PREFACE

You have already encountered business entities, even if you are just beginning your second year of law school. Some entities, such as corporations, were parties in cases you read (or were supposed to have read). In other instances the litigants may have been employed by, or dealt with, a business entity, though the entity was not a party. This course is different from the other courses in which you've encountered business entities because it deals with the internal working of business entities. Among other topics, we will look at the ways in which business entities are formed, how they get money from owners and lenders, and how they are governed.

A. HOW TO APPROACH THE COURSE

Your professor will doubtless suggest to you the way in which he or she wants you to think about the course. However, it may be useful to give you my own view as well, in part because I suspect most professors share most of my views in this regard, and in part because sharing my view may help you to understand this casebook better. If there is one big idea that runs through the law of business entities it is *capital formation*. That is, the process of collecting money from more than one person for the purpose of engaging in an enterprise.

The process of capital formation leads, in turn, to three key legal questions. First, what are the economic rights between the money providers? That is, how do the providers share profits? Equally? Proportionally to their investment? Do some providers (e.g., lenders) get paid before others (e.g., owners)? Second, what are the management rights between the money providers? Does each provider have an equal say? Do some providers have no say at all? Finally, what are the rights of outsiders against the business entity and its owners? Obviously contract and tort law provide the answer in many instances. But business entities law also provides answers in many settings. Are the owners liable with the entity? Are the owners liable only after the entity's assets are exhausted? Are the owners not liable at all, even if the entity's assets are gone?

I also want to give you two suggestions for approaching business entities as a law student. First, as you read the cases you should spend the necessary time to understand the transactions and the underlying motivations. Some students find a temptation to ignore those elements (especially if they're not initially interested in the subject) and they resolve to learn only the legal rules. This is a mistake for both high-road and low-road reasons. On the high road, the legal rules are not immutable laws of physics. They're developed in response to business transactions and the motivations behind them. So you can't come to any informed judgment

about the propriety of business entities law until you understand the milieu that generates that law. Second, on the low road, it's pretty nearly impossible to succeed in a business entities class simply by trying to learn only the legal rules. There are just too many rules of law in this course and you probably haven't got enough memory to learn them all without knowing the business context that generated those rules. So understanding the transactions will be a way for you to remember and understand more rules and how they relate to one another.

My second suggestion is to pay attention to the *text* of the statutes. For many law students, business entities is their first exposure to an area of law in which the rules are primarily statutory rather than judge-made. You will be repaid many times over for the time you put into reading the statutes.

B. THE PLAN OF THIS CASEBOOK

This casebook is organized into five parts. Part I is about practicing business law. Chapter 1 describes the various practice settings in which business lawyers work. Chapter 2 talks about business itself, and does so largely apart from the question of business entities. Chapter 3 talks about a few of the most central economic concepts that business entities face and also explores the rudiments of accounting. Every lawyer, and especially every business lawyer, needs an exposure to some economic ideas. This exposure is necessary if for no other reasons than that your clients will have this knowledge and you need to be conversant with the basics, at least.

Part II consists of a single chapter. Chapter 4 deals with the law of agency. Agency is not an entity but rather it is a system of relationships and consequences that exist when one person acts for another. Agency problems pervade business entities and other private law areas, as well.

Part III takes up the majority of the book. It deals with the law of corporations, which is the principal business entity. Chapter 5 deals with creating corporations and the difficulties that can be encountered in doing so. Chapters 6, 7, and 8 focus on the "dough-ray-mi," that is, the financial aspects of corporate law. Chapter 6 is about getting money from investors into the corporation; Chapter 7 is about getting it out to them. Chapter 8 is concerned with the ability of creditors to get paid when the entity does not have enough money.

Chapter 9 is about the power of the board of directors to govern a corporation. Chapters 10 through 13 talk about constraints on the board's power to govern. As you intuit, those constraints constitute a significant part of the law of business entities. Chapter 10 looks at external constraints on the board's power. Chapters 11 and 12 are concerned with the directors' duties of loyalty and care, called their fiduciary duties and the standards by which courts will decide whether those duties have been breached.

