

REGULATORY COMPETITION, CHOICE OF FORUM, AND DELAWARE'S STAKE IN CORPORATE LAW

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ABSTRACT

As Delaware corporate law confronts the twenty-first-century global economy, the state's legislators and jurists are becoming sensitive to increased threats to the law's sustained preeminence. The increased presence of federal laws and regulations in areas of corporate governance traditionally allocated to the states has been widely noted. The growth of federal corporate law standards may be undermining Delaware's confidence in the sustained prosperity of its chartering business—which has been a vital source of revenues and prestige for Delaware, its equity courts, and especially its corporate bar. The Delaware Court of Chancery appears to be concerned about the emigration of corporate law cases to other states' courtrooms, and is exercising its discretionary jurisdiction more expansively in parallel proceedings to deny defendants' motions to stay. There are even more aggressive measures that Delaware companies and lawmakers could take to restrict Delaware shareholders' choice of forum and keep these cases in Delaware. But Delaware has much to lose from trying to gain monopoly power over the adjudication of its corporate law. Indeed, in a system where corporate managers (or founders/controlling shareholders) select the state of incorporation—and hence effectuate the choice of Delaware corporate law—it is likely that allowing shareholder-plaintiffs freedom in forum selection has a salutary, modulating effect on Delaware corporate law. The ability of Delaware shareholder-plaintiffs to litigate elsewhere most likely plays a key role in preventing Delaware corporate law from becoming hostage to corporate defendants' interests.

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TABLE OF CONTENTS

	<i>Page</i>
I. INTRODUCTION	59
II. DELAWARE'S STAKE IN CORPORATE LAW.....	66
A. <i>Delaware's Financial Stake in Corporate Chartering</i>	66
B. <i>Fees and Prestige for the Delaware Bar</i>	69
C. <i>The Special Power and Prestige of Delaware's Chancellors and Supreme Court Justices</i>	71
III. CHOICE OF LAW: FOUNDATIONS OF THE INTERNAL AFFAIRS DOCTRINE.....	74
A. <i>History of the Internal Affairs Doctrine</i>	75
B. <i>Judicial Deference to the Chartering State</i>	78
C. <i>Choice of Corporate Law</i>	80
D. <i>The Regulatory Competition Defense for the IAD</i>	82
E. <i>Constitutional Claims for the IAD</i>	84
IV. FEDERAL THREATS TO DELAWARE'S PREEMINENCE IN CORPORATE LAW.....	89
A. <i>Eradication Through Express Preemption</i>	89
B. <i>Eclipse or Marginalization</i>	90
1. Federal Laws and SEC Regulations.....	90
2. Listing Standards from the Exchanges and the NASD	93
3. Shareholder Activist Initiatives.....	95
V. CHOICE OF FORUM: HORIZONTAL THREATS TO DELAWARE'S PREEMINENCE.....	96
A. <i>Incentives to File Suit Outside of Delaware</i>	97
B. <i>Alternative Tribunals, Alternative Procedural Rules</i>	100
1. In General	100
2. Juries.....	100
3. <i>In re Cox</i> and Plaintiff-Attorneys' Fees.....	101
C. <i>Delaware's Traditional Approaches to Resolving Forum Disputes</i>	104
1. First-Filed Actions— <i>Forum Non Conveniens</i> Doctrine	104
2. Second-Filed Actions—The <i>McWane</i> Presumption Favoring a Stay	107
D. <i>The Court of Chancery's Post-McWane Jurisprudence</i> ..	108
1. Less Deference to Strict Filing Chronology.....	109
2. Favoring the Better-Drafted Complaint	111

3.	Less Deference to Plaintiffs' Choices in Derivative and Class Actions	112
4.	Keeping Cases Presenting Novel Issues of Delaware Law	115
5.	The Indeterminate Effect of Contractual Choice of Forum Provisions.....	118
E.	<i>Topps—A Case Study in Keeping Forum</i>	119
1.	Internal Affairs Unbound: Our Law, Our Forum.....	119
2.	Delaware Adjudication and Clarity in Delaware Corporate Law	122
3.	Reconsidering Clarity and Efficiency in Delaware Corporate Law	123
F.	<i>More on Motives to Refuse to Stay</i>	126
1.	Publicity, Prestige, and Fees: Delaware's Incentive to Keep High-Profile M&A and Self-Dealing Cases.....	127
2.	Keeping Control Over the Brand in Order to Promote Chartering.....	130
3.	The Delaware Courts' Incentive to Support the Delaware Bar	130
VI.	MECHANISMS FOR KEEPING CASES IN DELAWARE AND THEIR RISKS	131
A.	<i>Federal Jurisdiction—A Prologue</i>	131
B.	<i>Bylaw Provisions</i>	132
C.	<i>Charter Provisions</i>	133
D.	<i>Legislation Restricting Forum Choice</i>	135
E.	<i>Judicial Doctrine (Case Law)</i>	135
VII.	CONCLUSION: HARDBALL TACTICS FOR KEEPING FORUM WOULD BE BAD FOR DELAWARE.....	137

I. INTRODUCTION

In matters of state corporate law, Delaware has won—that is the consensus among scholars, commentators, and practicing corporate lawyers. A majority of the largest public companies elect to incorporate in Delaware. Annual fees from selling corporate charters can generate as much as \$600 million or more¹—about one-fifth of the state's total annual tax revenue.

¹See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 556 n.13 (2002) (citing U.S. CENSUS BUREAU, DELAWARE STATE GOVERNMENT TAX COLLECTIONS: 2001 (2002),

Delaware's corporate law enjoys extraordinary respect and prestige, as do the state's corporate lawyers and judges. Litigation involving powerful, Delaware-incorporated companies fills the docket of the Delaware Court of Chancery (Court of Chancery) and the cover pages of *The Wall Street Journal*.

Delaware's preeminence in corporate law is vitally connected to the internal affairs doctrine (IAD). Under the IAD, incorporation effectuates a choice of corporate law that is binding on the corporation and its directors, officers, and controlling shareholders. Even if a Delaware-incorporated company, its managers, or controlling shareholders become defendants in out-of-state corporate lawsuits, Delaware's corporate statutes and fiduciary tenets will still govern. The IAD makes choice of corporate law durable, which is relevant to decision making about chartering, of course.

Given Delaware's success in chartering, the prestige enjoyed by its corporate law, and the "stickiness" of Delaware choice of law under the IAD, one might expect Delaware's legislators and judges to be confident, if not smug, in their success. Instead, there are signs that some of them may be anxious about the future preeminence of Delaware corporate law, and perhaps with good reason.

This article examines two plausible threats to Delaware's preeminence in corporate law—one arising from federal law, and the other from the potential out-of-state adjudication of Delaware corporate law cases. Its primary focus is the latter: the adjudication of Delaware corporate law cases beyond Delaware's courtrooms, and Delaware's actual and optimal response to this perceived threat. In this vein, the article sheds light on the relationship between core principles of Delaware corporate law, and rules of choice of law and choice of forum. It also provides a window into the larger institutional and practical forces shaping Delaware corporate law.

With respect to the "vertical" threat posed by federal law, Congress could always preempt corporate law for public companies based on its authority under the Commerce Clause.² Even the mere threat of such preemption, as Professor Mark Roe has demonstrated, shapes and potentially inhibits Delaware's freedom in crafting corporate legal standards.³ Furthermore, the burgeoning set of federal corporate law-related statutes, Securities and Exchange Commission (SEC) regulations, listing standards, and

available at <http://www.census.gov/govs/statetax/0108destax.html>).

²U.S. CONST. art. I, § 8, cl. 3.

³See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600-02, 636 (2003) (arguing that the development of Delaware corporate law is pervasively shaped by actual or perceived threats of federal preemption, such that an overall trend towards efficiency or inefficiency is indeterminate).

shareholder activists' "best practices" may be eclipsing the distinctness of Delaware's corporate law. Over time, this could reduce the incentive of out-of-state managers to charter in Delaware. There is little Delaware can do about this, other than avoiding provoking federal ire.

The "horizontal" jurisdictional threat to Delaware's preeminence—and Delaware's present and optimal response to it—is the focus of this article. In comparison to the growth of federal corporate law and its implications for Delaware, this is a subject which has gone largely unnoticed in corporate law scholarship.⁴ Under the modern, liberal rules of jurisdiction, shareholder-plaintiffs typically have the option to pursue Delaware corporate law cases in other state courts, as well as federal forums under diversity and supplemental jurisdiction.⁵ Consequently, disputes in high-profile mergers and acquisitions (M&A) transactions and allegations of fiduciary self-dealing governed by Delaware corporate law are more commonly being litigated outside of Delaware's state courts. Nor is this development unwelcome to other states, apparently. New York, perhaps most obviously, may benefit from the erosion of the Delaware courts' hold on high-profile corporate cases.⁶ In sum, Delaware's absolute control over its corporate law and its corporate law cases is under pressure "vertically" (as a result of the evolution of federal corporate law) and "horizontally" (as a result of Delaware corporate law claims being litigable and litigated out of state).

The optimal response for Delaware—the response that will promote the integrity and future preeminence of Delaware corporate law and Delaware's chartering business—is not immediately obvious. Clearly, the

⁴But see Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity*, 58 EMORY L.J. (forthcoming 2009); Mark Lebovitch & Laura Gundersheim, "Novel Issues" or a Return to Core Principles? *Analyzing the Common Link Between the Delaware Chancery Court's Recent Rulings in Options Backdating and Transactional Cases*, 4 N.Y.U. J.L. & BUS. 505 (2008).

⁵For discussion of the effect of long-arm statutes, the scope of federal jurisdiction, and the effect of removal, see Debra Lyn Bassett, *The Forum Game*, 84 N.C. L. REV. 333 (2006); Geoffrey P. Miller, *Overlapping Class Actions*, 71 N.Y.U. L. REV. 514 (1996).

⁶In the recent high-profile forum clashes in the sales of Bear Stearns to J.P. Morgan and Merrill Lynch to Bank of America, there were shareholder complaints filed in the Court of Chancery as well as the New York Supreme Court; in fact, the complaints were "first filed" in New York. The New York court demonstrated no predilection to defer to Delaware's jurisdiction in either instance. The New York actions in the state trial court, as well as certain federal derivative actions are cited in *County of York Employees Retirement Plan v. Merrill Lynch & Co.*, No. 4066-VCN, 2008 WL 4824053, at *1 n.2 (Del. Ch. Oct. 28, 2008). There was also a standoff between New York and Delaware in the forum dispute pertaining to the sale of Topps to private equity firms. *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 961-65 (Del. Ch. 2007) (discussing New York's interest in the litigation and the fact that "New York is one of the states that has formed a commercial part of its court system to improve its handling of business disputes").

