. The dominant form of ownership structure of corporations in the UK is dispersed ownership.[208] However, if a corporation engages in a transaction that harms the interests of a minority shareholder, the minority shareholder may receive similar protection. Under the 2006 Companies Act of the UK, directors bear fiduciary duties towards the corporation.[209] If the corporation enters a transaction that harms its interests, minority shareholders may bring a derivative action to seek damages.[210] The minority shareholders must first seek leave of the court. In deciding whether to grant leave, the court would consider whether the corporation has ratified the alleged breach with a vote of the disinterested members. The UK courts' approach thus would also take into account the consent of the disinterested shareholders in adjudicating corporate disputes.[211]

Under the UK's approach, if a majority of shareholders would like to initiate a transaction that may harm the minority's interest, the courts may substantively review the fairness of the decision.[212] However, the court would refrain from reviewing if the decision has been approved by the disinterested shareholders.[213] The UK courts thus can also be regarded as using a structured decision-making process that take into account the MoM approval in its judicial review. This approach alleviates the concern of the courts' lack of information and can, to a significant degree, enhance the legitimacy and the fairness of the decision. While current studies have emphasized the superiority of corporate laws in common law jurisdictions over those in civil law jurisdictions,[214] they have largely focused on

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restructurings could be a promising strategy for the German appraisal procedure as well.").

208. Armour et al., *supra* note 187, at 29.

209. Companies Act 2006,§172 (UK).

210. *Id.* at §260.

211. *Id.* at §239(4).

212. *See* David Cabrelli, *Shareholders' Rights and Litigation*, *in* COMPARATIVE COMPANY LAW: A CASE-BASED APPROACH 378–85 (Mathias Siems & David Cabrelli 2d ed. 2018).

213. *Id.* at 291(explaining that the votes of the interested shareholders would be ignored for the purpose of the vote on ratification and that if the corporate decision is ratified by the rest of the shareholders, the court would not permit the lawsuit to proceed further).

214. *See, e.g.*, La Porta et al., *supra* note 3.

the substantive rights of the shareholders and have ignored the judicial decision-making methods adopted by courts in different jurisdictions, which, this article argues, play a crucial role in minority shareholder protection.

III.
Structured Decision-Making under Constitutional Law on Takings

Structured pliability rules transcend the boundaries of corporate law and find relevance in diverse contexts characterized by majority-minority conflicts. This section delves into the realm of constitutional law. While most constitutional rights are not tradable and are thus different from the rights of shareholders, a specific set of constitutional laws—the law on takings—deals with the protection of minority property rights against majority expropriation.[215] The use of governmental taking power is an intrusion on the property rights of certain minority members of the state, which generates a conflict between the majority and the minority members of a state. For instance, when a government seeks to build a public highway and needs to expropriate private lands, the property holders can be viewed as minority members of the state, whose interests are adversely affected, while the expropriation benefits the majority of the members of the society. Since property rights can be expropriated by governments based on collective decisions, they can also be viewed as collective rights similar to those of shares owned by shareholders. How judges should review these collective decisions can thus be analyzed under the theory offered in this article.

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215. Law and economics scholars have long sought to identify the common structures underlying different bodies of common law and develop unified theories that can explain them. Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 Cal. L. Rev. 1, 43 (1985) ("Economic theory is unified because its theorems are derived from its axioms. Consequently, the Economic Analysis of Law must be capable of being unified insofar as it is an application of economic theory."). There are, however, insufficient studies about unity in corporate and constitutional law. *See, e.g.*, Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 Yale L.J. 119 (2003). One could, of course, provide a list of differences between the two bodies of law. This article, however, seeks to develop a theory that reveals their similar structures, which may yield important implications and further insights.

A. *Property Rules, Liability Rules, and the Case of Eminent Domain*

Like corporate law, the law on takings, i.e., the process of a government taking private land for public use, must resolve majority-minority conflicts; in the takings context, the minority is one property holder or a small group of property holders.[216]

The theory of property rules and liability rules can be applied to analyze the protection of private property in the takings context.[217] Under property rules protection, a government can only purchase property rights necessary for public use through voluntary exchange. The transaction costs would then be very high due to the "rent-seeking" problem—certain property holders might hold out on the decision in order to seek additional personal gain.[218] If the public project involves the assembly of many pieces of property, each property holder will have a veto right. For example, in *Kelo v. City of New London* (hereinafter referred to as "*Kelo*"), the city government intended to expropriate private lands for a development plan to potentially revitalize the local economy.[219] However, for the development plan to work, it was necessary to assemble all of the property rights in the area. In that scenario, no single property holder would bear the full cost of a delay of the development project. Therefore, they may have had an incentive to veto the decision even though the decision would benefit the community as a whole simply to bargain for more personal gain, leading to the problem of "anticommons" and the underuse of properties.[220]

