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The Case Against Statutory Menus in Corporate Law

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The author challenges the view among corporate law scholars that state legislatures should enact menus of predefined statutory rules from which corporations may select the governance terms of their choice. The private sector has produced menus of contract terms, such as standard form contracts and model documents, long before the idea of statutory menus became fashionable. There is no evidence that the market for private menus has failed, and legislatures are unlikely to be efficient menu producers. Advocates of statutory menus have suggested a number of rationales, most notably considerations based on transaction costs, network and learning effects, bounded attention, or endogenous preferences. But at closer look, none of these justifications are plausible because, if nothing else, they equally apply to private menus. The existing statutory menus do, however, clarify that certain governance terms are legal in cases where this would otherwise be uncertain. Yet that uncertainty could be reduced by other legislative means than menus. For these reasons, menu production should be left to the private sector.

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I. INTRODUCTION

Many corporate law scholars recommend that state legislatures enact menus from which business corporations may choose the governance arrangements that they prefer.[1] I disagree. The private sector has produced menus of corporate contract terms, such as standard form contracts and model documents, for decades. Compared to these private menus, menus that are laid down in corporation codes do not have additional benefits that would justify their enactment. Notably, there is no reason to believe that legislatures are more efficient menu producers than the private sector.

A "menu" may be defined as one or more predefined contract terms that contracting parties may choose from.[2] The Delaware General Corporation Law ("DGCL"), for instance, contains a number of menus. Perhaps the most famous of all menus, section 102(b)(7) of the DGCL, in effect allows companies to choose between two standards of directors' monetary liability for breach of fiduciary duty, namely between gross negligence and bad faith.[3] Section 141(d) lets companies choose between a unitary board with a one-year term, and a staggered board with two or three classes of directors and two and

1. *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 839 (1995) (suggesting that corporate statutes provide menus of governance terms); Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 3 (2006) (postulating that "menus matter"); Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 16–17 (2006) (discussing different menu approaches); Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination*, 6 J. EMPIRICAL LEGAL STUD. 279, 307 (2009) (recommending that states enact one or more "optional" laws for any given corporate law issue); Brian J. M. Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 182–85 (2011) (advocating a statutory menu for an exclusive forum provision). The only, and very mild, whiff of dissent that I was able to detect is Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CALIF. L. REV. 479, 584 (1998) (stating that they do not oppose the menu concept).

2. This definition corresponds to the uses of the term by the authors referenced *supra* note 1. The concept of legal menus was pioneered by Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51 (1992) (proposing a "menu bankruptcy system," whereby the founders of companies would select a bankruptcy regime for the event of insolvency).
It has been pointed out that the law of business organizations itself may be viewed as a menu that enables business organizers to choose among different business entities. *See* Listokin, *supra* note 1, at 280 n.3; Ayres, *supra* note 1, at 3; Hansmann, *supra* note 1, at 17. My critique of the proposition that corporate statutes should provide menus does not extend to the "super-menu" of business entities.

3. DEL. CODE ANN. tit. 8, § 102(b)(7) (2012). *See also* Klausner, *supra* note 1, at 841 (citing the provision as an example of a menu). As to the two fiduciary standards to choose from see *In re* the Walt Disney Co. Derivative Litig., 906 A. 2d 27, 63–67 (Del. 2006) (dicta stating that grossly negligent conduct can be waived, but not intentional derelictions of duty, which are a violation of the duty of good faith); Stone v. Ritter, 911 A. 2d 362, 370 (Del. 2006) (clarifying that the duty of good faith is part of the duty of loyalty).

three-year terms, respectively.[4] Other examples from the DGCL are mentioned in the text.[5] It is a matter of opinion whether one considers the number of menus in corporate codes large or small. The point of this article is that this number should not be increased.

Statutory menus may be open-ended or closed-ended.[6] Open-ended menus, which are favored by menu advocates,[7] allow parties to deviate from the predetermined menu options. Closed-ended menus, by contrast, constrain contractual freedom to the options provided by the menu, and, therefore, need to be independently justified.[8]

Menus are categorically different from default rules. A default rule is usually defined as a contract term provided by law that applies unless the parties have agreed otherwise.[9] Thus, "default" is an attribute, quality, or property of a legal rule. A menu is the legislative technique of specifying rules that contracting parties may incorporate into their contract. Defaults and menus may be freely combined,[10] but are functionally different.[11]

Advocates of the menu approach have advanced a variety of justifications for statutory menus. Professor Klausner, who was first to postulate menus of corporate contract terms, views menus as a way to capture network benefits and other externalities that predetermined

4. DEL. CODE ANN. tit. 8, § 141(d) (2012).

5. *See infra* Part III.G.2.

6. The terminology follows Ayres, *supra* note 1, at 10.

7. *See* Klausner, *supra* note 1, at 839 (postulating that "[f]irms could still customize their own terms"); Ayres, *supra* note 1, at 10 (expressing concern that courts transform open-ended menus into closed-ended menus); Gérard Hertig & Joseph A. McCahery, *Legal Options: Towards Better EC Company Law Regulation*, *in* BETTER REGULATION 219, 240 (Stephen Weatherill ed., 2007) (discussing the drawbacks of closed-ended menus).

8. Ayres, *supra* note 1, at 10. *See also* Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713, 750 (2003) (suggesting that Delaware's closed-ended menu concerning directors' terms of office is preferable to unlimited contractual freedom because of the inefficiencies of IPO charter contracting). Whether a statutory menu is open-ended or closed-ended is a matter of statutory interpretation, to which the usual principles apply.

9. *Cf.* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87 (1989) (defining defaults as rules "that fill the gaps in incomplete contracts").

10. For example, a rule "X shall apply, unless the parties agree otherwise" defines a default rule (X), but does not provide a menu. A rule "Parties may choose X, Y, or any other arrangement" is a menu combined with "no arrangement" as a default. A rule "X shall apply, unless the parties choose Y or any other arrangement" is a menu combined with X as a default rule.

11. The functional separation of defaults and menus goes back to Listokin. *See* Listokin, *supra* note 1, at 303–06 (finding state-to-state differences in the adoption rates of takeover defenses depending on states' default rules and menus, and explaining these differences by agency costs and transaction costs, respectively). In contrast to menus, default rules can be used to trigger the efficient disclosure of information or to help control managerial agency costs. *See* Ayres & Gertner, *supra* note 9, at 91 (recommending "penalty defaults" that incentivize a party to reveal its type to the other party); Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489 (2002) (arguing that corporate law should provide "reversible defaults" that managers would not prefer).

corporate contract terms may generate.[12] Professor Listokin argues that statutory menus generate transaction cost economies by reducing the required amount of drafting and negotiating,[13] and—following a theory by Professor Hansmann[14]—enabling companies to delegate future modifications of their chosen governance arrangements to the legislature.[15] Professor Ayres suggests that contract terms that are included in a statute will be more salient.[16] He thus recommends that policy makers promote the contract terms that they prefer by enacting statutory menus.[17]

The thesis that statutory menus are beneficial found support in an empirical study conducted by Listokin.[18] He studied the relationship between non-mandatory state anti-takeover statutes and adoption rates of takeover protections, particularly of fair price rules.[19] He found, among other things, that 40 percent of companies in Georgia, whose fair price statute constitutes a menu, have adopted a fair price rule, compared to only 28 percent of companies in states with no fair price statute.[20] Although Listokin provides a transaction cost explanation for his findings,[21] his study was not designed to explain why menus have an impact on companies' governance choices. Hence, the reasons why statutory menus seem to matter, at least in the case studied by Listokin,[22] remain in the dark.

A growing number of scholars view commercial law as a product

12. *See* Klausner, *supra* note 1, at 839. *See also* Ayres, *supra* note 1, at 9 (arguing that without a menu of standards, parties may draft their own standards, whose idiosyncratic language would "fail . . . to generate a coherent body of precedents . . ."); Listokin, *supra* note 1, at 281, 308 (positing that enabling statutes, including menus, create network effects). *Contra* Lemley & McGowan, *supra* note 1, at 584–85 (denying that menus will enhance the value of corporate contracts because of network effects, but not opposing the creation of menus).

13. *See* Listokin, *supra* note 1, at 284–85 (stating that menus reduce transaction costs by reducing the amount of drafting and negotiating in the process).

14. *See generally* Hansmann, *supra* note 1.

15. *See* Listokin, *supra* note 1, at 285 (arguing that menus reduce transaction costs because the state can modify the chosen rules in the future if necessary).

16. *See* Ayres, *supra* note 1, at 6–8 (arguing, using an example from employment discrimination law, that public pressure would make it difficult for an employer not to opt into a socially preferred menu item if he only has to "check a box" under a menu statute).

17. *Id*.

18. *See generally* Listokin, *supra* note 1. The study seems to have convinced Ayres that menus matter. *See* Ayres, *supra* note 1, at 4–5 (discussing Listokin's findings).

19. Listokin, *supra* note 1. A typical fair price rule allows tender offers at a price that is not deemed fair to proceed only if the target company's board recommends the offer and a supermajority of disinterested shareholders approves it. *See id*. at 286 with further references.

20. *Id.* at 303. The methodology that he used controls for differences in observable as well as in unobserved firm characteristics. *See id.* at 299–300. Using a methodology that only controls for observable firm characteristics, he found an ever greater difference in fair price protections between Georgian companies and companies in states that do not have a fair price statute. *See id.* at 300–02.