Court of Chancery is not pleased by the seemingly increased interstate travel of Delaware corporate law claims. If non-Delaware courts most commonly resolved Delaware corporate law disputes, this would dilute the distinctiveness of Delaware corporate law, and erode the value of Delaware's chartering business. The question arises, therefore, how far Delaware lawmakers and judges should go in attempting to limit shareholder-plaintiffs' freedom to litigate Delaware corporate law cases in other state courts?

Delaware's anxiousness about corporate claims emigration is notable in certain recent Court of Chancery rulings resolving forum disputes. In these rulings, the court is more commonly refusing to stay claims before it notwithstanding that earlier commenced parallel proceedings are ongoing elsewhere. Where it has the later-filed complaint in a forum dispute, Delaware has conventionally applied the "*McWane*" rule or presumption, which favors the granting of a stay.⁷ But the Court of Chancery is more commonly rejecting the *McWane* presumption, especially in forum disputes in parallel proceedings. More commonly, in refusing to stay the later-filed claim before it, the court is improvising—presenting novel arguments to distinguish *McWane* and keep jurisdiction.⁸

At the same time, in forum disputes where Delaware does have the first-filed complaint before it, the courts nearly universally refuse motions to stay, consistent with their long established *forum non conveniens* jurisprudence. They do so unhesitatingly, moreover, even if the case requires them to adjudicate novel issues in sister states' corporate laws.⁹ Adding together these two juridical practices, we see that Delaware's approach to comity is increasingly to keep both first-filed claims (consistent with its *forum non conveniens* jurisprudence) and second-filed claims (despite the *McWane* presumption).

In departing from *McWane's* presumption favoring the stay of later-filed claims, again, the Court of Chancery is enunciating new tests and principles to keep forum. For example, in *In re The Topps Co. Shareholders*

⁷*McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970); see also *infra* Part V.C-E (discussing the *McWane* rule and the Delaware Court of Chancery's recent departure from its doctrine).

⁸It has done so, especially, in noteworthy M&A disputes and fiduciary breach cases involving Delaware public companies. However, a notable exception to the pattern of Delaware keeping the high visibility, "glamour" cases is the Court of Chancery's grant of a stay in a shareholder claim challenging the proposed sale of Bear Stearns. The "trick" for Delaware in deploying forum doctrine is to keep most high publicity cases, but avoid negative publicity. See *infra* Part V.

⁹A terminological point: the selection among alternative federal or state tribunals—whether within or beyond Delaware—is referred to herein under the rubric of choice of "forum," notwithstanding that choice of "venue" would be an equally acceptable nomenclature.

Litigation,¹⁰ as part of its rationale for keeping forum, the Court of Chancery cited efficiency gains, constitutional principles, and the nature and purpose of the IAD. With respect to the latter, contrary to the court's protestations, the choice of law regime reflected in the IAD does not provide anything like a blanket basis for Delaware keeping forum over Delaware corporate law claims. As developed in Part III, once stripped of historically based, now antiquated notions, the IAD is only meaningful as a choice of law regime. It does not resolve Delaware's concern about the interstate adjudication of claims because choice of (Delaware) law does not mandate choice of (Delaware) forum. The IAD is neither dispositive of, nor even particularly meaningful to the resolution of forum disputes.

But the IAD has an even more fundamental shortcoming as a mechanism for Delaware achieving monopoly power over the development of its corporate case law. That is, the IAD does not require non-Delaware tribunals to apply Delaware's rules of civil procedure.¹¹ Although the IAD ensures the "stickiness" of substantive corporate law, foreign forums would apply their own rules of civil procedure (which of course could radically impact the litigation). Rules relevant to discovery and the recovery of attorneys' fees, for example, affect the strength and even the viability of plaintiffs' substantive claims. This means that even the prospect of out-of-state adjudication of Delaware corporate lawsuits (which would mandate the application of non-Delaware procedural rules to the case) foreseeably influences, *ex ante*, Delaware judges' own decision making. As it is surely aware, the Court of Chancery cannot be too draconian in limiting discovery or plaintiffs' fee reimbursement without propelling some number of cases to other jurisdictions—a result it ordinarily wishes to avoid. Moreover, if Delaware corporate defendants ordinarily prefer that their claims remain in Delaware, then the Court of Chancery can rationalize not being too harsh towards the plaintiffs and their lawyers as being in the defendants' best interest as well. In sum, the IAD does not afford Delaware the full measure of control over its corporate law that Delaware judges might think they want. But the result is most likely a fair, more moderate body of corporate law, which promotes Delaware's long term interests.

In recent forum disputes, the Court of Chancery has also claimed that large scale efficiency gains arise from having Delaware's courts adjudicate Delaware corporate law. While paying lip service to the competence of other state court judges, the Court of Chancery has expressed concern that

¹⁰924 A.2d 951 (Del. Ch. 2007).

¹¹The IAD's limits, as they relate to rules of civil procedure, have largely been unrecognized in the academic corporate law literature. See *infra* Part V.B.

non-Delaware judges will misapply and distort Delaware corporate law—rendering it less clear, less consistent, and less predictable—to the disadvantage of Delaware shareholders and market participants broadly.¹² These efficiency-based claims for Delaware's expansive (if not universal) jurisdiction over Delaware corporate law cases warrant closer scrutiny. Put simply, if Delaware corporate law is as clear and consistent as the Court of Chancery suggests (in worrying that it will be impaired by out-of-state adjudication), then it is difficult to believe that other courts will unwittingly misinterpret it. Alternatively, if the tenets of Delaware corporate law are too opaque or too vague to reliably be applied by other judges, then they are too opaque or too vague to be "read" by shareholders, deal planners, and the marketplace—which would suggest there is gross *inefficiency* (rather than wealth enhancing efficiency) in the structure of Delaware corporate law. Finally, if Delaware corporate law is fair and principled, then there is little reason to fear that out-of-state judges would purposely misapply it.

There surely are legal means for Delaware lawmakers and judges to thwart the interstate travel of Delaware corporate law cases. The conclusion reached herein, however, is that Delaware and its corporate law (as well as Delaware's judges and corporate litigators) have much to lose from strong-arm tactics to force forum. Overly expansive, sovereignty-based claims for the IAD open the door to harsh judicial responses and academic criticism, as do claims about the Delaware courts' unique competence to interpret and apply Delaware's corporate case law. The former involves a distinctly contestable claim about the law; the latter an arguably hubristic claim on the part of Delaware's judges. Given Delaware's embrace of flexible, open-ended fiduciary standards, warnings that out-of-state adjudication will damage the clarity and predictability of Delaware's corporate case law invite skepticism, if not harsh criticism, which Delaware should wish to avoid.

But the argument against forcing forum goes to the heart of corporate law, as proposed above. The porousness of the IAD, in tandem with modern, liberal rules of jurisdiction, operate to promote the reasonableness and hence the legitimacy and preeminence of Delaware corporate law. Shareholder-plaintiffs' option to be heard in alternative forums, under alternative procedural rules, creates a ballast against excessive partisanship in Delaware's own adjudication. Given Delaware's financial and prestige-based stakes in promoting its successful chartering business, a bias in favor

¹²See *Topp*, 924 A.2d at 959 ("The important coherence-generating benefits created by our judiciary's handling of corporate disputes are endangered if our state's compelling public policy interest in deciding these disputes is not recognized and decisions are instead routinely made by a variety of state and federal judges who only deal episodically with our law.").

of manager/controller friendly rules is likely to result (because directors or officers, or otherwise founders/controllers select the state of incorporation). Hence allowing ordinary shareholders freedom of choice regarding forum most likely exerts a salutary, equilibrating effect on Delaware corporate law.

This moderating influence operates on two fronts. First, if Delaware's substantive corporate law doctrines or its rules of procedure applicable to corporate law cases (for example in relation to plaintiff-lawyers' right to reimbursement of fees) become excessively partisan in management's direction, this would propel some number of claims to alternative tribunals—an effect which Delaware's judges wish to avoid and can correct for *ex ante*. Second, if out-of-state judges were persistently to fault Delaware's corporate law standards, or refused to apply them according to their terms, this would provide a salutary "red flag" alerting Delaware judges to the need to reset their compass. Furthermore, strictly speaking, out-of-state rulings cannot directly impair Delaware corporate law because they have no precedential effect on Delaware or other courts interpreting Delaware law.¹³ Like most powerful institutions, the Delaware courts might prefer to exercise their authority without caveats or outside influence. But in the development of corporate law, as elsewhere, the exercise of monopoly power is damaging and ultimately self-defeating. This article's thesis is that strong-arm tactics to curtail shareholders' choice of forum would undermine Delaware's preeminence in corporate law.

To recap, Part II of this article considers Delaware's monetary and nonmonetary stakes in preserving the preeminence of its corporate law and its successful chartering business. After discussing the historical development and rationales for the IAD, Part III concludes that as a choice of law regime, the IAD has little force as a rationale for Delaware keeping forum over Delaware corporate lawsuits. Part IV briefly surveys the growing influence of federal law in the corporate area, and the threat it poses for Delaware corporate law and chartering. Part V first reviews Delaware's established jurisprudence governing forum disputes, both for first-filed actions (under the rubric of *forum non conveniens*) and later-filed actions

¹³For U.S. Supreme Court authority elucidating the absolute authority of state courts to interpret state law, see *Railroad Commission v. Pullman Co.*, 312 U.S. 496, 499-500 (1941) ("The last word on the meaning of Article 6445 of the Texas Civil Statutes, and therefore the last word on the statutory authority of the Railroad Commission in this case, belongs neither to us nor to the district court but to the supreme court of Texas."). By implication *Pullman* also validates the notion that a state has the final word on the interpretation of its own laws. The autonomy of each state to enact its own laws and have its own courts interpret them is so fundamental that it is universally presumed without citation.

(under the *McWane* presumption). It then analyzes the new standards and rationales enunciated by the Court of Chancery in departing from this dual framework to resolve forum disputes in parallel proceedings. Part VI discusses various legal mechanisms available to curtail shareholder-plaintiffs' freedom in choosing among legitimate forums, while counseling forbearance in each case. Part VII, by way of conclusion, further elaborates why Delaware should eschew strong-arm tactics to force forum.

