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SYMPOSIUM: THEORY INFORMS BUSINESS PRACTICE

SYMPOSIUM EDITOR
CLAIRE A. HILL

INTRODUCTION: THEORY INFORMS
BUSINESS PRACTICE *Claire A. Hill* 3

OF THEORY AND PRACTICE *Tamar Frankel* 5

Much has been written about theory and practice in the law, and the tension between practitioners and theorists. Judges do not cite theoretical articles often; they rarely “apply” theories to particular cases. These arguments are not revisited. Instead the Article explores the working and interaction of theory and practice, practitioners and theorists. This Article starts with a story about solving a legal issue using our intellectual tools—theory, practice, and their progenies: experience and “gut.” Next the Article elaborates on the nature of theory, practice, experience and gut. The third part of the Article discusses theories that are helpful to practitioners and those that are less helpful. The Article concludes that practitioners theorize, and theorists practice. They use these intellectual tools differently because the goals and orientations of theorists and practitioners, and the constraints under which they act, differ. Theory, practice, experience and gut help us think, remember, decide and create. They complement each other like the two sides of the same coin: distinct but inseparable.

A COMMENT ON LANGUAGE AND NORMS
IN COMPLEX BUSINESS CONTRACTING *Claire A. Hill* 29

Complex contracts, such as those governing loans and acquisitions, create a state of the world—parties entering into a contract thereby become bound. The contract expressly summons up legal consequences for every promise it contains. But the relationship between the promises and the law’s force is attenuated. Very often contract provisions set the stage rather than provide the script: accommodation seems more the rule than the exception. Indeed, for most contracting parties, the law’s specter is one of many reasons to do what they promised to do, and often, not the most important reason. Parties also feel constrained by reputational and other extralegal forces within the complex contracting community. Moreover, the process of contracting itself can serve to elicit information and compliance. The combination of legal and extralegal forces permits parties to craft a constrained, yet flexible, relationship—probably the best the parties can do given the limits of language, knowledge and imagination.

WHY CONTRACTS ARE WRITTEN
IN "LEGALESE"

Claire A. Hill 59

Contracts have been reviled since before the Marx Brothers' infamous "there ain't no Sanity Clause" sketch as being replete with duplicative, cumbersome, inartful, and sometimes imprecise language. My Article seeks to understand why practice apparently hasn't made perfect—why the contract production process hasn't been honed to a point that contracts are as clear, and only as long, as would seem to be optimal. I argue that the contracting production process combines rational, and what some would consider irrational, elements to create a serviceable, but arguably second-best, product. But I also argue that what counts as second-best in this and other contexts may be harder to discern than is generally thought.

THE WRITTEN CONTRACT AS SAFE
HARBOR FOR DISHONEST CONDUCT

Lawrence M. Solan 87

The parol evidence rule excludes extrinsic evidence of prior or contemporaneous understandings of an agreement when the parties have signed a document that purports to encompass their entire understanding. In theory, this rule is designed to add certainty to business transactions and to inhibit the introduction of unreliable evidence into the litigation system. But in practice, if we eliminate the introduction of precontractual representations and understandings from the dispute resolution process, we create a safe harbor for unethical business practices in the early stages of contract formation. Using insights from linguistics and psychology, the Article argues that this problem is likely to occur regardless of what version of the rule is applied in any particular circumstance. Therefore, this Article recommends solutions from outside the law of contract to address both precontractual misconduct and false testimony in the courtroom. It recommends stronger sanctions against dishonest testimony in business disputes, and stronger consumer protection to avoid precontractual heavy-handedness and outright fraud.

ROUNDTABLE DISCUSSION:
THEORY'S CONTRIBUTIONS TO
CORPORATE LAW AND PRACTICE

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MODERATOR: JOHN C. COATES IV, Professor, Harvard Law School

PARTICIPANTS: LEE BUCHHEIT, Partner, Cleary, Gottlieb, Steen & Hamilton; ROBIN ENGELSON, Senior Vice President, GE Capital Commercial Finance; GARY FUNDERLICH, Vice President & General Counsel, AOL Canada Inc.; LARRY ISAACSON, Partner, Fried, Frank, Harris, Shriver & Jacobson; DAVID VAN ZANDT, Dean and Professor of Law, Northwestern University School of Law

WHO OWNS A CORPORATION
AND WHO CARES?