21. Listokin, *supra* note 1, at 305.

22. As usual, the external validity of Listokin's findings is an open question.

or service that does not necessarily have to be provided by the government.[23] In the same way, corporate menus should be viewed as products that could be produced by legislatures, the private sector, or both of them.[24] Private organizations, such as commercial publishers, business service providers, or trade associations, have produced standard form contracts and model documents for corporations for more than a century.[25] These private menus are widely available. The policy issue at hand is thus whether legislatures should enact corporate menus themselves, in addition to private menu production.[26] From this perspective, statutory menus are difficult to defend. The market for private menus may have its inefficiencies, but there is no evidence that it has failed. Even if this market had failed, there may be more effective remedies than to enact statutory menus.[27] Conversely, legislatures are hardly more efficient menu producers than private organizations.[28] Therefore, statutory menus might only be justified if they have intrinsic benefits that cannot be emulated by private menus.

The rationales of statutory menus put forward by their advocates[29] are unconvincing, however. Many of them equally apply to private menus, and some are implausible altogether.[30] The only plausible justification of statutory menus is that they are a way to clarify that certain governance arrangements are legal in cases where this would otherwise be uncertain.[31] This hypothesis, which has hitherto been overlooked, also explains Listokin's findings: A fair price menu like Georgia's may reassure companies that the fair price rule

23. *See generally* Gillian K. Hadfield, *Privatizing Commercial Law*, REG., Spring 2001, at 40; Gillian Hadfield & Eric Talley, *On Public vs. Private Provision of Law,* 22 J.L. ECON. & ORG. 414, 414 (2006); Steven J. Cleveland, *Process Innovation in the Production of Corporate Law*, 41 U.C. DAVIS L. REV. 1829, 1887–89 (2008); Bruce H. Kobayashi & Larry E. Ribstein, *Law as a Byproduct: Theories of Private Law Production*, ILL. L., BEHAV. & SOC. SCI. RESEARCH PAPER NO. LBSS11-27 (2011), *available at* http://ssrn.com/abstract=1884985. The law-as-product metaphor itself goes back to Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (framing the U.S. competition for charters as a market in which states compete as producers of corporate law). *See also infra* Part II.A.

24. *Cf.* Ayres, *supra* note 1, at 3 (using the "law-as-product" metaphor as a starting point for his argument that "menus matter").

25. Corporate form books were common around 1900. *See, e.g.*, THOMAS CONYNGTON, A MANUAL OF CORPORATE MANAGEMENT (electronic reproduction, The Making of Modern Law, Gale, Inc. ed., 2010) (3rd ed. 1909), *available at* Gale, Doc. No. F152815004; T. CARL SPELLING, MANUAL OF CORPORATE MANAGEMENT, WITH FORMS (electronic reproduction, The Making of Modern Law, Gale, Inc. ed., 2010) (1904), *available at* Gale, Doc. No. F150859332. *See also* HENRY WINTHROP BALLANTINE, BALLANTINE'S MANUAL OF CORPORATION LAW AND PRACTICE (electronic reproduction) (1930), *available at* HeinOnline, Ctrl. No. ocn244787381.

26. *See infra* Part II.B.

27. *See infra* Part II.C.

28. *See infra* Part II.D.

29. *See supra* text accompanying notes 12-17.

30. *See infra* Part III Sections A-F.

31. *See infra* Part III.G.

they plan to opt into will be enforceable against a hostile bidder. This is important because fair price rules, being takeover defenses, may otherwise receive heightened court scrutiny. However, the problem that the legality of certain governance terms is uncertain should be solved by more direct means than by statutory menus.

In light of all this, I conclude that legislatures should not take up the business of producing corporate menus. I dissent from the widely held view that more statutory menus are better. This is not to say, however, that those menus that are currently on the books should be repealed. These menus should be left as they are, as they will not do any harm and their production costs are sunk.

The remainder of this Article is organized as follows: In Part II, I frame the policy issue at hand and discuss the possibilities of market or government failure in this respect. In Part III, I discuss potential rationales of statutory menus and conclude that none of the conventional rationales is convincing. The one plausible rationale, namely to reassure companies of the legality of governance terms, should be pursued by other means than statutory menus. In Part IV, I conclude that the production of corporate menus had better be left to the private sector.

II. PUBLIC VS. PRIVATE PRODUCTION OF CORPORATE MENUS

A. MENUS AS PRODUCTS

Commercial law, including corporate law, ought to be viewed as a product or service.[32] According to this metaphor, private parties select a legal regime to govern their contractual relationships just like they would select a product to buy. These legal regimes may be produced by legislatures, by the private sector, or both of them.[33] In the same manner, we may view corporate contract terms as products, which companies either draft themselves or copy from a menu. Menus of corporate contract terms, in turn, are products themselves. As explained, they may be produced by governments—as is the case with statutory menus—or by private organizations, such as commercial publishers, trade associations, law firms, or other business service providers.[34]

32. *See* references *supra* notes 23–24.

33. For a brief review of historical examples of private law production see Hadfield, *supra* note 23, at 41–43.

34. *See supra* text accompanying notes 24–25. *Cf.* Kobayashi & Ribstein, *supra* note 23, at 25 (calling private entities that do not sell their model documents “byproduct lawmakers”).

B. THE POLICY ISSUE: PUBLIC OR PRIVATE MENU PRODUCTION?

If corporate menus are viewed as products, the policy question becomes whether the production of menus should be left to the private sector, or whether the issue warrants government intervention. Government intervention will enhance social welfare if the social costs of a failure of the private sector to produce menus are greater than the social costs of government intervention, including the risk of government failure.[35]

Advocates of statutory menus apparently believe that the social costs of private menu production are greater than the social costs of menu production by legislatures. They have advanced various justifications of statutory menus.[36] These justifications have one commonality, namely the implicit claim that statutory menus have properties that even the best privately created menus cannot replicate. It is believed, in other words, that statutory menus have intrinsic benefits compared to private menus precisely because they are part of a statute. I will discuss this claim below in Part III.

However, a policy analysis of statutory menus that only focuses on such intrinsic advantages of statutory menus would be incomplete and should consider two additional factors. On the one hand, the market for privately produced menus might theoretically fail. As I will argue below, there is no evidence in this respect, and even if the market did fail, there may be more effective remedies than menu production by legislatures (Part II.C). On the other hand, statutory menus involve a substantial likelihood of government failure: Legislatures may fail to produce efficient menus, and in any event they will be rather inefficient menu producers (Part II.D).

C. NO EVIDENCE OF MARKET FAILURE

Theoretically, the market for corporate menus could fail because menus have—to the extent that they are not protected by intellectual property rights[37]—the characteristics of public goods.[38] However,

35. *Cf.* DAVID L. WEIMER & AIDAN R. VINING, POLICY ANALYSIS: CONCEPTS AND PRACTICE 205–07 (4th ed. 2005) (linking market failure and government failure to policy interventions); Mark R. Kleiman & Steven M. Teles, *Market and Non-Market Failures*, *in* THE OXFORD HANDBOOK OF PUBLIC POLICY 624 (Michael Moran et al., eds., 2006) (arguing that, besides market failure, failure of private nonmarket institutions and government failure should be taken into account when considering a policy intervention).

36. *See supra* text accompanying notes 12-17.

37. For instance, not all standard form contracts are copyrighted. *See* Donald v. Zack Meyer's T.V. Sales & Serv., 426 F.2d 1027, 1030 (5th Cir. 1970) (contract terms identical with or merely paraphrasing terms that could be found in form books, hence not copyrightable); Donald v. Uarco Bus. Forms, 478 F.2d 764, 766 (8th Cir. 1973) (standard form contract no more than "trivial variation" from existing forms, hence not copyrightable). *See also* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied*

there is no evidence of a shortage of privately produced menus. On the contrary, private menus are produced in large numbers and are easily accessible. For instance, Westlaw® alone provides numerous databases of corporate forms.[39] These forms include templates for articles of incorporation and bylaws, and sometimes feature hundreds of alternative or optional provisions.[40] Some of these forms were specifically designed for small businesses.[41] Forms for articles of incorporation and bylaws (which tend to contain a greater number of governance terms than charters[42]) are also available on the world wide web, either for free or for a modest fee. A Google® search for the keywords ("articles of incorporation" sample) yielded 1.6 million results.[43] Searches for ("corporation bylaws" sample) and (free corporation bylaws) yielded about 42,200 and 3,840 results, respectively.[44] In addition to that, trade associations produce corporate menus as well. The National Venture Capital Association ("NVCA"), for instance, has published a suite of model documents for venture financings, including a model charter.[45] Therefore, there is no

Contract Terms, 73 CALIF. L. REV. 261, 292 n.78 (1985) (reviewing case-law on copyright protection of contract terms). Once a privately produced model law is adopted as law, it loses its copyright protection. *See* Veeck v. S. Bldg. Code Cong. Int'l, Inc., 293 F.3d 791, 800 (5th Cir. 2002).

38. *See* Kobayashi & Ribstein, *supra* note 23, at 12–13 (model predicting that weak intellectual property protection of privately created laws will lead to socially suboptimal private lawmaking). *See also* Goetz & Scott, *supra* note 37, at 292 (stating that the production of contract terms faces an inherent free-rider problem due to the limits of copyright law); Lemley & McGowan, *supra* note 1, at 571 n.399 (stating that contract terms might theoretically be copyrighted or patented but are freely copied by lawyers); *accord* Steven Walt, *Novelty and the Risk of Uniform Sales Laws*, 39 VA. J. INT'L L. 671, 689–90 (1999).

39. *See* WESTLAW, CORPORATIONS FORM FINDER, *available at* Westlaw FORMFINDER-BUS.