II. DELAWARE'S STAKE IN CORPORATE LAW

A. *Delaware's Financial Stake in Corporate Chartering*

In a recent retrospective, former Delaware Supreme Court Chief Justice Veasey proudly referred to his state's "international attractiveness as the incorporation domicile of choice."¹⁴ His point is universally accepted. Among the fifty states, Delaware has visibly succeeded in claiming the number one spot in attracting and retaining incorporations. Moreover, the preference for Delaware incorporation is especially notable among the richest and most powerful American corporations—a fact which undoubtedly contributes to the prestige and influence of Delaware corporation law.¹⁵

The statistics reflecting Delaware's dominance in the chartering business are subject only to slight variation year to year. As related by former Chief Justice Veasey,

Nearly sixty percent of the Fortune 500 companies and nearly the same proportion of those listed on the New York Stock Exchange are Delaware corporations. In addition, seventy percent of initial public offerings in 2004 on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ were Delaware corporations.¹⁶

Moreover, according to Professor Robert Daines, ninety-seven percent of all U.S. public companies incorporate either in their home state or in

¹⁴E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1402 (2005).

¹⁵*See id.* at 1403 (noting that Delaware is home to approximately sixty percent of Fortune 500 companies); *see also* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1560 (2002) (reiterating an earlier finding that firms incorporated in Delaware are worth significantly more than those incorporated in other states).

¹⁶Veasey & Di Guglielmo, *supra* note 14, at 1403.

Delaware.¹⁷ For firms choosing to incorporate outside their home state, eighty-five percent choose Delaware, and in total, Delaware accounts for fifty-eight percent of all U.S. public company charters.¹⁸ Consistent with these statistics, though scholars disagree about the reasons for and the impact of Delaware's success, its preeminence as the purveyor of nationally-relevant corporate law is beyond dispute.¹⁹

Since Delaware is a comparatively small state, the franchise taxes and filing fees paid annually by Delaware-incorporated entities make up a sizeable percentage of the state's annual tax revenue. For recent years, the figures vary from a low of sixteen percent to a high of twenty-five percent—with twenty percent being average.²⁰ As these figures reveal, a drop in franchise fees from existing or new charters could impair the state's budget, i.e., the funding of essential services including construction, education, and health care. As noted by Professor Lawrence Hamermesh, Delaware's legislators are acutely aware of the importance of franchise fees in the state's budget.²¹ This awareness encourages the General Assembly to keep Delaware's corporation code state-of-the-art.²² Indeed, Delaware's relative dependence on franchise fees in its state budget has a positive feedback effect on chartering. It adds credibility to Delaware's commitment to keeping its corporate law cutting edge.

Delaware's chartering success is not a byproduct of its geography. Aside from small, local businesses, the choice of where to incorporate usually has no nexus to the location of the company's headquarters or major operations. A company's senior managers select the state of incorporation

¹⁷Daines, *supra* note 15, at 1562.

¹⁸Bebchuk & Hamdani, *supra* note 1, at 578 & tbl.5.

¹⁹Delaware is also endeavoring to increase its market share in the area of smaller, closely-held firms, LLCs, and LLPs. For statistics and discussion of Delaware's financial incentives in obtaining greater franchise tax and filing fee revenue from these other, smaller entities, see Timothy P. Glynn, *Delaware's VantagePoint: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 125-31 (2008).

²⁰See Daines, *supra* note 15, at 1566 (explaining that fees from Delaware incorporations account for more than twenty percent of the state's revenues); Glynn, *supra* note 19, at 125 (observing a decline in franchise taxes in 2006 to approximately sixteen percent of the state's overall revenue). Delaware's substantial financial interest in attracting and keeping incorporations has been noted in corporate legal scholarship for at least three and a half decades—as far back as William Cary's seminal article describing Delaware as winning a "race for the bottom." William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 697-98 (1974) ("[T]he state of Delaware derives a substantial portion, roughly one-quarter, of its income from corporation fees and franchise taxes . . .").

²¹Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1753-54 (2006).

²²*Id.* at 1754.

(presumably with advice of counsel) based on which state's corporate laws they believe are best.²³ Delaware charges more in annual franchise and filing fees for the privilege of Delaware incorporation, but the greater marginal cost is unlikely to affect decision making for larger private and publicly traded companies.²⁴

Upon incorporation, the company's governance—its internal affairs—will be defined by the chartering state's corporate statutes, case law, and any special terms included in the company's charter or bylaws. Within corporate law, "internal affairs" encompasses the statutory and judicial standards defining the corporation's legal personhood, rules for the effectuating mergers and acquisitions, charter and bylaw amendments, procedures for shareholder and board voting and meetings, and the rights and responsibilities of shareholders, officers, and directors.

In effect, the scope of corporate "internal affairs" constitutes what is defined as corporate law in the United States. From the outside, however, corporate "internal affairs" encompasses a narrow range of corporate conduct. Neither the selection of the state of incorporation, nor the IAD effectuates a choice of law governing third parties' relations with the corporation. Suits involving contracts, torts, real property—hence relations with customers, suppliers, local communities, and claims by most creditors—are not part of the law of internal affairs fixed by the act of incorporation. Hence as they have crafted and "marketed" their corporate laws, Delaware lawmakers have not had to balance the welfare of powerful in-state

²³"Best" may mean most consistent with their private self-interest or the corporation's best interests more generally. Scholars who believe Delaware's open-endedness creates laxity and encourages self-dealing are identified with the "race to the bottom" school of thought, first given voice by Professor William Cary's famous article. See Cary, *supra* note 20. The alternative, "race to the top" school of thought posits that markets impound the quality of state corporate laws in securities prices, so that firms incorporating in states with efficiency-destroying corporate laws would pay a higher cost of capital—something corporate managers could ill afford. See, e.g., Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977). Finally, in recent "no more race" or "no race at all" versions, managers select Delaware corporate law because it is the acknowledged market leader (a safe move—akin to picking "Harvard"). For an articulate defense of this view, see Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 724-27 (2002). Moreover, they do so in a world where Delaware's corporate law has been constrained fundamentally by real or feared federal intervention. See Roe, *supra* note 3.

²⁴Delaware charges slightly higher franchise fees than do other states; but for large firms, the relative cost difference is *de minimis*. For information on Delaware franchise fee rates, see STATE OF DEL. DEPT OF FIN., 2007 FISCAL NOTEBOOK 97 (2008), http://finance.delaware.gov/publications/fiscal_notebook_07/Section07/corp_franchise.pdf. The franchise fee structure is set forth in the Delaware corporate code. See DEL. CODE ANN. tit. 8, §§ 391(a)(1)-(2), 503(a) (2001). Also, if one believes that Delaware law insufficiently restricts managerial agency costs, then managers who select Delaware are also able to "pass on" the higher cost of incorporation to the firm.

constituencies (such as organized labor) against the welfare of boards, officers, and shareholders of chartering firms. In this respect, the narrow scope of corporate law has facilitated the ability of Delaware lawmakers' to fine tune their corporate laws and to market them as a specialized, valuable product to chartering firms.

B. *Fees and Prestige for the Delaware Bar*

Delaware corporate lawyers are a highly influential interest group affecting the development of the state's corporate law. In terms of pay and prestige, they have a high-stakes interest in sustaining the preeminence of Delaware corporate law.

Wilmington's elite corporate law firms maintain a lucrative practice representing Delaware-incorporated companies involved in litigation in the Court of Chancery and Delaware Supreme Court. Out-of-state lawyers are not prohibited from advising clients on Delaware corporate law;²⁵ for example, many New York lawyers specialize in M&A transactions in which Delaware's corporate jurisprudence plays a formative role.²⁶ And general counsel of Delaware-incorporated public companies also have substantial expertise in Delaware corporate law matters. Nevertheless, because litigation is a common feature of public company M&A transactions, appearances before the Court of Chancery are commonplace in these transactions, and out-of-state attorneys typically retain Delaware co-counsel for these appearances.²⁷ Hence, a de facto system of fee sharing has developed between Delaware co-counsel and non-Delaware general counsel and M&A lawyers.

Delaware corporate litigators are also active both on the plaintiff and defense side in lawsuits alleging self-dealing and bad faith by officers, directors, and controlling shareholders. All of these are potentially lucrative areas of corporate practice. In sum, Delaware's corporate lawyers have

²⁵DEL. LAWYERS' R. OF PROF'L CONDUCT § 5.5 (2008).

²⁶The most illustrious of these is probably Wachtell, Lipton, Rosen & Katz, LLP. From the late 1980s onward, many "Wall Street" law firms developed M&A specialties.

²⁷The point is made, for example, by the "Deal Professor," Steven Davidoff. See Posting of Steven M. Davidoff to DealBook, <http://dealbook.blogs.nytimes.com/2008/05/14/clear-channel-lessons-learned> (May 14, 2008, 11:02 EST) ("There will almost always be a litigation hook to attempt to force a price renegotiation—and unlike in most situations, litigation is relatively costless in big deals: In a multibillion-dollar transaction, \$50 million \$100 million is less than the fees to the private equity firms."). See also Steven M. Davidoff, *The Failure of Private Equity*, 82 S. CAL. L. REV. (forthcoming 2009) [hereinafter Davidoff, *Private Equity*] (examining the aspects of private equity deals and the roles of attorneys in these negotiations and transactions).

substantial stakes in maintaining the preeminence of Delaware corporate law and the success of the state's chartering business.

Delaware corporate lawyers also influence the development of the state's corporation code through close collaboration with the Delaware General Assembly. This mutually beneficial professional relationship between Delaware's corporate bar and the General Assembly has been described by commentators, including Professor Lawrence Hamermesh. According to him, the Council of the Corporation Law Section of the Delaware State Bar Association has the function of "identifying and crafting legislative initiatives in the field of corporate law."²⁸ Rather than a standing body of the legislature, or legislative staff or lobbyists, these practitioners drawn from Delaware's elite corporate law firms take the lead in initiating changes to the Delaware General Corporation Law (DGCL).²⁹ In this respect, Delaware's corporate lawyers have maximized their prestige, power, and professional opportunities by promoting Delaware's preeminence in corporate law.

In 1987, Professors Jonathan Macey and Geoffrey Miller published what they described as an "interest-group theory" of the development of Delaware corporate law.³⁰ Their article focused on the influential role of the state's corporate lawyers in shaping the development of Delaware corporate law.³¹ In addition to having an incentive to promote the quality of Delaware corporate law overall, Macey and Miller's account emphasized the lawyers' incentives to foster the litigation of corporate lawsuits *in Delaware*.³² This interest-group perspective—which highlights the role of Delaware corporate lawyers in shaping the state's corporate law in their own and the state's interest—continues to have bite. (This is especially true as it complements other theories of the development of corporate law.)³³

In conclusion, it is apparent that the national success of Delaware corporate law has created tremendous financial opportunities for enterprising Delaware corporate lawyers. It is equally apparent that these lawyers would be alert to thwarting changes in law and practice which might undermine Delaware's stature in corporate law and the success of its chartering business.