Liability rules allow governments to coerce property holders into transferring the titles to their properties to the governments, while courts are to ensure that the property holders

216. Some scholars have noted the similarities between constitutional and corporate law. *See* Heller & Hills, *supra* note 36, at 1522 ("Like the controlling shareholder, the landowner(s) within a LAD who control a majority of the property (measured by valuation, square footage, etc.) can force the owners of a minority share of the land to sell their interest against their will. In either case, the controlling shareholder or landowner effectively has a power of private eminent domain.").

217. Some scholars treat the use of eminent domain power as a constitutional liability rule or "pliability rule." Bell & Parchomovsky, *supra* note 23, at 25-26.

218. Merrill, *supra* note 22, at 76.

219. Kelo v. City of New London, 545 U.S. 469 (2005).

220. Heller & Hills, *supra* note 36.

receive just compensation. The major challenge under liability rules, however, is that given a lack of information, courts may either overcompensate or undercompensate property holders.[221]

B. *Structured Pliability and the Land Assembly District Proposal*

Currently, the Constitution of the United States can be viewed as offering a combination of property rules and liability rules protection to the property owners in the context of the taking of lands. The Fifth Amendment imposes two major constraints on the use of eminent domain: public use and just compensation.[222] Public use has long been considered an ambiguous term; different legal scholars and courts have offered various theories about the meaning of "public use."[223] Some argue that governments can only expropriate private property rights to provide public goods that are nonexcludable and nonrivalrous.[224] Such a view, however, is inconsistent with the existing case law.[225] In practice, courts have adopted a broad

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221. For example, some scholars argue that the government should pay 150% of the condemned property's opportunity costs. RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 175 (1985) ("The 50 percent figure may not be perfect, but it is far from arbitrary: perhaps a 25 percent premium is better, or perhaps 75 percent. But in these circumstances, one should not demand perfect precision because there is no way to provide it."). However, such an approach would render the compensation predictable, and all property owners would bargain for the 150% premium even if their subjective value is actually less.

222. U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

223. DAVID A. DANA & THOMAS W. MERRILL, PROPERTY: TAKINGS 191 (2002). *See* Merrill, *supra* note 22, at 72-74; Heller & Hills, *supra* note 36, at 1485 ("Much of the literature surrounding eminent domain revolves around whether courts should more aggressively control condemnations by barring condemnations that do not (in the judge's opinion) serve a "public use."). The Kelo case is a famous case that shows that the definition of public use remains heavily contested. *Kelo*, 545 U.S. 469. *See also* Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229, 241 (1984) (holding that state may not take property only for another's private use, but may take the property if it is "rationally related to a conceivable public purpose"); Berman v. Parker, 348 U.S. 26, 33-35 (1954).

224. EPSTEIN, *supra* note 221, at 166.

225. *Kelo*, 545 U.S. 469. *See also Berman*, 348 U.S. 26.

interpretation of the meaning of public use and tend to defer to political decisionmakers.[226]

While the Fifth Amendment appears to have taken a liability rule approach—guaranteeing fair compensation but allowing the government to expropriate private lands, studies have shown that in practice, courts impose significant costs on the government in exercising the eminent domain power,[227] which thus incentivizes the government to first use voluntary exchange to obtain the property rights. Governments need to obtain legislative authority and go through burdensome litigation procedures, including drafting, filing, and engaging in trials. It is only when property owners hold up decisions and transaction costs become too high that governments turn to the use of their eminent domain power.[228] Interpreted in this way, the Fifth Amendment provides property rule protection for owners of property rights when there is a thick market; it offers governments the liability rule option in thin markets where owners hold out on decisions.[229] It thus encourages governments to transact with property owners and deter opportunistic actions.

However, the current approach still suffers from certain problems, especially in the context of land assembly because when the government is to collect several parcels of lands to form an assembly, it almost always faces a thin market.[230] To illustrate, suppose the government is to renew a neighborhood by building a shopping mall and the surrounding facilities such as roads and parking lots. The project requires the assembly of ten parcels of land that belong to ten different owners. The collective value of the project is estimated to be 5 million, while

226. Merrill, *supra* note 22; Heller & Hills, *supra* note 36, at 1485.

227. *See generally* Merrill, *supra* note 22.