Richard A. Booth 147

This Article focuses on the conventional theory that a corporation is owned by its stockholders and argues that the theory retains little if any explanatory or predictive force. After a brief consideration of the need for and function of legal theories in general and the evolution of the stockholder ownership theory, the Article proceeds to describe how the takeover wars of the 1980s brought into high relief the unavoidably conflicting interests of stockholders and managers, owing primarily to the fact that investor-stockholders are free to diversify whereas managers generally are not. Although the stockholder ownership theory is consistent with the duty to maximize stockholder wealth in the context of a sale of the entire corporation, there are numerous situations in which corporation law and norms recognize the legitimate interests of managers and controlling stockholders to the exclusion or detriment (but not both) of public stockholders, including controversies (real or potential) involving stock offerings, poison pills, sales of control, and management compensation. Finally, the Article considers whether the theory of corporate ownership may make a difference in the

outcome of real-world controversies, and concludes that it has affected the holding in several recent appraisal cases in which the courts have held that stockholders are entitled to a premium for control even though the transactions at issue did not involve a change of control. Numerous commentators have argued from problems with the stockholder ownership theory to the conclusion that management duty should be viewed as owed to a variety of stakeholder constituencies. Most recently, it has been suggested that the separation between ownership and control may be best understood as a response to team production problems. This Article suggests that a third approach makes more sense, namely, that manager-owners effectively hire public stockholders to provide liquidity and an objective measure of performance (among other things). In other words, going public is not necessarily a result of a need for capital and should not therefore be seen as constituting a transfer of ownership to the public.

IMPLICATIONS OF SHAREHOLDER
DIVERSIFICATION ON CORPORATE LAW
AND ORGANIZATION: THE CASE OF
THE BUSINESS JUDGMENT RULE

Peter V. Letsou 179

The business judgment rule has been a centerpiece of corporate law for almost two centuries. But over the last several decades, courts and commentators have struggled to find a rationale for the business judgment rule that, at once, reconciles the judicial deference granted to corporate managers with the more demanding standards applied to other professionals, such as doctors and lawyers. This Article attempts to end this struggle by offering a fuller account of the relationship between the preferences of diversified shareholders, on the one hand, and liability rules, on the other. Based on this account, this Article contends that the protections of the business judgment rule are necessary to address a concern unique to the corporate setting: the need to prevent diversifiable risk from dominating agent (i.e., managerial) decision making.

THE VENTURE CAPITAL INVESTMENT BUST:
DID AGENCY COSTS PLAY A ROLE?
WAS IT SOMETHING LAWYERS
HELPED STRUCTURE?

Joseph Bankman 211
and Marcus Cole

This Article examines the question of why venture capital firms would continue to raise technology funds, and then invest those funds, when they were certain that the business markets for such investments were overvalued preceding the “crash” of April 2000. We interviewed a number of venture capitalists, lawyers, entrepreneurs, and other industry observers in search of an explanation. The explanations offered by key decision makers for the observed investment behavior can be categorized as of three types of theories: agency cost theories, herd behavior and other cognitive bias theories, and non-agency cost theories. Agency cost theories suggest that the activity took place because of the divergence between the long-term reputational and other interests of fund general partners (venture capital firms), and the short-term interests of their limited partner investors. Herd behavior explanations apply herding theory to the general movement of venture capital firms, but fail to provide a satisfactory explanation for the direction of the “herd.” Non-agency cost theories include explanations premised upon gaming strategies by better-informed venture capitalists in the context of less-informed public markets at the end of the investment pipeline. All of the theories surveyed are problematic in at least some respects, and none fully explains the pattern of investment observed.

ROUNDTABLE DISCUSSION: CORPORATE GOVERNANCE

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MODERATOR: WILLIAM J. CARNEY, Charles Howard Candler Professor of Law, Emory University School of Law

PARTICIPANTS: JACK B. JACOBS, Vice Chancellor, Delaware Court of Chancery; RICHARD PAINTER, Professor of Law, University of Illinois College of Law;

ROBERT PRITZKER, President and Chief Executive Officer, The Marmon Group, Inc.; ROBERT H. SITKOFF, Assistant Professor of Law, Northwestern University School of Law.