²⁸Hamermesh, *supra* note 21, at 1755.

²⁹*Id.*

³⁰Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987).

³¹*See id.* at 498-505.

³²*Id.* at 503-04.

³³"Thus, the rules that Delaware supplies often can be viewed as attempts to maximize revenues to the bar, and more particularly to an elite cadre of Wilmington lawyers who practice corporate law in the state." *Id.* at 472.

*C. The Special Power and Prestige
of Delaware's Chancellors and Supreme Court Justices*

There are several respects in which Delaware's chancellors and supreme court justices enjoy unique status and power in comparison to other state judges. The Delaware Supreme Court has served as the unofficial "highest court" of corporate law, as a result of Delaware's success in chartering and Congress's historic reluctance to trespass on corporate internal affairs. Overstating only slightly, in a 2005 *University of Pennsylvania Law Review* article, former Delaware Supreme Court Chief Justice Norman Veasey stated that "[t]he Delaware Supreme Court, of course, has the last word in corporate jurisprudence. . . . The Delaware Supreme Court is certainly 'infallible' in the sense that it is the final word in corporate law."³⁴ His statements are consistent with Delaware's market share in public company incorporations, as well as Delaware's influence on other states' corporate laws.

About seventy-five percent of the Court of Chancery's docket is composed of corporate and other business-related cases.³⁵ There are only five judges on the Court of Chancery (one chancellor and four vice chancellors), and five Delaware Supreme Court justices, which means they acquire extraordinary expertise in corporate legal matters. Noting that eighty-five to ninety percent of the Court of Chancery's final judgments are not appealed, former Chief Justice Veasey concluded that "[t]he Court of Chancery makes much of our corporate law."³⁶ This scope of authority is truly extraordinary for a state trial court.³⁷

The power exercised by Delaware judges is enlarged substantially by the open-ended, enabling nature of the DGCL. This open-endedness allows Delaware corporations flexibility to tailor their governance structure to their precise goals and circumstances, in the name of promoting wealth maximization. The open-ended texture of the DGCL also means that Delaware's judges craft most of the crucial standards in corporate law, often

³⁴Veasey & Di Guglielmo, *supra* note 14, at 1408.

³⁵*Id.*

³⁶*Id.*

³⁷As if anticipating critiques of the Delaware courts' power, and to add legitimacy to its decision making, the Delaware constitution expressly provides for a bipartisan judiciary at both levels. Judges are appointed for twelve-year terms by the governor, after nomination by a bipartisan commission, and confirmed by the state senate. On both courts, there may be no more than a bare majority from any political party. Again, this formal bipartisanship contributes to the authority and perceived legitimacy of the court in its decisions affecting major business transactions. For further detailed discussion of the composition of the Delaware courts and their philosophy in deciding corporate law cases, see *id.* at 1402-07.

under the rubric of applying fiduciary duties to the conduct of directors, officers, and controlling shareholders.³⁸ Indeed, apart from appraisal cases, with few exceptions, it is difficult to identify corporate cases where the holding was dictated by the terms of the DGCL.³⁹

Of course, formally speaking, Delaware's corporation statutes are more authoritative than its case law (which cannot contravene them). But in practice, Delaware's equity courts have expanded their authority well beyond the boundaries of the DGCL. They have done so by invalidating corporate acts which they deemed inequitable under the circumstances, notwithstanding that the acts or transactions conformed to the letter of the DGCL.⁴⁰ Through this equitable mode of decision making, for example, the Delaware courts have defined the most important standards governing public company M&A transactions.⁴¹ In sum, the open-ended texture of the DGCL, in combination with the expertise, boldness, and ambitiousness of Delaware's judges in corporate law matters, has produced an extraordinary rich body of corporate case law, has fostered Delaware's success in chartering, and has led to the adjudication in Delaware's Court of Chancery of many of the most important corporate law cases in recent history.⁴²

³⁸See DEL. CODE ANN. tit. 8, § 122(9) (2001). See also *Kahn v. Sullivan*, 594 A.2d 48, 61 (Del. 1991) (using "reasonableness" and business judgment concepts as a heuristic in approving a several million dollar gift to the CEO's favored charity); *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969) (devising a rule of "reasonableness" to govern corporate charitable contributions in the face of the statute's open ended allowance).

³⁹See *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 248 (Del. 2001) (exhibiting a rare example where the Delaware Supreme Court held that fiduciary fair dealings criteria are inapposite in short-form mergers consistent with the Delaware legislature's affirmation of a streamlined process which allows controlling shareholders to bypass both board and shareholder consent of the disappearing entity).

⁴⁰See, e.g., *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439-40 (Del. 1971) (granting preliminary injunction to prevent management from changing the annual meeting date for the purpose of thwarting a proxy fight); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661, 670 (Del. Ch. 1988) (enjoining board's alteration of its structure to thwart a proposed consent solicitation and recapitalization transaction while mandating a "compelling justification" standard for board interference with shareholder voting for directors).

⁴¹For discussion of Delaware's M&A jurisprudence in relation to strategic struggles over jurisdiction, see *Kahan & Rock*, *supra* note 4; *Lebovitch & Gundersheim*, *supra* note 4.

⁴²See, e.g., *Jill E. Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1074 (2000) (arguing that Delaware corporate law's central reliance on judge-made standards confers a competitive advantage on this body of corporate law and fuels the state's success in attracting and retaining charters); *Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1591 (2005) (stating that "[t]he most noteworthy trait of Delaware's corporate law is the extent to which important and controversial legal rules are promulgated by the judiciary, rather than enacted by the legislature").

Another factor fostering Delaware's preeminence in corporate law is that the federal laws and SEC regulations applicable to M&A transactions have largely been confined to promoting disclosure. Again, the most influential standards shaping public companies' and shareholders' rights in M&A transactions arise from the Delaware courts' elaboration of fiduciary standards—rather than the DGCL, federal laws, or the SEC's rules.⁴³ For example, Delaware's fiduciary standards define the nature and scope of directors' duties in sales of corporate control and the scope of their discretion in erecting defenses to unsolicited takeover offers (the so-called *Revlon*⁴⁴ and *Unocal*⁴⁵ standards, respectively). Delaware's fiduciary standards also define the scope of acceptable profit-taking by controlling shareholders in freezeout transactions and other self-dealing scenarios.⁴⁶ To be sure, a broad set of federal laws and regulations influence public company M&A transactions. For example, the Williams Act's amendments to the Securities Exchange Act significantly influence the conduct of tender offers.⁴⁷ But beyond mandating disclosure and prohibiting fraud in these deals, the federal securities laws mostly prescribe only minimal due process-like requirements.⁴⁸ Naturally, Delaware's preeminence in the M&A area has generated great prestige for the state's judges.

⁴³Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U. L. REV. 211, 239-47 (2007) (arguing that Delaware has taken the lead in takeover regulation, filling the void left by the SEC and Congress). In the area of controllers' going-private transactions, for example, see Faith Stelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775, 781 (2007) (elucidating the fiduciary standards relevant to controllers' going-private transactions, as well as the background and secondary set of relevant federal regulations).

⁴⁴*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (requiring directors in a sale of control to take all steps reasonably necessary to obtain the best price in the shareholders' interest).

⁴⁵*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985) (applying a higher standard of judicial scrutiny when reviewing takeover defenses invoked by target boards of directors).

⁴⁶See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983) (requiring fair dealing and fair price in freezeout mergers of minority shareholders); see also *Kahn v. Lynch Comm'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994) (mandating that disinterested director ratification shifts the burden of proof to the plaintiff to demonstrate unfairness but does not reestablish business judgment deference in a freezeout merger context); Stelman, *supra* note 43. For discussion of the judicial standards applied to controlling shareholders' self-dealing transactions beyond the going-private context, see *Kahn v. Tremont Corp.*, 694 A.2d 422, 428-29 (Del. 1997).

⁴⁷For discussion of the history and limits of federal tender offer regulation, see Davidoff, *supra* note 43, at 215-24. For the views of a highly accomplished practitioner reflecting the salience of Delaware's M&A jurisprudence in takeover practice, see Igor Kirman, *Takeover Law and Practice*, in *DOING DEALS 2007: UNDERSTANDING THE NUTS AND BOLTS OF TRANSACTIONAL PRACTICE* 9, 18-19 (PLI Corp. Law & Practice, Course Handbook Series No. B-1594, 2007).

⁴⁸For discussion, see Stelman, *supra* note 43, at 800-02 (noting minimal due process-like requirements arising from the Williams Act).

Indeed, Delaware's prominence in high-stakes M&A transactions is in many ways the crown jewel of its corporate law. Professors Robert Thompson and Randall Thomas have recently completed an empirical analysis of the corporate cases on the Court of Chancery's docket. These professors found that shareholder class actions challenging M&A transactions, including going-private deals, composed the bulk of the corporate cases before the court.⁴⁹ Derivative suits alleging breaches of fiduciary loyalty were the second most prevalent, though not nearly as numerous.⁵⁰ In light of the prestige and media attention these cases generate, and the indirect financial benefits they afford the state, Delaware's chancellors and supreme court justices have a powerful interest in having these cases litigated in Delaware.

III. CHOICE OF LAW: FOUNDATIONS OF THE INTERNAL AFFAIRS DOCTRINE

Superficially, the IAD seems like it would solve Delaware's "forum problem"—that it would provide a rationale for keeping cases governed by Delaware corporate law in the Delaware courts. In this mode, the Court of Chancery's recent opinion in *In re The Topps Co. Shareholders Litigation*⁵¹ invoked the IAD to support its refusal to stay its jurisdiction. But despite *Topps'* assertions, neither efficiency based, constitutionally based or sovereignty-based claims for the IAD support Delaware's resolve to keep forum in parallel proceedings governed by Delaware corporate law. Ontological or taxonomical claims that corporations "are" creatures of state law are anachronistic and incoherent under modern corporate law and legal theory. For these reasons, the modern IAD is really meaningful only as a choice of law regime. As such, it has only marginal relevance in resolving forum disputes.

To provide a background for distinguishing choice of law and choice of forum issues, and to illustrate the limits of choice of forum arguments based on the IAD, the discussion below describes the IAD's origin and historical development.