228. Thomas Merrill argues that judicial review can impose a procedural "due process tax" on governments, which encourages governments to use the market mechanism. *See* Merrill, *supra* note 22, at 81, 90 ("[C]ourts, in setting the limits of eminent domain, should ensure that just compensation is paid and enforce the due process 'tax'—the legislative and constitutional requirements that push the assessment costs of eminent domain above the costs of market exchange in thick market settings. . . . It would simply make market exchange the medium of choice, and eminent domain a method of last resort.").

229. *See* Merrill, *supra* note 22, at 78 ("Legislatures, agencies, and private parties will rely upon eminent domain only when such reliance is efficient, that is when market exchange would consume more resources.").

230. *See* Merrill, *supra* note 22, at 81-82.

each parcel may be worth only 0.3 million. Suppose the government has obtained the consent of nine owners, but one of the owners who holds the land on which the parking lot is to be built refuses to transact with the government. The owner has incentives to hold up because she knows that she is able to veto a 5 million project, even though her land is only worth 0.3 million. Since each owner has an incentive to hold out to obtain a higher surplus, the project may fail if they could not successfully reach an agreement. It seems that liability rules would be necessary in this context.

Meanwhile, liability rules also face significant difficulties because the courts lack information on the value of the property rights. The determination of just compensation is frequently a major issue of the taking dispute.[231] A landowner may claim that he or she attaches a higher subjective value to his or her land, which is difficult for a court to evaluate. Given the lack of information about the subjective value of the land, the court may choose to offer compensation based on the objective value. By doing so, however, it probably undercompensates the property owner because most people attach a higher subjective value to their houses, which is evidenced by the assumption that they would have sold their property rights if they believed the subjective value of the houses to be below market value.[232]

This article suggests that courts should offer structured pliability rules protection rather than liability rules protection to property owners in the land assembly context. When the state is to assemble multiple parcels of lands for a project that enhances their collective value, the problem is similar to a corporate freeze-out merger. The owners of the lands to be taken by the government are like the minority shareholders who are forced to sell their shares in a freeze-out merger. The government is like the majority shareholders of a corporation who represents the interests of a majority of the members of the society. The problems facing the court in both cases are similar.

Courts can consider adopting structured decision-making methods, changing the standards of review or shifting the burden of proof in these cases to offer different types of review

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231. *See* Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. Env't. L.J. 110, 117 (2002).

232. Those property owners who refuse to sell probably attach subjective value to the houses that is above the market price.

based on the rate of approval of the property owners. In practice, the taking of private property often involves many different property rights. In *Kelo,* for example, the government needed to expropriate approximately 114 pieces of private property and 32 acres of land to be used for different purposes, including a waterfront conference hotel, a pedestrian "Riverwalk," a new U.S. Coast Guard Museum, and research and development office space.[233] Courts can take into account the approval rate of all of the affected property holders in each case in order to determine whether the government has provided just compensation to them. While courts have not considered this factor under the current law on takings, some scholars have proposed incorporating a majority rule in eminent domain cases called the "land assembly districts" (LADs).[234] This Section first considers the current proposal and argues that there are important drawbacks in LADs, which can be addressed with structured pliability rules.

1. *The Current Proposal of Land Assembly Districts*

The LADs are proposed by Michael Heller and Rick Hills.[235] They recognize that when a state is to expropriate and assemble parcels of land for a certain project, each landowner has an incentive to hold out to obtain greater compensation for his or her land. Private voluntary contracting thus may lead to underassembly due to high transaction costs.[236] Similarly, conventional eminent domain encounters difficulty in the valuation of property rights.[237] Thus, Heller and Hills propose that landowners should form a collective organization in which they collectively decide whether to sell the assembly of property rights in a neighborhood to a developer or a government.[238]

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233. *Kelo*, 545 U.S. at 474.

234. *See* Heller & Hills, *supra* note 36, at 1469 ("[P]ersons who hold a legal interest in a neighborhood's land should collectively decide whether the land ought to be assembled into a larger parcel.") (emphasis omitted).

235. *Id.* Some have proposed to establish similar institutions in other jurisdictions. *See, e.g.*, James Si Zeng, *Establishing Land Assembly Districts: A Proposal to Chinese Law on Rural Land Takings*, 10 FRONTIERS L. CHINA 690 (2015).