40. *See, e.g.*, WILLIAM MEADE FLETCHER, 1 FLETCHER CORPORATION FORMS ANNOTATED §§ 7:1–7:91, 8:11–8:620; 9:11–9:207, 10:3–10:514, 11:3–11:181, 12:2–12:42, 13:3–13:88, 14:2–14:7, 15:2-15:7, 16:2–16:6, 17:2–17:22, 19:1–19:20, 20:1–25:12 (5th ed. 2011, updated Jan. 2012), *available at* Westlaw FLTR-FRM (containing official forms of articles of incorporation published by state secretary of states, various sample articles of incorporation for different types of corporations, hundreds of templates for various charter provisions, forms of bylaws for corporations in different states, and templates for numerous bylaw provisions); MARVIN T. HYMAN, 1 CORPORATION FORMS §§ 2:4, 3:4 (updated Dec. 2011), *available at* Westlaw CORPFORMS (providing forms for articles of incorporation and bylaws, including alternative and optional provisions).

41. *See, e.g.*, STEVEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES: FORMS §§ 9:6–9:7, 9:14–9:15 (updated Dec. 2011), *available at* Westlaw ADVSBF (providing forms for articles of incorporation and bylaws, including alternative and optional provisions, for small businesses).

42. *See* Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 789–91 (2006) (observing that the charters of public companies vary to a very small degree).

43. Search results for ("articles of incorporation" sample), GOOGLE, http://www.google.com/search?q=%22articles+of+incorporation%22+sample (last visited Feb. 28, 2012).

44. Search results for ("corporation bylaws" sample), GOOGLE, http://www.google.com/search?q=%22corporation+bylaws%22+sample (last visited Feb. 28, 2012); search results for "free corporation bylaws", GOOGLE, http://www.google.com/ search?q=%22free+corporation+bylaws%22 (last visited Feb. 28, 2012).

45. See *Model Legal Documents*, NAT'L VENTURE CAP. ASS'N, http://www.nvca.org/index.php?

reason to believe that the private sector has failed to produce corporate menus in sufficient quantity or variety.

Even if an efficiency-minded policy maker came to the conclusion that the market for private menus has failed, statutory menus are unlikely to be an adequate remedy. Professors Kobayashi and Ribstein recently presented a model predicting that private lawmaking with no intellectual property protection will have the same socially suboptimal outcomes as public lawmaking.[46] Consequently, they advocate stronger intellectual property protection of privately produced laws.[47] The merits of their proposal are doubtful because governments may fail to enact efficient property rights to private laws for some of the same reasons that they may fail to produce statutory menus.[48] However, Kobayashi and Ribstein's model also suggests that statutory menus may exacerbate the market failure, as statutory models may weaken the incentives of private organizations to produce menus.[49] Therefore, a potential failure of the market for private menus is not a good rationale for the enactment of statutory menus.

D. RISK OF GOVERNMENT FAILURE

To assess the risk of government failure, the legislature's institutional competence to produce menus has to be compared to that of private menu producers.[50] Private menu producers arguably compete with one another.[51] Publishers of corporate form contracts compete for licensing revenue, and organizations that offer form contracts for free compete for the attention of potential clients or for reputation. As different entities have different competitive advantages in the market for menus, we can expect them to specialize in the production of particular kinds of menus, such as menus for small business, menus for large public corporations, or—in the case of the National Venture Capital Association's model documents—for venture

option=com_content&view=article&id=108 (last reviewed Feb. 2011).

46. *See generally* Kobayashi & Ribstein, *supra* note 23.

47. *Id*. at 36–41. *See also* Hadfield & Talley, *supra* note 23, at 438 (suggesting that governments ensure a functioning market for private laws through regulation, should that market fail without intervention).

48. *See infra* Part II.D. For instance, the prospect of a new property right creates strong incentives for interested parties to lobby for too strong protections, and even without that, a legislature may not be competent enough to enact an efficient intellectual property regime for private menus.

49. *See* Kobayashi & Ribstein, *supra* note 23, at 23 (predicting, based on their model, that public lawmaking will reduce the incentives of private lawmakers).

50. *Cf.* Hadfield & Talley, *supra* note 23, at 439 (stating that, in the case of market failure, "the choice [between public and private lawmaking] is a matter of comparative institutional competence and performance).

51. This assumption is widely held. See the formal models of private menu production by Hadfield & Talley, *supra* note 23, at 419–36; Kobayashi & Ribstein, *supra* note 23, at 7–11.

finance transactions.[52]

In comparison, a legislature's production function with respect to menus is unlikely to be efficient. First of all, the decision of what options and terms to offer in a menu is complex and requires a large amount of information. Menu producers, be they private or public, are hardly able to collect all of this information,[53] which is why they have to rely on surrogates. One obvious surrogate for this information is price signals. Commercial publishers are able to gauge the demand for their menus by looking at the sales or download figures of their form contracts.[54] This information is unavailable to legislatures. Another surrogate for the information that determines a menu's efficiency is feedback from the menu's users. Thus, menu producers that are close to their users, and therefore receive more feedback from them, will have an advantage over more remote menu producers. For example, the National Venture Capital Association seems to be better equipped to adapt its model documents to the needs of its members than a state legislature possibly could be. Even if these information problems could be overcome, legislatures may not have the capacity and the incentives to create innovative legal rules, whether or not they compete against each other.[55]

Beyond that, individual legislators have, at best, limited incentives to enact corporate menus. State legislators certainly are accountable to their voters, but it is unlikely that they will be judged by their record as creators of corporate law menus when they are up for reelection.[56] More generally, most state legislatures—with the exception perhaps of Delaware's[57]—are unlikely to have particular expertise in drafting governance terms, and producing corporate menus will hardly ever be on top of a legislature's agenda. Finally, the legislative process is, by its design, lengthy and expensive.

For these reasons, legislatures should neither be expected to be

52. *See supra* text accompanying note 45.

53. *Cf.* Hadfield, *supra* note 23, at 40 (arguing that the state as a law producer is inefficient in terms of collecting and processing information).

54. This argument is of course based on F. A. Hayek's insight that prices are a substitute for the information that ultimately determines demand and supply for a good. *See* F. A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 526 (1945).

55. *See* Hadfield & Talley, *supra* note 23, at 436 (model predicting that states will copy each other's laws and fail to learn about firms' governance needs); *accord* Kobayashi & Ribstein, *supra* note 23, at 22. *See also* Hadfield, *supra* note 23, at 40 (arguing that legislatures as monopolistic service providers are reluctant to innovate).

56. Cf. Hadfield & Talley, *supra* note 23, at 424–26 (making the model assumption that legislators legislate in such a way as to assure their reelection).

57. *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 764 (1997) (citing the Delaware legislature, which is assisted by the Corporate Law Section of the Delaware Bar, as an example of a competent standard-setting institution).

able to produce efficient menus, nor should they be expected to do so efficiently.

E. CONCLUSIONS

If corporate menus are viewed as products, the proposition that menus should be produced by legislatures becomes difficult to defend. Menus have been produced by private organizations for a very long time, and they are widely available.[58] Although there are theoretical reasons to assume that the market for private menus has its inefficiencies, there is no evidence of a market failure, and even if the market does fail, there may be more effective remedies than to enact statutory menus. By contrast, there is a plausible risk of government failure when it comes to producing menus. Legislatures are, given their characteristics and legislators' incentives, unlikely to be efficient menu producers.[59]

Viewing corporate menus as products also answers the question of what should be done with the menus that are currently on the statute books. These menus might not have been worth producing, but their production costs are sunk. Therefore, it would make no sense to erase existing corporate menus from current corporate codes.

III. ARE STATUTORY MENUS SUPERIOR TO PRIVATE MENUS?

Advocates of statutory menus have suggested various rationales for legislative production of menus.[60] These rationales, albeit diverse, have one commonality, namely the implicit claim that statutory menus have intrinsic benefits compared to private menus. As I will discuss below, this is implausible.

A. TRANSACTION COSTS

1. Menus Generate Economies of Scale and Scope

Menus of (corporate) contract terms have the potential to reduce contracting parties' transaction costs[61] because they generate economies of scale and scope. As the terms of a corporate contract can be copied at nominal cost, the producers of contract terms benefit from economies of scale, that is, the average costs of producing contract

58. *See supra* Part II.C.
59. *See supra* Part II.D.
60. *See supra* text accompanying notes 12–17.
61. *See* Listokin, *supra* note 1, at 284–85 (stating that menus reduce transaction costs by reducing the amount of drafting and negotiating in the process).

terms based on a menu are lower than the costs of producing individual contract terms. Put simply, it is cheaper to adopt boilerplate terms than to customize a contract. Any menu entails these economies of scale, regardless whether the menu is a standard form contract or a statute.

In addition to economies of scale, menus are likely to bring about economies of scope, that is, lower average costs of producing a related good. The reason why economies of scope occur in this context is that lawyers may use menus as a starting point for customization of governance provisions.[62]

2. Limited Potential for Transaction Cost Savings

The potential transaction cost savings resulting from corporate law menus must not be overestimated because they are limited in two important ways.

First, transaction cost economies are limited to the costs of drafting governance terms and, perhaps, to the costs of learning about the available options.[63] By contrast, menus cannot be expected to yield negotiating costs economies. To the extent that terms are negotiated at all, it does not matter whether the negotiations concern predefined terms or customized terms.

Second, not all companies will be able to reap the full transaction cost savings that a menu entails.[64] Thus, the aggregate benefits of a menu will be less than the (theoretical) transaction cost savings resulting from the menu's availability. To flesh out this proposition, it is useful to hark back to the metaphor of contract terms as products[65] and to view corporate contracting as a "make or buy" decision concerning the contract terms. When parties negotiate or amend a corporate contract, they need to decide whether to customize governance terms or to adopt predefined terms.