⁴⁹Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 167-68 (2004) (demonstrating that concern over excessive derivative claims is misplaced and Delaware's docket is composed, at present, mostly of shareholder class actions contesting M&A transactions).

⁵⁰For a recent, notable example of a derivative claim alleging a fiduciary loyalty breach, see *infra* note 214 and accompanying text (discussing the Delaware Court of Chancery's decision in *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007)).

⁵¹924 A.2d 951 (Del. Ch. 2007).

A. *History of the Internal Affairs Doctrine*

Again, under modern law the IAD is best understood merely as a choice of law regime.⁵² The roots of the IAD, however, lead back to a very different historical reality and set of legal concerns.⁵³

As Professor Frederick Tung's historical analysis illuminates: "The animating ideas behind the internal affairs doctrine were formed during the pre-industrial period—from the American Revolution to the middle of the nineteenth century."⁵⁴ Hence, the IAD, as it evolved in early twentieth-century judicial decisions, was infused with historical assumptions reflecting the early development of corporations in American law. The IAD reflected the very different way that corporations operated and were created in the late nineteenth and early twentieth century. As illustrated by *Topps*, these historical anachronisms at times still color the way courts deploy the IAD.

Corporations' early existence as "creatures of state law" is analyzed in the famous case of *Trustees of Dartmouth College v. Woodward*,⁵⁵ decided by the U.S. Supreme Court in 1819. (Of course, Dartmouth College was a nonprofit, educational corporation, rather than a business corporation, but the distinction was of no relevance to the Court's decision.) The central question in the case was whether the New Hampshire legislature, approximately fifty years after Dartmouth's incorporation, could alter a key term of its charter.⁵⁶ The Supreme Court wrestled with the question of whether the college, as a corporation, existed as an extension of the state government which chartered it.⁵⁷ The Supreme Court concluded the

⁵²See, e.g., Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 161 (1985).

To many corporate lawyers, the "internal affairs" doctrine—the notion that only one state, almost always the site of incorporation, should be authorized to regulate the relationships among a corporation and its officers, directors, and shareholders—is irresistible if not logically inevitable. Convenience and predictability of application, it is said, dictate that one body of corporate law govern internal affairs, while the most plausible state to supply that law is the state of incorporation, to whose legislative grace the corporation owes its legal existence.

Id.

⁵³See Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 47 (2006).

⁵⁴*Id.* at 46.

⁵⁵17 U.S. (4 Wheat.) 518 (1819). Technically, the case addressed a charter for a charitable corporation, Dartmouth College, but the charitable versus business corporation distinction was not considered significant.

⁵⁶*Id.* at 554.

⁵⁷New Hampshire inherited the charter authority from the British Crown upon the American Revolution—a fact which was not deemed of importance in the case. *Id.* at 559.

contrary was true: the charter creating the college was analogous to a state-sanctioned private contract, for example a marriage contract. On this basis the Court concluded that ex post emendation by the State of New Hampshire would be unconstitutional under the Contracts Clause.⁵⁸

As illustrated in the *Dartmouth College* case, early American corporations were created by the grant of a formal charter from their home state's legislature. This historic reality spawned the understanding of corporations as "creatures of state law." Furthermore, in this period, corporations were understood to possess limited powers—i.e., only those powers granted expressly in the charter. They applied for a charter from the state where they operated and were located. (Given the present state of global commerce, it is difficult to recall that as late as the mid or even late nineteenth century, most business was fundamentally local in nature.)⁵⁹ Nor was the receipt of a charter a foregone conclusion. To increase their chances of obtaining a charter, promoters commonly cited some state interest that the company's commercial endeavors would advance.⁶⁰ The idea of corporations "being" creatures of their incorporating state was supported, also, by the fact that states often contributed financing to these corporations, and placed representatives on their boards.⁶¹ Indeed, companies' separate legal personhood remained controversial; it was not self evident that their powers would be respected beyond the geographic boundaries of the state which chartered them.⁶² Against this backdrop, it is easy to see why corporations conventionally would have been conceived of as "creatures of state law." The legal and historic reality described herein, however, has long vanished. The assumptions about corporations it spawned are outmoded.

Secondly, the "corporations as creatures of state law" notion ignores the fact that Congress could federalize corporate law for companies engaged

⁵⁸*Id.* at 696-704.

⁵⁹*See, e.g.,* Tung, *supra* note 53, at 44-45; *see also* ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 17-19* (1977) (discussing various production and merchant trends in the eighteenth and nineteenth century including the fact that "family remained the basic business unit").

⁶⁰Tung, *supra* note 53, at 50 ("Moreover, the vast majority of business corporations chartered before 1800 were engaged in the provision of services traditionally associated with government. Banks, water companies, and transportation companies—for the construction or operation of canals, turnpikes, and bridges—comprised the overwhelming majority of business corporations."). *See also* 2 JOSEPH STANCLIFFE DAVIS, *ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS* 3, 4 (1917) (discussing that seventeenth through nineteenth century corporations were generally organized for governmental or religious purposes).

⁶¹*See* Tung, *supra* note 53, at 47.

⁶²*Id.* at 48 ("As a creature of the sovereign, each business corporation was thought to exist only within the territorial borders of the sovereign.").

in interstate commerce (i.e., most).⁶³ The fact that Congress has declined to enact a comprehensive federal corporate law reflects a concrete political reality, not an ontological or taxonomic reality that validates corporations' existence in state law.⁶⁴

Finally, modern corporate legal theory undermines the rationality of conceiving corporations as belonging in any sense to the state where they charter. Under modern theory—as is reflected in Delaware's case law—corporations are conceived of as a nexus of private contracts among the factors of production.⁶⁵ They are conceived of as private actors—legal agents of the persons who capitalize them (shareholders) and govern them (the board), rather than legal extensions of the chartering state. As modern corporate legal theory privileges this private, contractualist view of corporations, it undermines the logic of corporations being "creatures of state law." There is no umbilical cord that would tie a dispute against a corporation to the forum of the chartering state. In this private, contractualist view, Delaware's corporate law is only one example of the many legal regimes that private parties choose from in attempting to promote the wealth arising from commercial transacting.⁶⁶ This modern, contractualist view of the corporation and corporate law is also evident in the respect courts typically afford choice of forum provisions in corporate/commercial contracts.⁶⁷ It is also reflected in the severability of choice of law and choice

⁶³U.S. CONST. art. I, § 8, cl. 3 (granting Congress the authority to "regulate Commerce with foreign Nations, and among the several States").

⁶⁴This political resistance to centralized government authority over corporations is evident to the present, for example, in the backlash directed at the corporate governance-related provisions of the Sarbanes-Oxley Act of 2002. See Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, & 29 U.S.C.). Earlier on, such political resistance also meant that even the creation of the SEC was hotly contested and, indeed, postponed until the enactment of the Securities Exchange Act of 1934. See generally JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 1-72 (3d ed. 2003) (describing the events and crises that led to the creation of the SEC).

⁶⁵For a recent statement of the nexus of contracts view of the firm, in the context of an analysis of the IAD, see Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 663-64.

⁶⁶*Id.* See also Jens Dammann, *Adjudicative Jurisdiction and the Market for Corporate Charters*, 82 TUL. L. REV. 1869, 1882-85 (2008) (discussing the inconvenience that European corporations would face if provided with the option of incorporating in their choice country); Onnig H. Dombalagian, *Choice of Law and Capital Market Regulation*, 82 TUL. L. REV. 1903, 1912-17 (2008) (explaining the corporate governance problems the European Union would face if corporations could choose their incorporation country); Robert B. Ahdieh, *The (Misunderstood) Genius of American Corporate Law* 8-17 (Emory Pub. Law Research, Working Paper No. 08-35, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105904 (reviewing the basic problems faced in American corporate governance).

⁶⁷See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 594-97 (1991) (affirming the

of forum in these contracts.⁶⁸ Again, in this modern corporate ontology, the state has no meaningful "generative" authority which it can use to pull its corporate "creatures" back into its courtrooms. Hence choice of law and choice of forum are separate, distinct legal constructs. Choice of Delaware corporate law is simply indeterminate in regard to choice of forum.

B. *Judicial Deference to the Chartering State*

Tracking backward, the discussion above does not presume that the sovereignty-based concepts inherent in the early IAD were always irrelevant to courts' judgments about where claims should be adjudicated. To the contrary, even up to the early twentieth century, state courts commonly were unwilling to hear claims against foreign corporations.⁶⁹ This understanding of comity, in which judicial deference was due to the state of incorporation, was litigated in *Rogers v. Guaranty Trust Co.*, a 1933 decision of the U.S. Supreme Court.⁷⁰

In *Rogers*, the Court affirmed that New York's courts had acted within their discretion in refusing jurisdiction over the foreign corporate claims before them because the incorporating state (Illinois) was capable of providing an ample remedy.⁷¹ This conservative approach to comity reflected the fact that corporations only recently had been viewed as mere extensions of the state governments that "created" them. Basic principles of sovereign immunity and harmonious state relations were potentially at stake in courts "seizing" jurisdiction over complaints against foreign corporations.⁷² Amidst such early ambiguity, judicial abstention was the wiser course.

right of private parties to establish by contract the procedural rights that they will have in subsequent disputes relating to their agreement—including choice of forum provisions).

⁶⁸For a historically rich analysis of the precedential roots and political implications of this trend in favor of respecting choice of forum, see Edward A. Purcell, Jr., *Geography as a Litigation Weapon: Consumers, Forum-Selection Clauses, and the Rehnquist Court*, 40 UCLA L. REV. 423 (1992). Contrariwise, for discussion of Delaware's indifference to choice of forum provisions in the M&A documents in the Topps and Bear Stearns transactions, see *infra* notes 246-50 and accompanying text.

⁶⁹As Professor Tung notes, foreign courts tended to refuse jurisdiction over claims brought by in-state shareholders against out-of-state corporations. By refusing to hear the claims of "capital exporters," they could indirectly encourage in-state capital formation. Tung, *supra* note 53, at 68.

⁷⁰288 U.S. 123 (1933). See also *infra* Part V.E.1 (discussing *Rogers*' precedent and impact on the IAD).

⁷¹*Rogers*, 288 U.S. at 131 (finding that "jurisdiction will be declined whenever considerations of convenience, efficiency, and justice point to the courts of the state of the domicile as appropriate tribunals for the determination of the particular case").

⁷²Sovereign immunity is defined as "[a] government's immunity from being sued in its own courts without its consent." BLACK'S LAW DICTIONARY 766 (8th ed. 2004).