236. Heller & Hills, *supra* note 36, at 1468.

237. *Id.* ("Failure to pay landowners the true value of land assembly can cause (1) the government to ignore those costs, leading to inefficient overassembly, or (2) the private landowner to fight land assembly too vociferously, leading to wasteful underassembly.") (emphasis omitted).

238. *Id.*

The LAD proposal essentially uses a majority or a supermajority vote to determine the level of compensation owed to right-holders,[239] which is essentially similar to a majority-of-the-minority approval of a freeze-out merger in a corporation.[240] It incorporates the opinions of right-holders in similar situations to determine whether a decision is fair to the minority. In doing so, it introduces a weak form of property rule protection. The majority of the property holders in a LAD do not have any conflicts of interest in deciding to sell the property rights collectively held by the LAD to the government. Their decisions are more likely to represent, at least to some extent, the interests of all the property holders than a single property holder. If the property holders in similar positions indicate their consent to the government's offer of purchasing the property, there is a higher likelihood that the compensation level is just and the dissenters are merely holding up the decision for further gains since the compensation accepted by the majority of the LAD's members likely reaches a reasonable level of subjective valuation.[241]

The LAD proposal builds on the assumption that the interests of property holders within a neighborhood are fairly homogeneous.[242] LAD members may still have heterogeneous interests—for instance, some members may have higher sentimental values attached to their property, while others may be in need of cash and are more inclined to reach a deal with the government. The theory of LAD posits that all LAD members share the same goal of maximizing the price at which to sell their properties.[243] In addition, if a court is worried that some owners of tangible property rights may attach higher subjective values to their properties than owners of shares of stocks and that the interests of the property holders in a LAD are not

239. For the sake of simplicity, I assume the voting rights of LAD members are fairly allocated based on the value of their property rights.

240. Heller & Hills, *supra* note 36, at 1521 (recognizing that "[t]he problem of corporate 'freezeouts' provides one of the closer analogies to LADs.").

241. *Id.* at 1498 ("The compensation offered by the LAD would presumably reflect the median neighbor's subjective value of his or her land, weighted by the landowner's proportional share of the land. Such a figure would be at least as great as the fair market value of each parcel, but it might be lower than the subjective valuation that an individual landowner places on his or her land.").

242. *Id.* at 1500.

243. *Id.* at 1503 (stating that "LAD's narrow agenda is focused exclusively on maximizing the sale price of a neighborhood.").

homogeneous, the court can require a higher approval rate (for example, 95%) to determine that compensation is fair.[244]

Moreover, a LAD can be expected to bring greater gains to property holders. When fragmented property rights are pooled together, they can be used for larger projects, generating "assembly value."[245] LADs enable their members to bargain for a share of the assembly value and not just the value of individual properties.

In addition, LADs enable the majority of property holders to bargain for the subjective values they attach to their property rights, which is arguably superior to the current approach. Currently, it is recognized that governments should pay more compensation in taking some properties, such as houses that have been owned by their property holders for a long time, because the property holders may attach higher sentimental value to them.[246] While it is possible for courts to award compensation in an amount higher than the market value, such an approach may give rise to overcompensation and prevent the taking of property for socially-desirable projects. To illustrate, suppose that a state sets the compensation level at 150% of the market value. This will effectively deter a government from expropriating properties for economic development plans that would increase the value of the properties by 40%. Thus, the main problem is not undercompensation but a lack of institutions that can effectively help courts measure subjective value.[247]

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244. Some may consider the LAD proposal to be in violation of the basic concept of property. As Charles Reich put it, "[p]roperty draws a circle around the activities of each private individual or organization. Within that circle, the owner has a greater degree of freedom than without. . . . [B]y creating zones within which the majority has to yield to the owner[,] [w]him, caprice, irrationality and 'antisocial' activities are given the protection of law." Charles A. Reich, *The New Property*, 73 YALE L.J. 733, 771 (1964). However, property rights in modern states are often subject to certain limitations such as the eminent domain power. The LADs merely replace the eminent domain power when voluntary exchange of property rights between the government and the property holders is blocked by the fragmentation of property rights. Heller & Hills, *supra* note 36, at 1492. The court is also to protect the property rights of each individual member of the LAD against the tyranny of the majority.

245. *Id.* at 1470.