**INSTITUTIONAL FOUNDATIONS FOR ECONOMIC
LEGAL REFORM IN TRANSITION ECONOMIES:
THE CASE OF COMPETITION POLICY AND
ANTITRUST ENFORCEMENT**

William E. Kovacic 265

The widespread adoption by transition economies of competition policy systems raises important questions about the design and phasing of legal reforms in emerging markets. Success in transition economies in developing useful competition policy programs and other economic legal reforms requires close attention to the establishment of public and private institutions whose effective operation is essential to a legal regime. Properly conceived competition policy programs that account carefully for national circumstances can play a constructive role in promoting economic growth. The content of such programs can be structured to match the institutional capacity of each nation, and the mix of policy instruments can be adjusted over time as requisite institutions are improved. The enhancement of supporting institutions should be a priority for technical assistance projects.

CENTENNIAL LECTURE

**WHY SOME COUNTRIES ARE RICH AND
SOME ARE POOR**

Douglass C. North 319

Professor North describes the difficulties encountered in promoting development: although economists are well aware of the conditions that promote productivity and creativity, only formal rules can be easily changed. Formal rules are but one part of a set of institutions in which people operate: informal norms of behavior and the enforcement mechanisms for both formal and informal rules have profound effects on human thought and activity. Economists have traditionally endeavored to impose simplistic sets of formal rules on developing countries; this model is largely ineffective because it ignores the role of culture and beliefs in shaping behavior. The difficult but effective alternative requires study of a society's culture to understand ways in which the formal rules may be changed—consistent with the culture and belief system—to encourage productive and creative activity.

STUDENT NOTES

**LEARNING FROM THE STORM: LESSONS FOR
ILLINOIS FOLLOWING CALIFORNIA'S
EXPERIENCE WITH ELECTRICITY
RESTRUCTURING**

William A. Borders 333

State by state the role of generation, transmission, and distribution is becoming more dynamic and market driven as regulated electric monopolies shed their vertically integrated structures and reinvent themselves for the competitive marketplace. California's turbulent move to an open electricity market provides a good example of how this process can go wrong. This Note highlights some of the key developments in California's recent energy troubles, and considers the unique challenges for the Illinois electricity market. Borders concludes that through new federal and state transmission policy, heightened demand response, and consumer education programs, regulators can ensure that the market sends price signals to customers and that customers will have the means to respond to market information. Once provided with adequate transmission, pervasive demand response technologies, and a heightened understanding of the structure of electricity markets, consumers will have the tools nec-

essary to purchase electricity from diverse suppliers, react quickly to market fluctuations, and stimulate a vibrant power market at the wholesale and retail levels.

**A COMPREHENSIVE APPROACH TO CONFLICTS
BETWEEN ANTIDISCRIMINATION LAWS AND
FREEDOM OF EXPRESSIVE ASSOCIATION AFTER
BOY SCOUTS OF AMERICA V. DALE *Adrienne K. Zahner* 373**

This Comment examines the United States Supreme Court decision in *Boy Scouts of America v. Dale*, which held that New Jersey's Law Against Discrimination violated the First Amendment by preventing the Boy Scouts from discriminating on the basis of sexual orientation in the selection of members and troop leaders. Zahner analyzes the *Dale* decision in light of prior freedom of expressive association case law, and reconciles inconsistencies by proposing a comprehensive framework for dealing with conflicts between antidiscrimination laws and freedom of expressive association. The proposed framework provides absolute protection for freedom of association for purely expressive groups, very limited protection for purely economic organizations, and varying degrees of protection for hybrid associations with independent expressive and economic agendas. This approach effectively meets recognized rationales for freedom of expression, and provides optimal results with respect to politicization of personal characteristics.

**THE SAME-SOVEREIGN RULE RESURRECTED:
THE SUPREME COURT REJECTS THE INVOCATION
OF THE FIFTH AMENDMENT'S PRIVILEGE
AGAINST SELF-INCRIMINATION BASED UPON
FEAR OF FOREIGN PROSECUTION
IN *UNITED STATES V. BALSYS* *Carlin Metzger* 407**

In *United States v. Balsys*, the Supreme Court examined the scope of the Fifth Amendment's Privilege Against Self-Incrimination when invoked based on a fear of foreign prosecution. Applying the "same-sovereign" rule, the Court held that the Fifth Amendment only binds the government to which it applies and, therefore, the privilege cannot be invoked based solely upon a fear of foreign prosecution. This Comment analyzes the rationale in prior Supreme Court decisions addressing the scope of the privilege against self incrimination and contends that despite the Court's revival of the same-sovereign rule in *Balsys*, the privilege can extend to witnesses who can show a real and substantial fear of foreign criminal prosecution, direct aid by the United States to foreign prosecuting authorities, and a complementary system of criminal justice in the United States and the prosecuting state.