Nevertheless, even seventy-five years ago, this conservative approach to comity did not rise to the level of being a *rule* of judicial abstention. This was evident in *Rogers* itself, where the Supreme Court held that there were no formal limits on a state exercising its jurisdictional authority over foreign corporations, as such. This more expansive dimension of *Rogers* was subsequently affirmed by the Supreme Court, fifteen years later, in *Koster v. (American) Lumbermens Mutual Casualty Co.*⁷³ In *Koster*, the Court observed that *Rogers* stood only for the proposition that "the district court . . . was free in the exercise of a sound discretion [as part of its *forum non conveniens* analysis] to decline to pass upon the merits of the controversy and to relegate [the] plaintiff to an appropriate forum."⁷⁴ Secondly, *Koster* affirmed that *forum non conveniens* analysis should not be driven by hard and fast formal legal concepts (e.g., basing forum choice on choice of law).⁷⁵ To the contrary, in *Koster* the Supreme Court held in adjudicating motions to dismiss under *forum non conveniens*, the most important concerns were pragmatic ones relevant to serving the litigants' best interests in the expedient and fair resolution of the case.⁷⁶

In this vein, as stated in *Koster*, the relevance of foreign law, even foreign *corporate* law, is merely one of many factors that a court may consider in ruling on whether to hear or dismiss the case. In the words of the Court:

[T]he ultimate inquiry is where trial will best serve the convenience of the parties and the ends of justice. Under modern conditions corporations often obtain their charters from states where they no more than maintain an agent to comply with local requirements, while every other activity is conducted far from the chartering state. Place of corporate domicile in such circumstances might be entitled to little consideration under the doctrine of *forum non conveniens*, which resists formalization and looks to the realities that make for doing justice.⁷⁷

Koster remains the most authoritative word from the U.S. Supreme Court on the appropriate scope of judicial deference to the state of

⁷³330 U.S. 518 (1947).

⁷⁴*Id.* at 528.

⁷⁵*Id.* at 527.

⁷⁶*Id.* at 527-28.

⁷⁷*Koster*, 330 U.S. at 527-28.

incorporation in *forum non conveniens* motions. Hence, the logic of *Rogers* has been superseded by *Koster*. Judicial abstention in deference to the incorporating state is no longer the rule. Hence, the Court of Chancery's attempt to collapse choice of law and choice of forum—to keep forum in parallel proceedings based on the rationale that Delaware corporate law "belongs" in the Delaware courts—is not supported by U.S. Supreme Court precedent.

Moreover, the recent Court of Chancery cases expounding Delaware's right to keep forum over disputes governed by Delaware corporate law even conflict with the Delaware Supreme Court's own *forum non conveniens* jurisprudence. That is, in *Berger v. Intelident Solutions, Inc.*, the Delaware Supreme Court asserted Delaware's right to refuse to dismiss a claim governed by Florida corporate law, even where the case presented novel issues of Florida corporate law.⁷⁸ This Delaware Supreme Court precedent presents a challenge for the Court of Chancery's claims that Delaware has a superior, if not universal, right to keep cases governed by Delaware corporate law.

C. Choice of Corporate Law

Nevertheless, taken on its own terms, as a modern choice of law scheme, the IAD makes good sense. "Lex Incorporationis"—that is, the rule that the incorporating state's corporate law "sticks" to the corporation's internal affairs—provides a clear, stable rule for resolving conflicts of laws questions. Clarity in corporate choice of law is maximized by privileging the law of the state of incorporation.⁷⁹ A different choice of law rule for corporate internal affairs—one which relied on the place of the company's principal operations or headquarters, for example—would import more subjective and changeable factors into the choice of law analysis. This would yield less certainty for courts, investors, and third parties.

As a choice of law regime, the IAD is codified in the Restatement (Second) of Conflicts of Laws.⁸⁰ The Restatement sets forth the basic premise of the IAD—that the corporate law of the state of incorporation will govern a corporation's internal affairs irrespective of where any dispute is

⁷⁸See *Berger v. Intelident Solutions, Inc.*, 906 A.2d 134, 137 (Del. 2006) (holding, as part of its *forum non conveniens* analysis, that "Delaware courts often decide legal issues—even unsettled ones—under the law of other jurisdictions").

⁷⁹See DeMott, *supra* note 52, at 166-67 (discussing states' different approaches to applying local corporate law to foreign and "pseudo-foreign" corporations).

⁸⁰See RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§ 301-310 (1971).

litigated.⁸¹ Second, the Restatement sets forth an expansive definition of corporate internal affairs⁸² (consistent with that described above in Part II.A).⁸³

The Restatement also endorses the presumption of "singularity" in the IAD—i.e., that a corporation's internal affairs should be governed *exclusively* by the law of the state of incorporation. In this respect, conflicts analysis in corporate law is far more streamlined or even simplistic than the conflicts of laws regime applicable to most other areas of law.⁸⁴

Singularity in choice of corporate law is also reflected in the Revised Model Business Corporation Act (MBCA). The MBCA provides that states complying with its choice of law dictates should refrain from "interfering" in other state's corporation laws—that is, from supplementing or amending foreign corporations' internal affairs provisions.⁸⁵ This is set forth in section 15.05(c) of the MBCA, which provides that a state shall not "regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."⁸⁶ Singularity in corporate choice of law allows corporate actors definitively to predict which state's laws will define their rights and obligations. Because parity is important in the treatment of shareholders, and predictability is especially important in commercial arrangements, singularity in corporate choice of law—as reflected in the IAD, the Restatement, and the MBCA—makes good sense. The singularity presumption in the IAD favors courts interpreting foreign corporation laws conservatively, in the fashion most faithful to the intent of the incorporating state. But respect for singularity in corporate choice of law (or even the goal of clarity in corporate law) does not mandate confining Delaware corporate law claims to the Delaware courts. The American civil justice system simply

⁸¹*Id.* § 302 cmt. g.

⁸²*See id.* § 302 cmt. a. As set forth therein, internal affairs include but are not limited to: steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares.

Id.

⁸³*See supra* Part II.A.

⁸⁴The multifactor tests and state interests to be weighed under modern conflicts of law analysis stands in stark contrast to the abiding principle of singular choice of corporate law codified in the Restatement and enshrined in the IAD. For treatment of the modern, highly synthetic, multifactor analysis that characterizes modern conflicts analysis, see generally SYMEON C. SYMEONIDES, *THE AMERICAN CHOICE-OF-LAW REVOLUTION: PAST, PRESENT AND FUTURE* (2003).

⁸⁵MODEL BUS. CORP. ACT § 15.05(c) (1984).

⁸⁶*Id.*

does not presume that the geography of adjudication will match the locus of lawmaking.

D. *The Regulatory Competition Defense for the IAD*

Claims of efficiency in modern corporate law are extremely forceful, although highly controversial.⁸⁷ In most corporate law cases and commentary, the term "efficiency" connotes wealth maximization—broadly conceived—and not just local cost savings. Those who believe in corporate law's efficiency, view singularity in corporate choice of law as being essential. For regulatory competition purposes, keeping each state's corporate laws separate and distinct promotes the selection of efficient, wealth-enhancing corporate laws.

However, so long as one accepts the difference between courts' applying law and making law, efficiency arguments based on the IAD do not mandate that a state's laws must be adjudicated only by that state's courts. So long as the distinction between adjudication and judicial lawmaking is accepted as a meaningful one (and the principle is fundamental in the American judicial system), and respected by the courts in general, the regulatory competition/ efficiency claims for the IAD do not support Delaware's right to keep forum over the adjudication of Delaware corporate lawsuits.

Nevertheless, the Court of Chancery is deploying the efficiency claims made for its corporate laws as part of its arguments for restricting Delaware corporate lawsuits to Delaware's courtrooms. To better evaluate this line of argumentation, the discussion below briefly reviews the claims made for Delaware corporate law's efficiency, and also for regulatory competition's effectiveness in producing wealth maximizing corporate laws. To summarize the conclusion reached below: claims about Delaware corporate law's efficiency and efficient regulatory competition have been overstated. The evidence for corporate law's (and Delaware corporate law's) efficiency is largely indeterminate. Accordingly, it is daring but risky for the Court of Chancery to deploy efficiency arguments in this strategic manner to force forum in its favor.

⁸⁷This is especially true, as reflected in Delaware's case law, because modern corporate law is interpreted to be essentially just another species of commercial law, so that its objectives are construed narrowly as relating to maximizing the wealth of the transacting parties. See *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 647 (Del. Ch. 2005) ("This is corporate law, after all, a species of commercial law . . ."). For discussion of the normative implications of this view, in the context of going-private transactions by controllers, see Stevelman, *supra* note 43, at 906-07.

According to Judge Easterbrook and Professor Fischel, the singular choice of corporate law principle embodied in the IAD plays a crucial role in fostering efficiency and wealth maximization in corporate transactions.⁸⁸ As they describe it, singularity in corporate choice of law is essential to the operation of state regulatory competition and hence the development of salutary, efficient, wealth-enhancing corporate laws.⁸⁹ They write: "Because only one state's law governs the 'internal affairs' of a corporation, . . . competition can be effective."⁹⁰ From this perspective, the IAD facilitates brand recognition and differentiation. It helps consumers of corporate law (e.g., managers, shareholders, and the securities markets) distinguish which brand they prefer as most likely to enhance their wealth. For those who believe that shareholders and the broader market are able to make such an informed, rational choice (i.e., discern the quality of a firm's state corporate laws as part of their investment decision), singularity in corporate choice of law is a valuable feature of the system.

Given the appeal of efficiency claims for investors, as in academic corporate law, it is not surprising that the Court of Chancery is employing them as ammunition in its recent choice of forum decisions. But the claims for there being macroeconomic wealth gains arising from Delaware corporate law—a *fortiori* efficiency gains from requiring that Delaware's corporate law be adjudicated in Delaware—are quite shaky upon examination.

Strong form claims for the efficient effects of regulatory competition in corporate law are encountering new challenges in scholarship and in practice. Although early scholarship showed promise, more than a decade of further empirical analysis has failed to substantiate strong evidence of Delaware corporate law's wealth maximizing effects.⁹¹

⁸⁸Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 697-98 (1984).

⁸⁹*Id.*

⁹⁰*Id.* at 697.

⁹¹Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 129 (2004) (presenting evidence for theories of efficiency in corporate law and concluding that "[n]otwithstanding the extensive theoretical and empirical literature on this question, there is no consensus as to the desirability of the current system"); William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 9-11 (collecting and analyzing decades of empirical studies about efficiency effects from Delaware chartering and concluding that "[t]he results of over twenty-five years of empirical work thus remain inconclusive"); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002) (finding mixed empirical data in study of whether corporate managers migrate to or away from states with strong antitakeover laws).