246. Janice Nadler & Shari Seidman Diamond, *Eminent Domain and the Psychology of Property Rights: Proposed Use, Subjective Attachment, and Taker Identity*, 5 J. EMPIRICAL LEGAL STUD. 713, 715 (2008).

247. *See* Heller & Hills, *supra* note 36, at 1487 ("We need institutions that will encourage the parties themselves—condemnees and condemnors—to

While the LAD proposal may partially address the problem of determining the compensation for subjective value in eminent domain cases, it still faces certain challenges. A major problem is the tyranny of the majority within LADs. Different right-holders may have different subjective valuations of their properties. Hence, the consent of the majority of the right-holders in a neighborhood does not necessarily indicate that the decision is fair to the other rightsholders. It is quite possible that a majority of the neighborhood will unite to make a decision that harms the interests of the dissenting members.[248]

To address this problem, Heller and Hills have designed a right to "opt out" of LADs.[249] Under the proposal, property holders can decide to "opt out" of a LAD and to seek just compensation from a court if they are not satisfied with their LAD's decision.[250] This ensures that landowners receive "no less than the constitutional measure of just compensation,"[251] which can be viewed as offering liability rule protection to the members who disagree with the LAD majority decisions.

This solution, however, faces the same valuation challenge—it remains unclear how courts should evaluate the fair market value of the rights of opt-out holders and how courts can take into account majority approval in their determination of just compensation. Heller and Hills argue that few members would choose to opt out because of litigation costs.[252] However, it is also possible that litigation would impose significant costs on the government and other LAD members if the properties held by the dissenting minority in a particular case are crucial

reveal how much they value the rival uses of fragmented neighborhoods or assembled land.").

248. *Id.* at 1499 ("[T]he courts fear that a majority of neighbors will unite around the goal of restricting a nearby parcel's uses and thereby enhance the value of the neighbors' own land at the burdened parcel owner's expense.").

249. *Id.* at 1496.

250. *Id.* ("The final aspect of LADs is the right of any individual landowner to opt out of the proposal even if that proposal is approved by whatever type of majority vote the LAD statute requires. In such a case, the dissenting landowner would have the right to insist that his or her parcel be purchased through ordinary eminent domain procedures.").

251. *Id.* at 1497.

252. *Id.* ("[T]here would be few opt-outs because the contingency fee lawyers who litigate condemnation cases get paid only if they can improve on the LAD's initial offer.").

for the assembly value.[253] Take the *Kelo* case as an example. Suppose the holders of the properties affected by the development plan of the city of New London formed a LAD, which made a collective decision to sell the properties to the government. Kelo, however, decided to opt out and challenged the decision in court. If the court reviewed the governmental decision to purchase the land at a price agreed to by the LAD in the same way as it reviews a government taking of private land, the litigation process would impose significant costs on the government. The court could review whether the decision was for "public use." The judicial review would delay the process and affect the deal between the LAD and the government, given that Kelo's properties were part of the development plan. The right to opt out thus would destroy the purpose of having the LAD in the first place. The government might thus offer to pay the dissenting member a higher price. Expecting this, each member of the LAD would have an incentive to hold out on the decision even after the LAD collectively reached an agreement with the government if the collective decision was not binding. The government thus would lack the incentive to seek consent from the majority of the LAD members and might prefer to use directly its eminent domain power from the beginning and to defend its decision in court. [254]

The problem faced by LADs is essentially a problem of judicial decision-making. To promote the use of LADs and to encourage governments to seek consent from the MoM property holders, it is necessary for courts to offer some incentives to governments to obtain the LAD's consent.[255] The litigation costs imposed on governments should thus be alleviated to encourage a government in a particular case to try to obtain the consent of the majority of the property holders by offering a purchase price that is higher than the market price and partially compensates the property holders for their subjective valuations of their properties.

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253. *Kelo*, 545 U.S. at 489, fn.24. (noting that some "argue to the contrary, urging that the need for eminent domain is especially great with regard to older, small cities like New London, where centuries of development have created an extreme overdivision of land and thus a real market impediment to land assembly.")

254. If, however, each member is bound by the LAD's decision, there might be a concern about the "tyranny of the majority" within the LAD.

255. Goshen, *supra* note 10, at 412 (explaining that "property-rule approach gives the minority more bargaining power.").

2. *Improving Land Assembly Districts with Structured Pliability Rules*

This article contends that the LAD proposal can be improved if courts more clearly incorporate the decisions made by the majority members of the LAD in judicial review. Courts can employ structured decision-making procedures to reduce the litigation costs of governments when they have obtained the support of a majority of a LAD. Specifically, courts can adjust the litigation costs of the parties in several ways.