Without a menu, companies have only two choices: to customize a contract term or not to adopt a term at all, in which case the legal default rule applies. Ignoring information asymmetries and other sources of inefficiencies, companies will customize a term if the intrinsic benefits of that term are higher than the drafting costs, or

62. *Cf.* Lemley & McGowan, *supra* note 1, at 576–77 (identifying these effects as economies of scale in an input or complementary good).

63. *Cf.* Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1392, 1397 (1992) (stating that "standard form off-the-rack rules have almost no effect on the transaction costs of publicly traded corporations" (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991))).

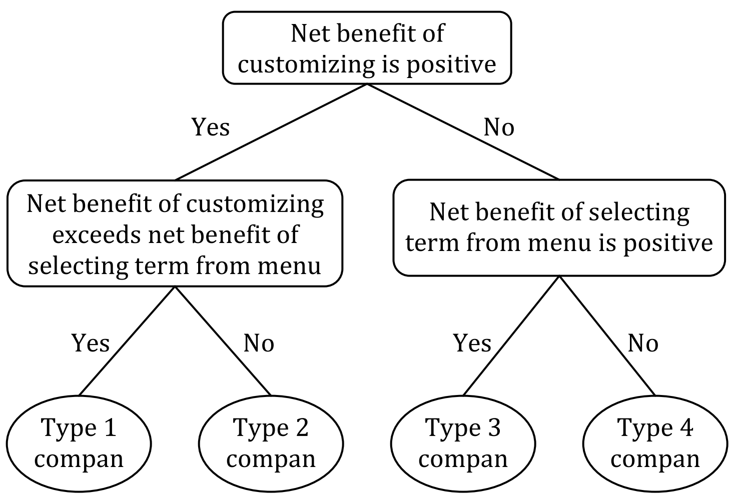
64. *Cf.* Rasmussen, *supra* note 2, at 62 (stating that, according to the Coasian contractual theory, parties will not bargain for a superior rule if the additional benefits are lower than the bargaining costs).

65. *See supra* Part II.A.

otherwise stick with the default. A menu adds a third option for the contracting parties, namely to select a term from the menu. Yet not all companies will do this, as they may still prefer to customize a contract term, or to stay with the default rule. And for those parties that will select an item from the menu, the benefits will be different, depending on what they would do without a menu.

To see why, consider that companies may differ with regard to their transaction costs of selecting governance terms in three ways. First, companies' net benefits from customizing a governance term may or may not be positive. Second, companies' net benefits from adopting a governance term from a menu may or may not be positive. Third, the net benefits of customizing a governance term may or may not exceed the net benefits of selecting a provision from a menu. These three dimensions can be arranged in a decision tree that identifies four types of companies that will behave differently depending on whether a menu is available (see figure 1).

Figure 1: Costs of selecting governance terms for different firm types



Type 1 companies derive positive net benefits from customizing a governance term, and these benefits also exceed the net benefits of the most suitable menu option. An example of such a company would be a large corporation with peculiar governance needs, which does not find suitable terms in the menu. Type 1 companies can be expected to customize their governance arrangements, whether a menu is available or not. Therefore, they do not benefit from a menu.

Type 2 companies also derive positive net benefits from customizing a term, and even higher net benefits from choosing a menu item. An example would be a large company, whose governance needs are satisfied by one of the terms provided by the menu. If there is no menu, a type 2 company would customize its governance terms, but it would prefer to select a term from a menu, if available. A menu thus enables type 2 companies to economize on drafting costs.

Type 3 companies derive negative net benefits from customizing a contract term and would therefore stick with the default rule if there were no menu. However, they do have positive net benefits from selecting a menu item. Hence, a menu allows type 3 companies to choose a contract term that they could not choose without the menu because the costs of customizing the term are higher than the term's benefits. An example would be a small company whose organizers value customized terms but do not think it worthwhile to spend money on customizing a contract in the absence of a menu. Accordingly, type 3 companies benefit from a menu as well.

Finally, type 4 companies derive negative net benefits from customizing a contract term *and* from selecting a term from a menu. This may be the case for small companies in a state whose default rules are suitable for their governance needs. Type 4 companies would stick with the statutory default rules, whether a menu is available or not, because none of the menu options yield higher benefits than the costs of selecting a menu item. As a consequence, they will not benefit from a menu.

Figure 2 summarizes the effects of a corporate law menu on the four types of companies.

Figure 2: Contracting choices of different firm types

	Company Type			
	Type 1	Type 2	Type 3	Type 4
Behavior without menu:	Customize	Customize	Stick with default	Stick with default
Behavior with menu:	Customize	Select term from menu	Select term from menu	Stick with default

As Figure 2 shows, menus make a difference for type 2 and type 3 companies only. But even for these companies, transaction cost savings are only the upper limit of their economies resulting from the availability of a menu. For type 2 companies, the net benefits resulting from the menu are equal to the net benefits of selecting a menu item minus the net benefits of customizing a governance arrangement.

These benefits equal companies' savings in drafting costs if, and only if, we assume that the menu provides exactly the term that a company would have customized. Whenever the most suitable menu option is less than ideal, type 2 companies' net benefits resulting from the menu are lower than their transaction cost economies. For type 3 companies, the net benefits of the menu are equal to the net benefits of the contract term of their choice compared with the statutory default. These benefits are necessarily lower than the potential transaction cost savings, as type 3 companies, by definition, would not incur the drafting costs of customizing terms in the absence of a menu.

How big a fraction of companies belongs to each of the four types, and what their transaction costs and benefits of governance terms are, are empirical questions. The potential economies resulting from a menu's lower contracting costs are unlikely to be enormous, however. As I have shown, only a fraction of all companies will use a menu at all, and the net benefits of those companies that will use a menu may well be lower than their (hypothetical) transaction cost savings.

3. No Transaction Cost Advantages over Private Menus

There is no good reason to believe that statutory menus will entail bigger transaction cost savings for business organizers and companies than private menus. A menu's economies of scale do not result from the legal status of the document that contains the menu—i.e., a statute or a privately created document—but from the fact that governance terms from a menu need not be drafted.

For illustration, consider two states, A and B, whose corporate statutes are identical, except that the statute of state A provides open-ended menus of governance terms, whereas the statute of state B contains no menus. The bar association of state B, however, has published model articles of incorporation and model bylaws that contain the same options of governance terms as the statutory menu of state A provides. Informational issues aside,[66] it is hard to see why the transaction costs of selecting and drafting governance terms in state A should be lower than in state B. In both states, business organizers and companies are able to select terms from the menu, whether that menu is part of a statute or a private model document. Either way, some companies will select a term from the menu, some will stick with the default rules, and others will customize their documents despite the availability of a menu.[67]

66. For a discussion of these issues, see *infra* Part III.E.
67. *See supra* Part III.A.2.

For these reasons, a statutory menu cannot be justified on the basis that it entails transaction cost savings, as the same thing holds true for privately created menus.

B. DELEGATION OF FUTURE CONTRACT MODIFICATIONS

Listokin explains his empirical finding that menus affect adoption rates of fair price rules[68] by Hansmann's delegation theory. This theory says that companies often do not override statutory defaults in order to economize on future transaction costs, namely the costs of modifying a governance arrangement if circumstances change.[69] Thus, companies delegate future modifications of the arrangement to the state legislature by way of a dynamic reference to the current version of a statutory rule. According to Hansmann, the potential for transaction cost economies is substantial given the onerous charter amendment process and the long life of corporations.[70]

In contrast to the transaction cost rationale,[71] the delegation theory applies to statutory menus only, as only governments have the power to unilaterally modify contracts among private parties. However, the delegation theory rests on implausible assumptions.

The delegation theory only works with respect to a fraction of changes in governance needs. State legislatures can only react to systematic changes in governance needs, but are unable to accommodate idiosyncratic changes in the governance needs of individual firms. Such across-the-board changes in governance needs may happen, as the rise of the institutional investor and the invention of the poison pill demonstrate.[72] But these tectonic shifts rarely occur, and a firm's individual governance needs may change more frequently during the firm's long life for idiosyncratic reasons, such as changes in ownership structure, a restructuring, or changes in the company's business. With respect to these changes in governance needs, it is futile to delegate future contract modifications to the legislature.

The delegation theory further rests on the assumption that

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68. *See supra* text accompanying notes 18–20.

69. *See* Hansmann, *supra* note 1, at 2 (stating that, by adopting default rules, "parties allow for the constant readjustment of their relationship over the long period of time that it may last"); Listokin, *supra* note 1, at 285, 305 (arguing that menus, such as Georgia's opt-in fair price statute, reduce transaction costs because the state can modify the rules in the future if necessary).

70. *See* Hansmann, *supra* note 1, at 8–9.

71. *See supra* Part III.A.3.