Chapters 13 and 14 explore shareholder rights. Chapter 13 mostly concerns publicly held corporations, and Chapter 14 is more focused on privately held companies. Chapter 15 is about changing control of corporations. That subject is typically a separate course in most law schools, so this chapter is primarily an introduction.

Part IV comprises two chapters, and its focus is on business entities other than corporations. They are much briefer than the discussion of corporate law, not because they are less important, but because much of corporate law carries over to these other entities. Chapter 16 looks at partnerships, including limited partnerships. This is an important business entity in large part because it is the default entity. That is, when more than one person owns a business, those owners are usually partners of a partnership unless they've taken specific action to form another entity instead. Chapter 17 involves limited liability companies (LLCs). This is perhaps the most frequently selected business entity for new businesses. From a legal standpoint, LLCs are essentially a blend of corporate law and partnership law. Thus, if you've paid attention from Chapter 5 through Chapter 16, Chapter 17 will be quite easy.

Finally, Part V, Chapter 18, is a look at the way in which lawyers and their clients go about choosing the appropriate entity for a particular business. The placement of this chapter at the end of the book may seem paradoxical, because choosing the appropriate entity is one of the first decisions planners usually make. However, as a student you won't be able to make real sense of Chapter 18 unless you have a detailed knowledge of the business entities from which to select. Hence its placement at the end.

C. HOW EACH CHAPTER IS ORGANIZED

It might help you, when reading the materials for the first time and when reviewing, to know how each chapter is organized. I have deliberately been relatively consistent in the way the material is presented. Most of the chapters have sections entitled "Background and Context" and "The Current Setting." Background and Context material is designed to put the law into some social or historical milieu. These sections provide a richer understanding of the material, but some professors may omit all of them and most professors will omit at least some of them. I've set these sections out separately to make it easier for professors to assign the material and to make the divisions within the material clearer to you. "The Current Setting" is meant to signal to you, and your professor, that the material is not background and context. That is, it focuses mainly on legal, rather than historical or social, ideas and primarily on the law as it exists in the United States currently.

A problem with many casebooks, especially those that go through several editions, is that the editors leave in old cases when they should take them out. I have been guided by Justice Holmes's observation that the reported cases, "in the course of a generation take up pretty much the whole body of the law, and restate it from the present point of view. We could reconstruct the corpus from them if all that went before were burned"[1] I have eliminated from each edition cases reported more than 20 years before. I either have included a newer case discussing the same issue, written new text discussing that issue in lieu of adding a new case, or eliminated

1. Oliver Wendell Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 458 (1897).

any mention of the issue. I believe this approach has several advantages. First, and most important, if I have been unable to find a suitable newer case to replace an old one, that strongly suggests that the issue is no longer of real importance. Thus, a brief discussion or perhaps even elision of the issue is best for students.

Second, if the issue is still important enough to be litigated, a fresher case is likely to present more nuance than the older one. Perhaps it will bring in legal or social developments occurring since the original case. In any event, the newer case is likely to be written in a more modern style that makes the issue and discussion more easily understood. All of these are advantages to law students, in my view.

Nonetheless, I have made two exceptions to the twenty-year rule. The first is two of the federal insider trading cases. Those cases are still bedrock law, always cited by the courts, and are in an area that many professors (including me) omit from the basic business entities course. The other exception is that I proudly feature *Meinhard v. Salmon* in the partnership chapter, even though it was decided in 1928. I could make up reasons for including it, but the real explanation is that I like the facts, I like the language of Chief Judge Cardozo's majority opinion (and Judge Andrews' dissent, for that matter), and I very much like teaching it to law students. In my defense, I must fall back on Emerson's aphorism that "a foolish consistency is the hobgoblin of little minds."