First, if the majority of a LAD's members agree to the decision to sell the properties to the government, the court can develop a rule that bars the dissenting members of the LAD from challenging the government-set compensation level (which has been agreed to by the majority of the property owners in similar situations), similar to the business judgment rule unless the dissenting members can present evidence that strongly suggests that the negotiation process was coercive or otherwise not representative of the true will of the members.[256]

Second, the court can shift the burden of proof to the dissenters to show that despite the LAD's decision, the government's offering price is still below the fair value of the dissenters' property rights. This proposal is similar to that of the structure of corporate litigation in freeze-out mergers, where the majority shareholders can reduce the procedural costs imposed by judicial review by seeking the consent of a majority of the affected minority shareholders.[257] Moreover, it is possible to award dissenting members compensation lower than the deal price reached by the LAD and the government. As a result, the dissenting minority members of the LAD will be less inclined to hold out on the decision by suing because of the potential risk that they may receive compensation in an amount lower than the price agreed to by the LAD. Meanwhile, the government has a stronger incentive to reach an agreement with the LAD rather than using its eminent domain power to expropriate private

256. *MFW*, 67 A.3d at 502, 536.

257. To be sure, the dissenting minority's constitutional rights may be restricted under the proposed rules. I do not intend to discuss whether the proposed LAD mechanism would be constitutional. This article merely intends to show that structured decision-making may more effectively resolve the majority-minority conflict. Without structured decision-making or some rules that allow courts to alleviate the litigation costs of the government in taking cases, the LAD mechanism would likely face significant challenges.

properties because this increases their likelihood of winning. Compared with the first approach, the incentives offered in this approach are generally weaker since the government may still be dragged into a lawsuit that lasts for a long time.

Third, it is also possible for a court to reduce the costs imposed on the government by allowing the government to acquire the private property without any delay if the decision is supported by a majority of the LAD members and reviewing the fairness of the compensation afterwards, which is similar to the procedural design of appraisal actions. Currently, governments need to go through judicial proceedings if their use of eminent domain power is challenged, through which they incur significant costs.[258] In the famous *Kelo* case, for example, the local city council appointed the New London Development Corporation (NLDC) as its agent to develop a plan to revitalize New London.[259] The NLDC obtained most of the necessary properties through voluntary exchange, while a few property holders, including Kelo, refused to sell.[260] Kelo challenged the use of eminent domain power by claiming that the taking would violate the "public use" requirement, and the trial court granted a permanent restraining order prohibiting the taking of Kelo's properties, delaying the taking process for years.[261] If the transfer of properties had been approved by a majority of the LAD members in similar situations, the court might have considered allowing the transfer to be completed while reviewing whether the compensation offered to Kelo was fair. This approach would significantly alleviate the procedural costs imposed on governments and incentivize them to seek approval from LAD members.

To be sure, one may be concerned that such an approach would violate the takings clause in the Constitution since it essentially allows governments to bypass the requirement of public use. However, the Supreme Court of the United States already adopted a deferential attitude towards the element of

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258. Merrill, *supra* note 22, at 77 ("Finally, both court-made and statutory law guarantee a person whose property is subject to condemnation some sort of hearing on the condemnation's legality and the amount of compensation due.").
259. *Kelo*, 545 U.S. at 475.
260. *Id.*
261. *Id.*, at 475.

public use in *Kelo* and a few other cases.[262] While it is possible that a dissenting member of a LAD may attach a higher subjective value to the property rights and hence demand higher compensation, allowing the member to delay the decision agreed to by the LAD members may frustrate the purpose of having LADs. If policymakers ever adopt LADs to help determine just compensation in the taking of private properties, a court should reduce the litigation costs imposed on a government if a LAD has agreed to sell an assembly of property rights to the government or its agents by a majority or a supermajority vote and if the negotiation process is fair.[263]

Thus far, the above discussion focuses on alleviating the litigation costs for governments. Legislatures and courts may also consider enhancing litigation costs for dissenting property holders in LADs by learning from the design of appraisal actions. For example, a dissenting property holder should not be allowed to receive a share of the payment made by the government to the LAD. As a result, the property holder needs to finance the litigation.[264] In addition, courts can make it clear that property holder may receive compensation in an amount lower than the price approved by their LAD.[265]

Under structured pliability rules, dissenting property holders would face a choice: they could either accept the government's offer and join their LAD's majority decision or litigate the case to its end. In the latter situation, the dissenters would have to show evidence in support of their claim of subjective value and bear the procedural costs as well as the uncertainty of the outcome.[266] Courts would then significantly raise the

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262. *Id.*; Berman v. Parker, 348 U.S. 26 (1954); Haw. Hous. Auth. v. Midkiff, 467 U.S. 229 (2006).