72. For a statistic of the growth of institutional shareholdings, see Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value or Stock Market Prices*, 59 STAN. L. REV. 1465 app. at 1568 tbl. 4, fig. 6 (2007). For a discussion and evaluation of the huge impact of poison pills (in combination with staggered boards) on hostile takeovers see generally Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002).

legislatures are able to identify systematic changes in governance needs and to adapt their statutes within a reasonable period of time.[73] This assumption may be plausible with respect to Delaware's legislature, but less so with respect to the vast majority of state legislatures that do not have a specialized infrastructure for corporate lawmaking.[74]

A critical pillar of the delegation theory is that the charter amendment process for public companies allegedly involves high transaction costs.[75] However, it is hard to believe that amending a charter is so expensive. Aside from that, as mentioned, a delegation of charter amendments to the legislature would only save transaction costs in those rare cases when companies' governance needs change across the board. In any event, the delegation theory does not explain Listokin's findings in a convincing manner. As mentioned, Listokin studied the effects of menus on the adoption of fair price rules.[76] Fair price rules, however, can be adopted through a bylaw amendment,[77] which is less onerous than a charter amendment.[78]

Delegating governance modifications to the legislature through the use of menus—as opposed to default rules—also has an important drawback, as this would create legal uncertainty. Default rules apply whenever a contract is silent about a particular issue. If a default rule changes as a result of evolving case-law or a statutory amendment, this change applies to all companies that have not overridden the default. When companies select a term from a statutory menu, by contrast, they make a positive choice, by referring to a particular statutory provision in their charter or bylaws. In such a case, it will be uncertain whether the reference to a statutory provision is dynamic or static. The respective charter or bylaw provision could be read as referring to the current version of the statute, or to the version of the term as it was in effect when the company adopted the reference in its charter or

73. *Cf.* STEFAN BECHTOLD, DIE GRENZEN ZWINGENDEN VERTRAGSRECHTS: EIN RECHTSÖKONOMISCHER BEITRAG ZU EINER RECHTSETZUNGSLEHRE DES PRIVATRECHTS [THE LIMITS OF MANDATORY CONTRACT LAW: A LAW AND ECONOMICS CONTRIBUTION TO THE POLICY OF PRIVATE LAW] 214 (2010) (arguing that for Hansmann's theory to work, corporations' internal governance failure must be greater than government failure).

74. *Cf.* Kahan & Klausner, *supra* note 57, at 764 (citing the Delaware legislature as an example of a competent standard-setting institution). The Delaware General Assembly is assisted in corporate law matters by the Corporate Law Section of the Delaware Bar Association. *Id.*

75. *See* Hansmann, *supra* note 1, at 8–9. Note that Hansmann originally developed the delegation theory to explain why companies rarely contract around defaults in their charters. *See id.* at 4 (citing this as his positive claim).

76. *See supra* note 19 and accompanying text.

77. *See, e.g.*, GA. CODE ANN. § 14-2-1113(a) (2012).

78. *Compare* DEL. CODE ANN. tit. 8, § 242(b) (2012) (defining the charter amendment process for Delaware corporations) *with* § 109(a) (stipulating that stockholders may amend bylaws but the charter may delegate this power to the board).

bylaws. The uncertainty about the character of references to a statutory menu could be mitigated by a statutory presumption in favor of a dynamic reference, yet lawyers might still find reasons to argue that the presumption should be overturned in a particular case. The only way to eliminate this legal uncertainty would be to include the statutory language of the menu in the company's charter or bylaws, but this would thwart the purpose of a dynamic reference, which is to allow for future modifications of the term by the legislature.

For all of these reasons, the delegation theory is not a plausible rationale for statutory menus.

C. NETWORK EFFECTS

1. Network Effects Hypothesis Hard to Falsify

Klausner and other advocates of statutory menus view menus as a way to capture network benefits.[79] Network effects exist if the current users of a good benefit when other users start using the same good.[80] Network effects, which occur on the demand side of a market, are not to be confused with supply-side economies of scale. Supply-side economies of scale, like the economies that result from adopting predefined contract terms,[81] end when a governance term is adopted.[82] Klausner argues that network effects are present in corporate contracting because the adoption of identical terms by other parties would increase the likelihood that a term will be litigated and thus interpreted and clarified by courts.[83] If states include menus in corporate statutes, the theory goes, the menu options would become focal points of such "interpretive networks."[84]

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79. *See* Klausner, *supra* note 1, at 839; Ayres, *supra* note 1, at 9 (arguing that without a menu of standards, parties may draft their own standards, whose idiosyncratic language would "fail . . . to generate a coherent body of precedents . . .."); Listokin, *supra* note 1, at 281 and 308 (positing that enabling statutes, including menus, create network effects).

80. Paul Klemperer, *Network Goods (Theory)*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS ONLINE (Steven N. Durlauf & Lawrence E. Blume eds., 2008), *available at* http://www.dictionaryofeconomics.com/article?id=pde2008_N000138. *See also* Klausner, *supra* note 1, at 772. For an overview of the economic literature on network effects see Lemley & McGowan, *supra* note 1, at 488–500.

81. *See supra* Part III.A.1.

82. *Cf.* Lemley & McGowan, *supra* note 1, at 596 (supply-side economies of scale "end at the point the product is shipped").

83. Klausner, *supra* note 1, at 775–79. The author subsumes several related phenomena under the concept of network effects that are usually considered as supply-side economies of scale and learning economies, rather than as network effects. *Cf. id.* at 782–84 (discussing "legal services network externalities"), 785–86 (discussing "marketing network externalities"), 786–89 (discussing "learning effects"). *See also* Lemley & McGowan, *supra* note 1, at 562, 566–67, 576–78, 582–83 (critique of the terminology and of the types of network externalities discussed by Klausner).

84. Klausner, *supra* note 1, at 839.

The "interpretive networks" hypothesis is hard to falsify because it is difficult to isolate network effects from the intrinsic benefits of contract terms and from such related phenomena as supply-side economies of scale, learning effects, or herd behavior.[85] For instance, Klausner cites contract terms that have evolved towards either standardization or customization as evidence of network effects,[86] but it is hard to see why this standardization or customization, respectively, should be caused by network effects, and not by the other phenomena mentioned.[87] Kahan and Klausner found adoption and standardization patterns of a new term in corporate bond indentures that they interpret as evidence of learning benefits *or* network externalities.[88] Yet this finding does not verify, let alone falsify, the network hypothesis.[89] Kahan and Klausner also cite the fact that IPO charters in the United States are highly standardized as evidence of network effects.[90] However, a more straightforward explanation is that most governance arrangements do not have to be in the charter to be valid. By not including them in the charters, companies may simply economize on transaction costs.[91]

2. Hypothesis Rests on Debatable Assumptions

The claim that network effects exist in corporate contracting rests on several assumptions, for which accuracy is debatable. Most importantly, the hypothesis assumes that the intrinsic benefits of a governance term are low compared to its network benefits.[92] This

85. *Cf.* Lemley & McGowan, *supra* note 1, at 594–98 (discussing economic phenomena that could be mistaken for network effects).

86. *See* Klausner, *supra* note 1, at 816–25 (discussing bond indentures and their standardization by the American Bar Foundation's Corporate Trust Indenture Project, the evolution of protective clauses for bondholders, entity choice by Silicon Valley start-ups, and "plain vanilla" charters of public corporations).

87. *Cf.* Lemley & McGowan, *supra* note 1, at 575 (doubting the explanatory power of network theory with respect to the adoption of standardized charters).

88. *See* Kahan & Klausner, *supra* note 55, at 743–46 (stating that the adoption of covenants in increasing pace after a loophole in existing bond indentures had been exploited "moderately supports" the learning or network externalities hypotheses), 746–48 (stating that the high standardization of terms is "more direct evidence" of learning or network externalities), 750–51 (stating that the fact that many companies used a standard term rather than a term that was, in the authors' judgment, better, is evidence of a lock-in created by network effects).

89. Lemley and McGowan even view Kahan and Klausner's findings as contradicting the network effects hypothesis. They argue that the rapid adoption of new bond covenants shows that the inherent benefits of the new terms were greater than the potential network externalities. *See* Lemley & McGowan, *supra* note 1, at 581–82.

90. *See* Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L. Q. 348, 350–53 (1996).

91. This may explain why there is very little variation in the charters of public companies. *See* Klausner, *supra* note 42, at 790 (reporting that he found very little variation in the charters of more than 600 public companies).

92. *Cf.* Lemley & McGowan, *supra* note 1, at 572 (arguing that the network benefits are

seems unlikely. On the one hand, the intrinsic benefits of a governance arrangement—particularly a potential reduction of managerial agency costs—may be substantial.[93] Klausner's conclusion that governance mechanisms are "wonderfully diverse"[94] (although they cannot be found in charters) is at least a cue that the intrinsic benefits of governance arrangements are much higher than their potential network benefits. On the other hand, the benefits of network effects are limited to the likelihood that a future precedent will create greater legal certainty about a particular governance arrangement. As I will show, this probability may be quite low.

For the "interpretive networks" hypothesis to work, one would have to assume that there is substantial uncertainty about the legality or the interpretation of a contract term, that judicial precedents actually reduce this uncertainty,[95] and that the marginal benefits of these precedents are substantial. I shall discuss these assumptions first with respect to a governance arrangement's legality, and then with respect to a governance term's interpretation.

First, precedents may well reduce uncertainty about a governance term's legality. For instance, Delaware case-law has removed the initial uncertainty about the legality of the poison pill[96] and has subsequently decided which types of pills are legal and which are not.[97] However, the marginal benefit of the first precedent on a governance term's legality will be very high, but the marginal benefit of subsequent decisions will be close to zero. This is at odds with the assumption that an "interpretive network" will grow and will become more valuable with each and every new case.[98]

Second, it is disputed that precedents reduce the uncertainty associated with different ways to interpret a contract term.[99] The claim is particularly implausible with respect to the case-law

unlikely to be greater than the intrinsic benefits of a rule).

93. *Cf.* Lemley & McGowan, *supra* note 1, at 572

94. Klausner, *supra* note 42, at 784. The author cites FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 12 (1991), who claim that corporate contracts are "wonderfully diverse."

95. *See* Klausner, *supra* note 1, at 777 (making this assumption explicitly).

96. *See* Moran v. Household Int'l, 500 A. 2d 1348, 1358 (Del. 1985) (holding that the adoption of a poison pill benefits from the business judgment rule).

97. *See generally* Carmody v. Toll Bros., 723 A. 2d 1180 (Del. Ch. 1998) (invalidating the so-called "dead hand" pill); Quickturn Design Systems, Inc. v. Shapiro, 721 A. 2d 1281 (Del. 1998) (invalidating the so-called "no hand" pill).