At least in recent years the securities markets seem driven more by herd behavior than fundamental, rational valuation. The recent, arguably very belated upheavals in the securities markets—in which the stock prices of almost all public companies, including major commercial and investment banks, plummeted precipitously and then remained breathtakingly volatile for months—undermine confidence that the securities markets rationally impound all publicly available, material information in a timely fashion. Skepticism is even more appropriate where the information made available to the market is technical, dynamic, and composite—as is the case with respect to a body of state corporate laws.⁹²

Finally, as Professor Mark Roe has demonstrated, federal law exerts pervasive limits on Delaware lawmakers' willingness to be adventurous in shaping the state's corporate laws as they might wish.⁹³ According to Roe, the overhang of federal opprobrium, *a fortiori* express preemption, inhibits Delaware judges' and legislators' willingness to experiment in crafting maximally efficient corporate laws.⁹⁴ Moreover, Delaware's status as the market leader in nationally significant corporate law would hinder its incentive to be experimental. Experimentation would unsettle Delaware corporate law's brand recognition and, hence, potentially its ongoing success in chartering.

Because the IAD and regulatory competition in corporate law do not obviously enhance wealth, they also do not support Delaware's right to adjudicate Delaware corporate lawsuits. As such, these efficiency claims do not provide a basis for collapsing Delaware choice of law into Delaware choice of forum.

E. *Constitutional Claims for the IAD*

In crafting their corporation codes, California, New York, and a few other states have refused to accept the presumption of singularity in corporate choice of law.⁹⁵ These states' corporate statutes include "foreign corporations" provisions designed to supplement those of the incorporating

⁹²The capital markets' belated and seemingly irrational, or at least haphazard, response to upheavals in the credit and mortgage-backed securities markets and federal bailout of financial institutions would appear to undermine strong claims of market rationality and efficiency.

⁹³See Roe, *supra* note 3, at 646 (concluding that every corporate crisis "raises the threat or the reality that the issue will move from the states to Washington").

⁹⁴*Id.* at 597-98.

⁹⁵CAL. CORP. CODE § 2115 (West 2008); N.Y. BUS. CORP. LAW §§ 1317-20 (McKinney 2003).

state.⁹⁶ In line with the singularity principle in corporate choice of law, the Court of Chancery and Delaware Supreme Court recently rebuffed California's application of its preferred stock/foreign corporations provision to a Delaware incorporated issuer.⁹⁷ The Delaware Supreme Court opined that the singular choice of law principle enshrined in the IAD is based on federal constitutional law principles.⁹⁸ Upon review (as illuminated below), Delaware's constitutional law analysis falls short; its claims for the IAD having federal constitutional underpinnings are overblown. It does little to further Delaware's claims about the IAD and less to support Delaware's claims about forum. As was true of efficiency rationales, federal constitutional law principles provide an infirm footing for Delaware to keep forum over Delaware corporate lawsuits.

The Delaware Supreme Court's opinion in *VantagePoint Venture Partners 1996 v. Examen, Inc.*⁹⁹ speaks volumes. But it says less about the constitutional basis of the IAD than it does about Delaware's concern for protecting its stature in corporate law. The *VantagePoint* litigation is notable, especially, because it illuminates Delaware's defensiveness about keeping control over its brand of corporate law. This concern is illustrated in the court's discussion of the IAD, and the presumption of singularity in corporate choice of law. This same defensiveness is also evident in the Court of Chancery's recent forum decisions in parallel proceedings, as discussed below in Part V. In light of their relevance to these forum rulings (which are the centerpiece of this article), the Delaware courts' decisions in *VantagePoint* are discussed immediately below.

The facts in the recapitalization transaction under scrutiny in the *VantagePoint* decisions merit review.¹⁰⁰ Section 2115 of California's corporation code establishes a class voting right for holders of preferred stock of closely held, foreign-incorporated issuers.¹⁰¹ The statute's purpose

⁹⁶See, e.g., CAL. CORP. CODE § 2115(a) (West 2008); N.Y. BUS. CORP. LAW § 1318 (McKinney 2003).

⁹⁷*VantagePoint Venture Partners 1996 v. Examen, Inc. (VantagePoint II)*, 871 A.2d 1108, 1109-10 (Del. 2005).

⁹⁸*Id.* at 1115-18. In 2007, in *Topps*, the Court of Chancery also invoked the federal constitutional basis of the IAD—which is, once again, highly contestable. *In re The Topps Co. S'holders Litig.*, 924 A.2d 951 (Del. Ch. 2007).

⁹⁹871 A.2d 1108 (Del. 2005).

¹⁰⁰See *VantagePoint Venture Partners 1996 v. Examen, Inc. (VantagePoint II)*, 871 A.2d 1108 (Del. 2005); *Examen, Inc. v. VantagePoint Venture Partners 1996 (VantagePoint I)*, 873 A.2d 318 (Del. Ch. 2005).

¹⁰¹Importantly, the preferred voting provision applies only to closely held issuers and only when they meet a demanding test for having significant California operations, revenues, or investors. CAL. CORP. CODE § 2115 (West 2008). The statute is discussed in depth in *VantagePoint II*, 871

is to ensure the enfranchisement of preferred shareholders in transactions where the incorporating state's corporation code does not afford them class voting rights. Most pertinently, under the DGCL, all the equity holders of Examen, Inc. would vote as one class in the merger at issue. In the process, the particular financial interests of the preferred holders might be overborne. This is precisely what California's class voting provision was intended to protect against.

Had the California courts asserted their jurisdiction more aggressively, the dispute might have been resolved in California, and presumably to a different result. Instead, the corporate issuer, Examen, commenced the lawsuit seeking a declaratory judgment in the Court of Chancery.¹⁰² In this fashion, Examen sought to head off California's application of its preferred stock voting statute.¹⁰³ Five days later VantagePoint—a holder of Examen's preferred stock—filed a complaint in California Superior Court seeking affirmation that the preferred voting rights delineated in California's section 2115 were applicable in the merger.¹⁰⁴ VantagePoint sought special relief to require the separate class vote of preferred holders, or damages in lieu thereof.¹⁰⁵

In recognition of the parallel proceedings, the California court deferred to the Court of Chancery, where the litigation had first been commenced. But in deferring to the first-filed complaint, consistent with classic *forum non conveniens* doctrine, California virtually ensured Delaware's refusal to validate the application of section 2115.

In resolving the choice of law question against the application of California's voting provision, the Court of Chancery first determined that the two states' voting regimes were in conflict, and hence mutually exclusive. (This result was not self evident.)¹⁰⁶ Next the Court of Chancery engaged in a straightforward application of the IAD. It held that Delaware's voting rules trumped California's—since Examen was a Delaware corporation.¹⁰⁷ Despite VantagePoint's urging, the Court of Chancery deliberately refused to address whether the singular choice of law presumption in the IAD was mandated by federal constitutional law principles. Rather, in working

A.2d at 1109-10. See also CAL. CORP. CODE § 171 (West 2008) (defining foreign corporation). To qualify under the statute: (1) the average of the property factor, the payroll factor, and the sales factor as defined in the California Revenue and Taxation Code must be more than fifty percent during its last full income year; and (2) more than one-half of its outstanding voting securities must be held by persons having addresses in California. CAL. CORP. CODE § 2115(a)-(b) (West 2008).

¹⁰²VantagePoint I, 873 A.2d at 319.

¹⁰³*Id.*

¹⁰⁴*Id.* at 320.

¹⁰⁵*Id.*

¹⁰⁶VantagePoint I, 873 A.2d at 323.

¹⁰⁷*Id.* at 325.

through the conflicts of laws problem before it, the court cited the Delaware Supreme Court's decision in *McDermott Inc. v. Lewis*¹⁰⁸—a landmark internal affairs decision.¹⁰⁹

Contrariwise, on appeal, the Delaware Supreme Court accepted VantagePoint's constitutional law challenge. VantagePoint argued that Delaware was compelled either to uphold the application of California's preferred stock voting provision or, otherwise, to rule that it conflicted with the Fourteenth Amendment's Due Process Clause and the Dormant Commerce Clause.¹¹⁰ In contrast to the Court of Chancery's reticence on this subject, the Delaware Supreme Court validated the federal constitutional law underpinnings of the IAD. It held that applying California's voting statute to the merger would conflict with due process—on the rationale that due process protects corporate actors' interest in being able to ascertain which standards will apply to transactions and conduct.¹¹¹ And the Delaware Supreme Court concluded that the Commerce Clause also barred applying California's section 2115 to the merger.¹¹² (It also reiterated the old

¹⁰⁸531 A.2d 206 (Del. 1987).

¹⁰⁹See *VantagePoint I*, 873 A.2d at 323-24 (discussing, in detail, the internal affairs principles validated in *McDermott*, 531 A.2d at 214-17).

¹¹⁰*VantagePoint Venture Partners 1996 v. Examen, Inc. (VantagePoint II)*, 871 A.2d 1108, 1112-13 (Del. 2005).

¹¹¹*Id.* at 1113. The "right-to-know"/due process defense of the IAD, however, is not as forceful as the Delaware Supreme Court's discussion would suggest. Certainly in public companies, the standards that actually apply to the rights and duties of directors, officers, and shareholders are extraordinarily multilayered and context-specific—as the discussion in *supra* Part III demonstrates. The multilayered nature of these intersecting bodies of law that govern directors', officers', and shareholders' rights and expectations is why, for example, corporate directors hire expert, expensive corporate lawyers who understand not only the subtleties of the corporate case law and the intricacies of the statutes, but also the federal securities laws and regulations, and the requirements promulgated by the stock exchanges. Beyond the context of closely held, unregistered firms, the multiplicity of standards that make up modern corporate governance undermines a strong right-to-know/due process defense of the IAD.