263. Scholars have noted that "government officials frequently complain about the costs and delays of eminent domain." Merrill, *supra* note 22, at 80.

264. For the discussion of the procedural costs imposed on the dissenting members in appraisal actions, see ROBERT CHARLES CLARK, CORPORATE LAW 508 (1986); PETER V. LETSOU, CASES AND MATERIALS ON CORPORATE MERGERS AND ACQUISITIONS 429 (2006); Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967, 1005 (2006) (asserting that "[a]ppraisal litigation is complicated and expensive" and that "many shareholders find it difficult to meet the complicated procedural requirements and deadlines of the appraisal remedy").

265. Korsmo & Myers, *supra* note 119, at 865-66.

266. Heller and Hills also hinted that minority members in LADs may need to bear additional litigation costs if they choose to opt out, which incentivize them to agree to the LAD's decision. Heller & Hills, *supra* note 36, at 1497

litigation costs for dissenting property holders. Property holders would be less likely to opt out and resort to litigation unless they believed that their property had truly been undervalued. While the precise magnitude of the costs that the government and the property owners should bear is difficult to determine and falls outside the scope of this article, this article proposes that the approval rate of similarly situated property holders should at least be taken into account in setting these costs. This approach would be superior to the court applying the liability rules and assessing the value of the property directly.

C. *Responding to Potential Counterarguments*

The above analysis rests upon certain assumptions about the similarities between the behavior of business investors and governments. This section considers and defends against some potential counterarguments about the similarities between constitutional law and corporate law.

A major potential critique of the above analysis may be that legislatures and governments behave differently from majority shareholders. Theoretically, legislatures and executive governments do not pursue profits like shareholders. They thus may also consider the interests of the minority property holders in a state.[267] One may believe that while majority shareholders in corporations are free to initiate any merger transactions, governments may refrain from exercising their eminent domain power and only obtain legislative authority to pursue certain public goals.

(“Nevertheless, we expect there would be few opt-outs because the contingency fee lawyers who litigate condemnation cases get paid only if they can improve on the LAD’s initial offer.”). This article further contends that for this mechanism to work, courts should adopt structured decision-making and employ standards to review the LAD’s decision in order to impose a litigation “tax” on the minority, see *infra* Section III.B.2

267. *See generally* Matthew C. Stephenson, *The Price of Public Action: Constitutional Doctrine and the Judicial Manipulation of Legislative Enactment Costs*, 118 YALE L.J. 2 (2008) (“The deterrence rationale for a just compensation rule is therefore sensible only if we assume that the government is better informed than the court as to the consequences of the taking but gives insufficient relative weight to the interests of the property owners.”). Some scholars argue that the majority also respects the minority rights, this question depends on empirical evidence. Jeremy Waldron, *The Core of the Case Against Judicial Review*, 115 YALE L.J. 1346, 1404 (2006).

While different scholars may have different views about the behavior of legislatures and governments, this critique does not affect the major conclusions of this article. Structured pliability rules address two important concerns in the protection of private properties—the difficulty in evaluating just compensation and the holdout problem. They do not aim to provide the right incentives for governments. If governments fail to internalize the costs imposed on property holders and act under a "fiscal illusion,"[268] structured pliability rules would incentivize the governments to seek consent from property holders to the greatest extent to reduce litigation costs. Structured pliability rules are thus superior to liability rules. If, on the other hand, governments act benevolently to expropriate private properties for public use, they still face the problems of evaluation and holdouts, and structured pliability rules may be employed to alleviate these problems.

Another potential challenge to the above analysis is that governments may not change their behavior even when heavier litigation costs are imposed by the court. This may be true because governments act as an agent of all members of a state and thus spend other people's money, or because governments do not pursue profits like shareholders and thus do not behave as rational actors.[269] For these reasons, even if courts impose

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268. DANA & MERRILL, *supra* note 223, at 41-46. BUCHANAN & TULLOCK, THE CALCULUS OF CONSENT 4 (1962) ("Political theorists, by contrast, do not seem to have considered fully the implications of individual differences for a theory of political decisions. Normally, the choice-making process has been conceived of as the means of arriving at some version of "truth" some rationalist absolute which remains to be discovered through reason or revelation, and which, once discovered, will attract all men to its support. The conceptions of rationalist democracy have been based on the assumption that individual conflicts of interest will, and should, vanish once the electorate becomes fully informed.").