98. Nevertheless, menus do have benefits when the legality of governance terms is uncertain. *See infra* Part III.G. This rationale, however, has nothing to do with network effects.

99. *Compare* William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249, 269–70 (1976) (arguing that more precedents will result in less uncertainty), *with* Anthony D'Amato, *Legal Uncertainty*, 71 CAL. L. REV. 1, 10–11 (1983) (arguing that more precedents create more uncertainty). Not surprisingly, Klausner agrees with Landes and Posner. *See* Klausner, *supra* note 1, at 777.

concerning fiduciary standards. Standards exist because parties to a relational contract, such as a corporation,[100] are unable to specify their duties completely ex-ante and thus rely on litigation as an ex-post mechanism of judicial review.[101] If parties are unable to specify their duties in a contract, however, there is little reason to believe that case-law could specify the duties of future litigants in a more concrete way.[102] An evolving body of precedent might even increase the uncertainty about the application of fiduciary standards, as the equitable character of these standards may favor case-by-case decisions that create inconsistencies in the case-law. Hence, the marginal benefit of precedents interpreting fiduciary duties is unlikely to be positive, as the "interpretive networks" hypothesis assumes.[103] Rather, the marginal benefit is likely to be zero, if not negative.

In light of the above, it seems quite unlikely that network effects affect the choice of board governance terms.[104]

3. Private Menus May Also Generate Network Effects

Even assuming that network effects are present in corporate contracting, it is difficult to see why statutory menus would generate more efficient network effects than menus of governance terms crafted by private entities. If private model documents are widely used, one would expect their terms to be litigated from time to time. According to the network theory, these model documents would become focal points of interpretive networks, just like statutory menus would. For example, the National Venture Capital Association's model documents are arguably widely used as a basis for venture capital transactions.[105] In addition, contract terms that are similar to the NVCA model documents, and may be based on them, have been litigated recently.[106]

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100. *See* Ian R. MacNeil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 492 (1985) ("the corporation itself is one of the greatest relational contracts ever").

101. *See* Ayres, *supra* note 63, at 1404 (stating that courts could promote efficiency by imposing obligations ex-post that parties are unable to contract for ex ante).

102. *Cf. id.* at 1415 ("anything that corporations can't contract for at a trivial cost, legislatures won't be able to provide"). This equally applies to judge-made rules.

103. *Cf.* Lemley & McGowan, *supra* note 1, at 572 (calling the limits to the value added by interpretive case-law "fairly strict").

104. *Cf. id.* at 570 (concluding that network effects in corporate law will be weak at best).

105. There is no usage statistic of the NVCA model documents. However, the NVCA has about 400 members, most of which are venture capital firms, and there is no good reason to believe that NVCA members shun the model documents provided by their organization. *See About NVCA*, NAT'L VENTURE CAP. ASS'N, http://www.nvca.org/index.php?option=com_content&id=339 (last visited September 15, 2012) (stating that the NVCA has 400 plus members); *Members*, NAT'L VENTURE CAP. ASS'N, http://www.nvca.org/index.php?option=com_mtree (last visited September 15, 2012) (listing NVCA members alphabetically).

106. *See* SV Investment Partners, LLC v. ThoughtWorks, Inc., 7 A.3d 973, 990 (Del. Ch. 2010) (stating that the disputed wording customarily appears in certain charter provisions, and quoting the NVCA model term sheet as an example); Shiftan v. Morgan Joseph Holdings, Inc., No. 6424-CS,

We should therefore not assume that only statutory menus generate network effects, should they exist at all in corporate contracting.

4. Network Theory is Normatively Inconclusive

Even if statutory menus do generate network effects, and these are stronger than those generated by private model documents, an efficiency-minded policy maker would still not know what to do with this information. Network effects may be either value-increasing or value-decreasing, as network externalities may lead to equilibria with optimal, excess or suboptimal standardization, to an equilibrium dominated by a suboptimal product[107], or to too quick an abandonment of a product.[108] Which of these scenarios will materialize depends on the magnitudes of the inherent benefits of a contract term and of its network benefits, on the heterogeneity of governance needs in this respect among firms, and on the sequence in which firms adopt a term.[109] These assumptions are highly fact-specific.[110] Without knowledge of these facts, we cannot even determine the sign of the network effect, that is, whether a network generates positive or negative externalities.

The factual indeterminacy of the network theory implies that the theory is normatively inconclusive.[111] Even if network externalities do affect corporate contracting, they should not affect a policy maker's decision to enact statutory menus because he or she will not know whether the network effects thus created will increase or decrease efficiency.[112] Additionally, externalities are pervasive in the economy, and the mere presence of externalities does not, by itself, imply that government intervention will be beneficial.[113] For all these reasons, network effects are not a good rationale for statutory menus.

2012 WL 120196, at *8 (Del. Ch. Jan. 13, 2012) (stating that certain events commonly trigger certain rights of a preferred stockholder, and quoting the NVCA model term sheet as an example).

107. In our case, the "product" is of course a contract term specified by a menu. *See supra* Part II.A.

108. Klausner, *supra* note 1, at 789. For a modeling of different scenarios with different outcomes see *id.* at 805–12.

109. *Id.* at 813–14.

110. *Cf.* Lemley & McGowan, *supra* note 1, at 498 (stating that it is important to determine how large a portion of the demand curve is affected by network effects, and to identify the ratio of inherent value to network value of a product). *See also* Klausner, *supra* note 1, at 775 (stating that "the extent to which the presence of network externalities leads to socially suboptimal contracting [is an] empirical question").

111. *See* Lemley & McGowan, *supra* note 1, at 586 (stating that network theory is indeterminate with respect to many legal questions).

112. *Cf. id.* at 584–85 (stating that the authors see no reason to suppose that network effects make menus of governance terms necessary).

113. *See, e.g.*, MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 58 (1993) ("The problem of third-party effects from exchange relationships is pervasive and not aberrational. Almost every transaction one can conceive of is likely to impose costs on third parties."). *See also*

D. LEARNING EFFECTS

To the extent that menus have the effect of standardizing corporate contracts, they make it cheaper for people who have to deal with these terms to familiarize themselves with them.[114] In other words, menus may give rise to learning externalities.

Learning effects are not limited to statutory menus. The extent to which a contract form generates learning effects depends on its popularity rather than on its legal status as a statute or a private model document. In addition, there is anecdotal evidence that private menus do generate learning benefits. For instance, the National Venture Capital Association's model documents are used to teach law students venture capital law and transactions.[115] Therefore, learning effects are not a plausible advantage of statutory menus over private ones.

E. SALIENCE OF GOVERNANCE TERMS

Ayres recommends that policy makers promote contract terms that they prefer by including them in a statutory menu, where the terms would be more salient than if contracting parties had to draft such terms on their own.[116] This salience hypothesis rests on two alternative assumptions.

The first of these assumptions is that humans have bounded attention, that is, they have a limited capacity of receiving and processing information.[117] Thus, the theory goes, a governance term will attract more attention from decision makers (directors, managers, shareholders, and their advisers) if the term is part of a statutory menu than if it is not. This is the same thing as to say that information costs of learning about the availability of contract terms are lower when the terms are included in a menu.

Second, the salience hypothesis may be based upon the behavioral assumption that individuals' preferences are endogenous. Formulated in these terms, the salience hypothesis predicts that a statutory menu

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supra text accompanying note 35.

114. *Cf., e.g.*, Kahan & Klausner, *supra* note 57, at 723–24 (discussing how standard terms increase investors' familiarity with a term). As mentioned, Klausner subsumes learning effects under the concept of network effects. *See supra* note 83.

115. *See* Jesse M. Fried, Venture Law and Finance, Course Materials, Harvard Law School, Spring 2011 (on file with author).

116. *Cf.* Ayres, *supra* note 1, at 6–8 (arguing, using an example from employment discrimination law, that public pressure would make it difficult for an employer not to opt into a socially preferred menu item if he only has to "check a box" under a menu statute). *See also* Quinn, *supra* note 1, at 173–82 (arguing that menus may help people overcome their status quo bias).

117. Bounded attention may be viewed as part of the assumption of bounded rationality. *See* Bebchuk, *supra* note 8, at 740. Bounded rationality is one of the core assumptions of transaction cost economics. *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 45 (1985).

will tilt corporate decision-makers' preferences towards the governance terms offered by the menu.[118] The endogenous preferences assumption is hard to distinguish from the information cost assumption because the supposedly preference-changing event may just be an event that informs people about their options. In other words, endogenous preferences can be modeled, in cases like this, as exogenous preferences combined with an exogenous shock that lowers information costs from a prohibitive level to a low level.[119]

Independently of the assumptions underlying the salience hypothesis, it is an empirical question whether statutory menus are more salient than private ones. There are reasons to doubt this, too. On the one hand, corporate contract terms can be expected to be salient among commercial lawyers, regardless whether a term is contained in a statutory menu, in a private menu, or in individual contracts. Hence, to the extent that charters and bylaws are drafted by lawyers, a menu will hardly make a term more salient. To the extent that companies are incorporated by laypersons, on the other hand, there is little reason to believe that the parties know the corporate statute of their state—and thus the menus it provides—better than a private form contract that they may use as a template for their governance choices.

For these reasons, greater salience of the governance terms contained in a menu should not be viewed as an advantage of statutory menus in comparison with private menus. But even if statutory menus do make contract terms more salient, there may be alternative means to promote specific contract terms. For instance, governments could distribute and advertise model documents that contain, and possibly highlight, the terms that they prefer. Before recommending statutory menus, an efficiency-minded policy maker might want to consider these alternatives as well.