One of the most useful features of this casebook is the way in which the "Notes and Questions" sections are organized. I have divided the notes and questions into five types, labeled each, and set them out in the same order throughout the book. Not every "Notes and Questions" section will have each type. The first type is called, believe it or not, *Notes*. This has factual information, usually about the preceding case, the kind of transaction, or the applicable law. The second type is called *Reality Check*. These questions are designed to make sure you understand the transaction, the dispute, and the resolution. They should be of particular value before class and at the end of the course, when you're preparing for the final exam. The third type is called *Suppose*. These questions ask you to be a bit flexible in your thinking. They ask you to imagine that the facts or the law were slightly different from the actual case. One of a lawyer's most frequent tasks is to analogize or distinguish one set of facts from another. The *Suppose* questions give you practice in doing that. The fourth type is *What Do You Think?* These are policy and theory questions. They ask you for your view of the case's result on the parties, the social effect of the rule in the case, or a more general theoretical question. These may seem a bit divorced from reality at first, but I think law students tend to underestimate the power of theory on the world in which they live.

Finally, some of the "Notes and Questions" sections end with a *You Draft It* exercise. These are, as you see by the name, opportunities to hone your drafting skills. My pedagogical view is that drafting exercises that are simply made up by the professor are not nearly as valuable as those drawn from actual legal practice. Moreover, many drafting assignments that law students undertake require them to draft whole documents or at least extended sections of documents. These are, of course, valuable skills. However, I believe that an underappreciated writing skill is the talent to draft small, very focused, pieces. These pieces are often absolutely critical to the success or failure of a transaction. So, based on those two premises, I have created the *You Draft It* sections. In every instance, the assignment is based

on actual language that was important in the case just discussed. Frequently I will ask you to redraft language that was at the center of the case so that first one party and then the other would clearly prevail. Sometimes the drafting involves a statute. In any event, your professors might not assign these exercises (and certainly won't assign all of them to be turned in and evaluated!) but they are quite useful nonetheless. You might find it particularly useful to swap your draft with that of another student in the course to critique one another's work. Another approach is to have the members of a study group take turns so that only one student's draft is critiqued. This approach, incidentally, would replicate a frequent practice setting. That is, a legal issue has arisen, sometimes without warning, and one member of a legal team is given the task of drafting language that solves the problem. The other members then critique that draft as a group.

Periodically in almost every chapter I have inserted problems called *Putting it to Work*. These are more extended problems that either pull together several issues or that examine an issue in more depth than in the Notes and Questions. My hope is that these problems will give you a taste of what it is like to be a practicing corporate lawyer. I've tried to make the *Putting it to Work* problems replicate the kinds of issues a new lawyer in a firm might be asked to handle. Of course, these problems are necessarily truncated to make them manageable in light of the time available to both students and professors. Nonetheless, I am hopeful they will make you practice sensitive. That is, that by working through them you will come away with a better understanding of the skills you will need in practice.

There's another element of this casebook that I think sets it apart from other books and that, I'm hoping, will make it more useful to students and their professors. At the end of each chapter is a list of *Terms of Art in This Chapter*. Each term of art is one that is first discussed more than tangentially in the chapter. The term of art is also italicized at its first principal appearance. You might want to preview the chapter by looking at the list before you read the chapter. I think that becoming aware of important terms and then finding the definitions within the chapter context is vital to learning. For that reason I have not placed the definitions with the terms of art at each chapter's end. However, I have assembled them in a glossary at the back along with definitions. So, if you need a quick refresher on a particular term, you can look in the glossary for help.

Let me say a word about the footnote conventions in this casebook. Footnotes in my own text are sequentially numbered in each chapter. Footnotes in cases and in other extracts retain their original numbers. Footnotes that I have inserted in a case or extract are indicated both by an asterisk and by *ED.* at the end of the footnote.

I hope you enjoy using this casebook. It seems to me that students often don't reflect on the book they're using unless it's so problematic that it's a hindrance to their learning. I sincerely hope that this book helps you rather than hinders you as you learn the law of business entities. I also hope you like it.

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