269. *See* Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 345-48, 354-57 (2000) ("We cannot assume that government will internalize social costs just because it is forced to make a budgetary outlay. While imposing financial outflows on government will ultimately create political costs (and benefits), the mechanism is complicated and depends on the model of government behavior used to translate between market costs and benefits and political costs and benefits."); Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 568 (1986) ("Commentators assume that costs are discounted because they are not directly borne by the decisionmakers themselves. But neither are benefits. To the extent that both are discounted in roughly the same proportions, no bias should result."); Edward Rubin, *Rational States?*, 83 VA. L. REV. 1433, 1439-42 (1997) ("There is no such market in the political realm; thus, as

additional costs on the decision-making process, governments' behavior cannot be changed by adjusting litigation costs. The validity of this argument, of course, depends on empirical evidence about the particular government at stake and its behavior. Some scholars point out that many local governments are under strong budget constraints and thus would be cost-sensitive.[270] Under these circumstances, structured pliability rules will thus be more effective in promoting socially efficient outcomes.[271]

One may also raise the objection that property rights in land may be different from property rights in shares of corporations because citizens may attach higher subjective value to their lands while the interests of the shareholders are more homogeneous.[272] Thus, while the MoM shareholders generally make decisions to maximize the interests of minority shareholders as a whole, especially in United States-listed corporations,[273] a majority of LAD members may not represent the interests of all LAD members. To address this concern, courts should take into account the idiosyncratic value of land in a particular case and give less weight to the majority decisions made by the LAD than they do in corporate litigation. If a court finds that the structured decision-making goes too far, it could at least shift the burden of proof or slightly adjust the litigation costs of the parties through other relevant procedural rules.

Conclusion

Tyranny of the majority is a problem faced by both minority shareholders in a corporation and minority members of a state. Traditional law and economics theorists have identified property rule and liability rule protection for minority rights.[274]

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public choice suggests, there is no basis for simply ascribing rational behavior to political institutions.").

270. *See* Stephenson, *supra* note 267, at 29 ("While the federal government, as well as the governments of some states and large cities, may not be all that concerned about the amounts of public money that contemplated takings would require, many local governments are more financially constrained.").

271. Merrill, *supra* note 22, at 78 ("Legislatures, agencies, and private parties will rely upon eminent domain only when such reliance is efficient, that is when market exchange would consume more resources.").

272. Henry Hansmann, *Ownership of the Firm*, 4 J. L. Econ. & Org. 267, 302 (1988). ("[H]omogeneity of interest … is evidently a significant factor in the widespread success of the modern investor-owned business corporation").

273. *Id.*

274. *See generally*, Guido Calabresi & A. Douglas Melamed, *supra* note 14.

This article proposes that courts can protect minority interests with structured pliability rules by adopting structured decision-making methods. Courts should encourage majority and minority members to reach agreements by taking into account the decision-making process in their judicial decisions. Courts can adopt different standards and rules to adjudicate the corporate dispute and shift the burden of proof to different parties to vary the litigation costs imposed on the parties. Given that courts generally lack information on the preferences of private parties and that both majority and minority members act as rational players, this incorporates the parties' consent in judicial review, which is superior to the liability rules approach. This theory has important policy implications for judicial review in appraisal actions and corporate litigation in other jurisdictions, highlighting the pivotal role played by judicial decision-making method in the United States in protecting minority shareholders, an aspect insufficiently emphasized in current literature.

Additionally, this article underscores the structural similarities between judicial review in corporate and constitutional law. The economic analysis of law has the potential to uncover shared structures underlying different areas of law.[275] While law and economics scholars have successfully explained private laws such as tort, property, and contract laws using unified economic theories,[276] there have been limited studies analyzing the common structures of corporate and constitutional law.[277] This article aims to demonstrate the analogous issues of minority protection in American constitutional law and American corporate law, suggesting that they share more in common than currently recognized. Such an approach brings new insights to existing theories in both domains.

275. Robert Cooter, *supra* note 215.

276. *Id.*

277. For a study on the similarities between corporate and constitutional law, see Chander, *supra* note 216.