F. FACILITATION OF NEGOTIATIONS

It is conceivable, but unlikely, that statutory menus mitigate certain informational deficiencies of the negotiating process concerning corporate governance arrangements.

In a negotiating situation with incomplete information, a party

118. *Cf.* Ayres, *supra* note 1, at 15 (stating that Georgia—the state in Listokin's study that offers a fair price provision as a menu—"made it more socially acceptable for corporate managers to offer fair price amendments").

119. An analogy may illustrate this point. It is hard to determine whether Starbucks® has changed the coffee consumption preferences of American consumers in favor of more sophisticated preparation methods than drip-filter coffee, or whether Americans had not known about other coffee preparation methods before Starbucks® made them available. Either way, what is important is that the object of preference, be it coffee or contract terms, has become more salient.

risks giving away his or her private information (or the fact that the party has such information) if he or she proposes a particular contract term to the other party.[120] For example, an attempt to buy a supposedly worthless object may give its owner the cue that the object is worth more than he had believed.[121] In the corporate context, such a situation may arise when a shareholder or, in a public corporation, management, proposes to adopt a particular governance arrangement. The other shareholders may come to believe that the proponent has private information about the payoff of the proposed arrangement. That private information need not be inside information. It is only necessary that the proponent has private information about his own payoff. Therefore, even a proposed governance change by a noncontrolling shareholder may prompt the other shareholders to distrust the proposal if they have reasons to believe that the proponent's payoff structure is (a) unknown to them and (b) differs from their own payoff structure.[122]

Shareholders may be wrong to make this "adverse inference," as the proponent may honestly believe that the proposed change is in the best interest of the corporation. Given that the effects and ramifications of governance arrangements are sometimes hard to assess, it is difficult for the proponent to reassure shareholders of his sincerity. He needs to resort to some sort of signaling, which is by definition costly.[123] The need for signaling might be lower if the proposed governance arrangement is part of a menu.[124]

Consider the example of a sincere shareholder of a public corporation who submits a proposal for the adoption of a customized governance arrangement that the board opposes. The board may accuse the shareholder of rent-seeking, alleging that the shareholder pursues a political agenda, short-term interests, or otherwise has a hidden agenda. This allegation can be made even if a shareholder proposes a governance arrangement that is common among similar companies, but it may seem more plausible if the shareholder proposes

120. *Cf.* DOUGLAS G. BAIRD, ROBERT H. GERTNER & RANDAL C. PICKER, GAME THEORY AND THE LAW 81 (1994) (citing an example from a movie).

121. *Id.*

122. *Cf.* Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 70 U. CIN. L. REV. 347, 375, 377 (1991) (distinguishing between "private wealth maximization" and "common wealth maximization" as shareholder goals and stating that shareholders may even seek rents in a widely held corporation).

123. *See, e.g.*, Johannes Hörner, *Signalling and Screening*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS ONLINE, *supra* note 80, *available at* http://www.dictionaryofeconomics.com/article?id= pde2008_S000129 (restating the assumptions of a simple signaling model, including costliness of the signal).

124. *Cf.* Hertig & McCahery, *supra* note 7, at 235 (stating that menus reduce "the transaction and reputation costs of justifying to investors why they are not in compliance with a code of good practice recommendation").

an uncommon arrangement.[125] A proposal for a governance arrangement that is based on a statutory menu might look less suspicious than an uncommon term, as the proposed term was drafted by a disinterested third party, namely the legislature.[126]

The hypothesis that governance arrangements that were predefined by a disinterested third party facilitates the negotiation over such terms is testable, as it predicts that customized shareholder proposals will receive lower approval rates than off-the-rack proposals, all other things being equal. However, there are reasons to doubt that such an effect will be detected. The general benefits and drawbacks of governance arrangements are widely known, and even if the proposed arrangement is rather peculiar, a sophisticated shareholder, director or proxy adviser should be able to assess the arrangement's merits independently of who proposed it. Furthermore, the situations where the proponent's payoff structure is completely private may be rare. For example, it is not a secret that managers and controlling shareholders have private benefits of control, or that public pension funds or trade unions may pursue a political agenda via shareholder proposals.[127]

Even if menus do significantly mitigate the informational deficiencies of the corporate contracting process, this effect is unlikely to be restricted to statutory menus. In most cases, a private party that has drafted a menu, such as a bar association or a legal publisher, may be viewed as being as disinterested as a legislature is.

For these reasons, the negotiation facilitation theory does not justify the enactment of statutory menus.

G. LEGAL CERTAINTY

1. An Overlooked Rationale for Statutory Menus

The most plausible reason why statutory menus may have advantages over private menus has been overlooked hitherto. That is to say, only statutory menus can create legal certainty about whether a particular governance term is permissible.

125. *Cf.* Klausner, *supra* note 1, at 785 (suggesting that uncommon, innovative, or idiosyncratic governance arrangements could be understood as reflecting adverse information about a public company).

126. In a way, this function of menus is related to Fama and Jensen's proposition that decisions in organizations, such as widely held corporations, will be more efficient if "decision management" (initiation and implementation) and "decision control" (ratification and monitoring) are conducted by separate bodies. *See* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 303–04, 307–11 (1983).

127. *See* Joseph Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361, 378–83 (2010) (discussing the political motives of public pension fund managers).

As a matter of policy, uncertainty about the legality of corporate governance terms should be avoided, at least to the extent it can be avoided at nominal cost through better legislation. A lack of legal certainty adds legal risk to companies' governance choices and thus lowers the expected value of the chosen arrangements. This may prompt companies to incur legal fees to assess or mitigate the legal risk, or to refrain from adopting an arrangement altogether if the risk is too high.

The benefits of legal certainty may be even greater when agency costs are factored in. Lawyers, especially, are known to have significant influence over the governance choices of public companies.[128] There are reasons to believe that lawyers are risk-averse when advising clients, as their income strongly depends on their reputation and it is easier to lose than to build up a reputation.[129] However, there are plausible objections against this hypothesis,[130] and it is unclear how strong the distortions caused by lawyers' risk aversion are.[131] Nevertheless, to the extent that the hypothesis is correct, agency costs potentially increase the value of legal certainty.

The legal certainty hypothesis explains Listokin's finding that more Georgia-incorporated companies adopt fair price provisions compared to companies from states that do not offer a fair price provision menu:[132] fair price rules are takeover defenses, and control contests are an area of corporate law that has traditionally received heightened court scrutiny.[133] Boards of companies from states with no fair price statute may be reluctant to adopt a fair price rule because they cannot be certain that the rule will be enforceable in the event of a hostile bid. And if a court is to invalidate such a provision, it is likely that this will come—from the board's perspective—at the worst possible moment, namely in the midst of a takeover battle. Georgia-

128. *See* John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301, 1371–72 tbl. 6, 1373–74 (2001) (finding that an IPO company's counsel's M&A proficiency predicts the prevalence of takeover protections in the company's IPO charter); Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1592 tbl. 6, 1594 tbl. 7, 1595 (2002) (finding that the number of states in which an IPO company's law firm has represented IPO companies predicts IPO companies' likelihood of incorporation in Delaware).

129. *See* Kahan & Klausner, *supra* note 90, at 353–55 (outlining the incentives of lawyers when they provide advice on governance choices, and surmising that lawyers' risk aversion leads to excessive standardization of corporate governance arrangements).

130. *Cf.* Lemley & McGowan, *supra* note 1, at 578 (arguing that lawyers compete on quality and therefore have incentives to distinguish themselves through innovative terms [i.e., riskier advice]).

131. *Cf.* Kahan & Klausner, *supra* note 90, at 353 (denying making a claim about the strength or prevalence of this effect).

132. *See supra* text accompanying note 20.

133. *See, e.g.*, WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 512–14 (3rd ed. 2009) (outlining the development of case-law regarding the board's duties in control contests).

incorporated companies, by contrast, just need to opt into the fair price statute, and are thus guaranteed that the fair price rule will be enforceable.

2. Most Existing Menus Enhance Legal Certainty

If the legal certainty hypothesis is correct, one would expect corporation statutes to provide menus in those subject matters where contractual freedom is otherwise strictly limited. Corporate statutes do precisely this.

The statutory menus commonly mentioned in the literature[134] pertain to areas that leave little room for private ordering. Some of these menus are even closed-ended. The rules that allow companies to choose between a unitary board and a staggered board are closed-ended menus, as they prohibit more than three or four classes of directors and arrangements under which there is not a director election every year.[135] Rules stipulating that the charter may provide for cumulative voting are closed-ended menus as well, as companies may only opt for the voting mode as defined by the statute.[136] Rules authorizing companies to give shareholders the right to call a special meeting of shareholders[137] enhance legal certainty, for if they were not on the books, one might argue that calling a shareholder meeting is within the board's privilege to manage the affairs of the corporation.[138] Not too long ago, Delaware added sections 112 and 113 to its General Corporations Law, which expressly permit corporations to adopt bylaw provisions that enable shareholders to nominate director candidates on the company's proxy and that provide for reimbursements of expenses in connection with director elections.[139]

134. *See, e.g.*, Klausner, *supra* note 1, at 841 (citing waivers of duty of care liability and staggered boards as examples); Hansmann, *supra* note 1, at 16–17 (citing staggered boards, cumulative voting, fair price rules and waivers of duty of care liability as examples); Klausner, *supra* note 42, at 797 (citing staggered boards, cumulative voting, shareholder votes by written consent, and the shareholder right to call special meetings as examples).

135. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d) (2012); N.Y. BUS. CORP. LAW § 704 (McKinney 2012); MODEL BUS. CORP. ACT § 8.03(c), 8.06 (1984). *See* Bebchuk, *supra* note 8, at 750 (discussing the closed-ended character of § 141(d)).

136. *See, e.g.*, DEL. CODE ANN. tit. 8, § 214 (2012); MODEL BUS. CORP. ACT § 7.28(b) –(c) (1984).

137. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(d) (2012). *But see* MODEL BUS. CORP. ACT § 7.02(a)(2) (1984) (shareholders' right to call a special meeting is mandatory).

138. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2012). Note that stockholders of Delaware companies may not call meetings concerning certain matters even if a company's charter or bylaws contain an authorization pursuant to section 211(d). See the references cited in Marathon Oil Corp., SEC No-Action Letter, 2009 WL 851468, at *9 (Feb. 6, 2009).

139. DEL. CODE ANN. tit. 8, §§ 112, 113 (2012). For a discussion of the events that led to the amendment see Sabrina Ursaner, Note, *Keeping "Fiduciary Outs" out of Shareholder Proposed Bylaws: An Analysis of CA, Inc. v. AFSCME*, 6 N.Y.U. J. L. & BUS. 479, 483–95 (2010).

Such bylaw provisions had not been considered unlawful previously, but the amendments removed some uncertainty in this respect.[140]

Perhaps the most famous of all corporate menus is Delaware's section 102(b)(7), which in effect allows companies to choose between two standards of directors' monetary liability for breach of fiduciary duty, namely between gross negligence and bad faith.[141] Menus of standards have found an advocate in Ayres, who argues that, without a menu, parties that override the default would "adopt differing language across disparate contracts that fails to generate a coherent body of precedents . . .."[142] This is in essence the network benefit rationale applied to standards, which is implausible for the reasons explained above.[143] A more intuitive rationale for menus of fiduciary standards is that fiduciary duties are otherwise considered mandatory.[144] In this sense, section 102(b)(7) is a closed-ended menu of standards.

All of the above-mentioned statutory menus pertain to areas of corporate law where contractual freedom is strictly limited. Some of the menus are closed-ended, that is, contractual freedom is limited to the options provided by the menus. The remaining menus clarify that companies may legally adopt the terms contained in these menus. Thus, creating legal certainty is de facto an important rationale of statutory menus.

3. Menus Not the Best Way to Enhance Legal Certainty

My conclusion that menus reassure parties of the legality of governance arrangements does not imply that menus are the best way to achieve this. The lack of legal certainty that makes menus necessary stems from the fact that corporate statutes do not always delimit the boundaries of contractual freedom in a very clear way. For instance, the litigation that preceded the enactment of sections 112 and 113 of the Delaware General Corporations Law[145] might not have happened if it had been clear to everyone that proxy access and indemnification provisions in bylaws were legal under Delaware law. Statutory menus fight the symptoms caused by the uncertain boundaries of contractual

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140. *See* Brendan Sheehan, *Greetings from Delaware*, CORPORATE SECRETARY, May 2009, *available at* http://corporatesecretary.com/articles/regulation-and-legal/11228/greetings-delaware (stating that the statute did not previously prohibit such bylaw provisions, yet the amendments would bar related challenges of access proposals with the SEC in the future).

141. DEL. CODE ANN. tit. 8, § 102(b)(7) (2012). *See also supra* note 4.

142. Ayres, *supra* note 1, at 9.

143. *See supra* text accompanying notes 99–103.

144. *Cf.* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238 (Del. 2008) (holding that a shareholder-proposed bylaw amendment that might require the board to violate its fiduciary duties is invalid).

145. DEL. CODE ANN. tit. 8, §§ 112–113 (2012). *See supra* note 144.

freedom but do not necessarily cure that disease, as it may still remain an open question whether a menu is open-ended or closed-ended.

Before recommending menus, an efficiency-minded policy maker should examine other ways to delineate the boundaries of contractibility within corporate law more clearly.[146] This is not an easy task, however. The presence of standards and of far-reaching and open-ended mandatory statutory rules, such as the board's privilege to manage the affairs of the corporation and to propose charter amendments,[147] creates a certain amount of uncertainty concerning the contractibility of many other statutory provisions that is difficult to avoid.[148] Potential ways to increase legal certainty include a statutory provision that lists all other provisions that are mandatory,[149] or statutory carve-outs that exempt certain subject-matters from the scope of a particular rule or standard. To get back to Listokin's example of fair price statutes, a state legislature could enact a rule providing that corporations may adopt any fair price rule.[150] Yet even in this case, a court might invalidate a particular fair price rule in a corporation's bylaws because the rule might occasionally compel the board to violate its fiduciary duties.[151] To avoid those fears, a statute could provide that directors' fiduciary duties shall not be construed as limiting the board's power to propose or adopt fair price rules. Rules of this kind may create even more legal certainty than Georgia's opt-in fair price provision, as their scope would not be restricted to the contract terms expressly specified in the menu.

To sum up, statutory menus are just one way to increase legal certainty about the legality of governance terms in those domains

146. *Cf*. Ayres, *supra* note 1, at 6 (noting that there is a "growing drafting movement to write statutes that more clearly delineate which provisions are contractible and which are not").

147. *See* DEL. CODE ANN. tit. 8, §§ 141(a), 242(b)(1) (2012); MODEL BUS. CORP. ACT § 10.03(a) (1984). In other jurisdictions, the analogous rule to section 141(a) is not mandatory. *See, e.g.*, MODEL BUS. CORP. ACT § 8.01(b). Boards outside the U.S. generally do not have a privilege to initiate charter amendments. *See* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 73–74, 186 (2nd ed. 2009) (comparing the relevant rules in the U.S., the U.K., Japan, Germany, France, and Italy). For an extensive critique of section 242(b)(1) *see* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 842–92 (2005).

148. For example, one of the issues in *CA, Inc. v. AFSCME* was whether a governance term (proposed by shareholder) would conflict with the board's fiduciary duties. *See* CA, Inc., 953 A.2d at 238–40.

149. Title 10 of the Swiss Code of Obligations, which deals with employment contracts, contains such a list of mandatory provisions. *See* OBLIGATIONENRECHT [OR] [CODE OF OBLIGATIONS] Mar. 30, 1911, SR 220, art. 361. *See also* Eeva Kolehmainen, *The Directive Concerning the Posting of Workers: Synchronization of the Functions of National Legal Systems*, 20 COMP. LAB. L. & POL'Y J. 71, 88 (1998) (praising an EC directive for listing those rules that are mandatory).

150. Whether fair price rules should be permitted at all is not of concern here.

151. This scenario would be similar to *CA, Inc. v. AFSCME*, where a proposed bylaw amendment was held to be in violation of Delaware law because it might require the board to violate its fiduciary duties. *See* CA, Inc., 953 A.2d at 238–40.

where corporate law does not grant companies much contractual freedom. However, menus are unlikely to be the best means to this end. Therefore, legal certainty is not, by itself, a valid rationale for statutory menus.

H. CONCLUSIONS

All in all, statutory menus have few advantages over private menus. Statutory menus are unlikely to generate more transaction cost economies than private menus, and any kind of menu's potential for transaction cost savings is strictly limited. The theory that menus enable companies to delegate future modifications of their governance arrangements to the legislature is implausible for several reasons. The hypothesis that statutory menus generate network benefits rests on debatable assumptions, would be equally true for private menus, and is normatively inconclusive. Statutory menus may generate learning effects, but so may private menus. Moreover, it is difficult to see why statutory menus should be more salient than private ones. Finally, it is doubtful that statutory menus are better able than private menus to make the process of negotiating governance arrangements more efficient.

The only plausible reason why statutory menus might matter has hitherto been overlooked. Statutory menus are a way to tell companies that a particular governance term is legal. All commonly known menus in corporate law relate to subject-matters where contractual freedom is strictly limited, if they are not closed-ended altogether. The fact that legal certainty is a plausible explanation for why statutory menus might matter does not imply, however, that statutory menus are the best remedy for the uncertainty problem. Rather, this problem should be solved by other, more direct means than by statutory menus.

IV. CONCLUSION: LEAVE MENU PRODUCTION TO THE PRIVATE SECTOR

It has become fashionable among legal scholars to recommend that legislatures enable business corporations to select governance terms from a menu of predefined rules that are laid down in the applicable corporate code. The claim that such statutory menus are efficiency enhancing has received a boost by Listokin's empirical finding that companies in a state with an opt-in fair price statute are more likely to adopt a fair price rule than companies in states with no fair price statute.

Advocates of statutory menus overlook the fact that private organizations produce corporate menus of their own, such as standard form contracts and model documents.[152] The policy issue is thus whether legislatures should intervene in the market for private menus. As there is no evidence of a market failure, and legislatures are unlikely to be efficient menu producers, statutory menus might only be justified if they have intrinsic benefits that cannot be emulated by private menus. However, this is not the case: the common justifications of statutory menus are unconvincing, as many of them equally apply to private menus, and some are altogether implausible.[153] The only plausible explanation for why statutory menus may matter is that they are a way to tell companies that a particular governance arrangement is legal if this would otherwise be uncertain.[154] Fittingly, all commonly known examples of menus in corporate law, including the fair price provisions studied by Listokin, pertain to subject matters where contractual freedom is strictly limited. While it is desirable to delineate the boundaries of contractibility more clearly, menus merely fight the symptoms instead of curing the disease. Therefore, enhancing legal certainty is not a valid rationale for statutory menus.

In light of the above, state legislatures should not be in the business of producing menus of corporate contract terms alongside the private sector. Those menus that already are on the books can be safely left in place, as their production costs are sunk. But states should refrain from adding new menus to their corporate codes.

152. *See supra* Part II.
153. *See supra* Part III Sections A–F.
154. *See supra* Part III.G.