¹¹²*VantagePoint II*, 871 A.2d at 1113 (quoting *McDermott*, 531 A.2d at 217) ("Under the Commerce Clause, a state 'has no interest in regulating the internal affairs of foreign corporations.'"). See also *id.* at 1115-17 (discussing the singular choice of law feature of the IAD as being a necessary feature of stability and efficiency in corporate law, consistent with Commerce Clause rationales). Despite the Delaware Supreme Court's reasoning, it is difficult to accept that allowing the application of California's supplementary voting statute would impose a meaningful burden on corporate transacting, at least in a transaction where a vote of the common holders is already a prerequisite of the transaction's consummation. Furthermore, there are many legal protections and requirements which are layered onto corporate transactions by the Williams Act and these are not presumed invalid under the Dormant Commerce Clause. The same analysis would apply to the voting requirements arising from the New York Stock Exchange's requirements (which are indirectly subject to the SEC's and hence Congress's authority). Given the many layers of procedural rules that inform public company transactions—which are not found impermissibly to burden interstate commerce—it is hard to justify the view that California's "closely-held" preferred voting stock rule

"creatures of state law" rationale for the IAD in prohibiting the class vote contemplated by California's voting provision.)¹¹³

For our purposes, the substance, i.e., the merits of the supreme court's constitutional law discussion in *VantagePoint* is mostly beside the point.¹¹⁴ What is most revealing and important for our purposes is the remarkable overbreadth of the Delaware Supreme Court's constitutional law excursus. In effect, the constitutional law discussion in *VantagePoint* is effectively an advisory opinion. This is because Delaware's views about the U.S. Constitution cannot bind any state other than Delaware. At least as a matter of formal law, the discussion of federal constitutional law principles in *VantagePoint* was gratuitous. The overbreadth in *VantagePoint* is noteworthy and revealing because the Delaware Supreme Court has a well deserved reputation for deciding only the case before it and avoiding unnecessary legal controversies—consistent with Delaware's best interests. Nevertheless in *VantagePoint* the Delaware Supreme Court seized upon the framework of the IAD to protect the integrity of Delaware law from possible intrusion by other states (in this case, California).

Hence, the actual purpose of the Delaware Supreme Court's constitutional law discussion in *VantagePoint* was to signal to other states, including California, that Delaware would "go to the mat" to defend the singular choice of law principle inherent in the IAD. In this regard *VantagePoint* illuminates Delaware's concern about maintaining its preeminence in corporate law (as do the forum rulings analyzed in Part V). As *VantagePoint* illuminates, however, Delaware's appeal to federal constitutional law cannot resolve Delaware's concerns about the future preeminence of its corporate law.

The discussion immediately below shifts focus to analyze the increasing pressure on Delaware corporate law arising from the growth of federal corporate law. Part V returns to Delaware's increasing concern about choice of forum and the interstate adjudication of Delaware corporate law claims.

would have such an impermissible effect, or that the same rule applied to public companies would be an impermissible burden on interstate commerce in conflict with the Dormant Commerce Clause.

¹¹³*Id.* at 1114-16. The Delaware Supreme Court cited the U.S. Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America* for the "creature of law" concept, but *CTS* does little to elaborate on the content of that assertion in a way that would give substance to the claim. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89-90 (1987).

¹¹⁴For an excellent discussion, see Glynn, *supra* note 19, at 108-23 (describing Delaware's defensive response to enactment of the Sarbanes-Oxley Act and its expression in the choice of law controversy in the *VantagePoint* litigation).

IV. FEDERAL THREATS TO DELAWARE'S PREEMINENCE IN CORPORATE LAW

A. *Eradication Through Express Preemption*

Explicit federal preemption is the most salient, though not the most pressing threat to Delaware corporate law. There is no question that preemption is legally possible. Under the Commerce Clause, Congress has authority to regulate almost any aspect of interstate corporate affairs,¹¹⁵ and legal scholars have at times enthusiastically supported the enactment of federal minimum corporate law standards.¹¹⁶ Nevertheless, federal disinclination to preempt state corporate law dates back to the enactment of the Securities Act of 1933¹¹⁷ and the Securities Exchange Act of 1934.¹¹⁸ Rather than preempting state law, Congress has provided for a system of dual (federal and state) regulation of corporate governance. In enacting federal proxy laws, for example, Congress avoided legislating the subject matter that shareholders could vote on—leaving that to the states' corporate laws.¹¹⁹ Even in 1968, in enacting the Williams Act and establishing federal tender offer laws, Congress focused primarily on promoting disclosure. It left entirely to state regulation the scope and nature of boards' freedom to resist unwanted bids.

The federal courts have also sought to avoid preempting state corporate law. This is evident in the U.S. Supreme Court's interpretations of section 10(b) and Rule 10b-5.¹²⁰ For example, in the landmark case of *Santa Fe Industries, Inc. v. Green*,¹²¹ the Court declined to extend the federal antifraud prohibition to allegedly unfair acts and transactions which did not involve misrepresentation.¹²²

But preemption may be becoming more palatable to Congress. For example, the pressure of globalization may make uniform, federal standards of American corporate law more attractive. Congress's enactment of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) is

¹¹⁵Note how broadly interstate commerce is construed under the Commerce Clause; Congress would not be confined only to companies meeting the definition of public companies under sections 12 and 15(d) of the Securities Exchange Act.

¹¹⁶Cary, *supra* note 20, at 701-02.

¹¹⁷15 U.S.C. § 77a (2006).

¹¹⁸*Id.* § 78a.

¹¹⁹*See Auer v. Dressel*, 118 N.E.2d 590, 592-93 (N.Y. 1954) (establishing what matters shareholders have a right to vote on—as a question of state rather than federal law).

¹²⁰*See* 15 U.S.C. § 78j (2006); 17 C.F.R. § 240.10b-5 (2008).

¹²¹430 U.S. 462 (1977).

¹²²*Id.* at 479.

illustrative.¹²³ In SLUSA, Congress preempted most private investor class actions alleging fraud under state law.¹²⁴ Only at the last minute did Congress pull back to avoid preempting lawsuits alleging misrepresentation by corporate fiduciaries.¹²⁵ Without the last minute "Delaware carve-out" (as it has come to be known), an essential piece of state corporate law, including Delaware's "fiduciary duty of disclosure," would have been preempted by federal law.¹²⁶

B. *Eclipse or Marginalization*

Delaware is more likely to lose preeminence in corporate law as a result of being gradually eclipsed or marginalized by the accretion of federal corporate laws, SEC regulations, and stock exchanges' listing standards. On top of these, "best practices" proffered by shareholder activists may go far in blurring the distinctiveness of Delaware's brand of corporate law.¹²⁷ This thick "supra-layer" of national corporate law standards might persuade corporate managers to opt for the convenience of chartering in their home state.

1. Federal Laws and SEC Regulations

Upon the enactment of the Sarbanes-Oxley Act of 2002 (SOX),¹²⁸ and the SEC's implementing regulations, federal law reached a new high water mark in areas of corporate law traditionally governed by the states. In actuality, the accretion of federal "corporate laws" had been ongoing for

¹²³Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

¹²⁴*Id.* § 16(b) (codified at 15 U.S.C. § 77p (1998)).

¹²⁵*Id.* For discussion of SLUSA's scope, see *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82-88 (2006).

¹²⁶*Kahan & Rock, supra* note 42, at 1587-88. Nevertheless, the federal disinclination towards express preemption is the rule rather than the exception; and this rule was illustrated once again in Congress's enactment of the Class Action Fairness Act of 2005. See Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified in scattered sections of 28 U.S.C.).

¹²⁷Technically these are outside federal law, but their force and utility is shaped by the federal shareholder proposal rule under SEC Rule 14a-8. See 17 C.F.R. § 240.14a-8 (2008). For a similar emphasis on "brand recognition" as a mechanism supporting Delaware's sustained preeminence in corporate law, see Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129 (2008).

¹²⁸Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, & 29 U.S.C.).

decades, as scholars have noted.¹²⁹ A few examples suffice to illustrate this ongoing expansion of federal corporate law.¹³⁰

In 1977, Congress enacted the books and records provisions of the Foreign Corrupt Practices Act (FCPA), thereby establishing federal standards for public companies' record keeping and accounting.¹³¹ The FCPA also requires public companies to devise and maintain systems of internal controls sufficient to safeguard against insider misappropriation and other illicit payments.¹³² The FCPA, together with the antifraud prohibitions in the securities laws, have broadly supplemented public company directors' fiduciary duty of care, disclosure and oversight, as defined by state law.¹³³ Similarly, by the late 1970s, the federal ban on insider trading had largely outstripped the complementary state fiduciary ones.¹³⁴ The former simply proved more useful and adaptable in most cases.¹³⁵

¹²⁹For commentary on the increasing role of federal securities law in areas identified traditionally under the rubric of internal corporate affairs, see, e.g., J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 335-38 (2004); Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251, 281-86 (2005); John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91, 91-96 (2007); Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 941-74 (2003); Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 98-123 (2005); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1529-43 (2005); Joel Seligman, *The New Corporate Law*, 59 BROOK. L. REV. 1, 36-37 (1993); Faith Stevelman, Foreword, *Corporate Governance Five Years After Sarbanes-Oxley: Is There Real Change?*, 52 N.Y.L. SCH. L. REV. 475, 486-92 (2008); Robert B. Thompson, *Corporate Governance After Enron*, 40 HOUS. L. REV. 99, 104-06 (2003). For an argument for enhanced international securities laws, see Roberta Romano, *The Need for Competition in International Securities Regulation* (Yale Int'l Ctr. for Fin., Working Paper No. 00-49, 2001), available at <http://papers.ssrn.com/abstract=278728>.

¹³⁰For commentary on the complementarity of federal and state standards in corporate governance by two sitting Delaware jurists, see Myron T. Steele, *Sarbanes-Oxley: The Delaware Perspective*, 52 N.Y.L. SCH. L. REV. 503, 506-11 (2008); Leo E. Strine, Jr., *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW. 1079, 1099-1100 (2008).

¹³¹Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 78m(b) (2002).

¹³²See Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1278-82 (1999) (noting the rise of the monitoring board in the 1990s); Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1520-23 (2007) (reviewing the fact that monitoring boards became a safe harbor in the 1980s).

¹³³See Melvin A. Eisenberg, *The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237, 242-44, 254-56 (1997).

¹³⁴See *Diamond v. Oreamuno*, 248 N.E.2d 910, 914 (N.Y. 1969).

¹³⁵See generally STEPHEN M. BAINBRIDGE, *SECURITIES LAW: INSIDER TRADING* 7-23 (1999) (reviewing insider trading and discussing the effects of the *Diamond* case).

By 1982, with the SEC's enactment of integrated disclosure, and certainly by 1988 when the U.S. Supreme Court decided *Basic Inc. v. Levinson*,¹³⁶ federal law was defining what information shareholders need to evaluate their company's status and managers' performance.¹³⁷ In addition, an increasing number of lawsuits which might have been brought as breach of fiduciary duty claims, were reformulated as securities law misrepresentation claims. As a result, shareholder litigation under the federal securities laws has edged out many shareholder claims that would otherwise have been brought under state fiduciary law.

Federal enforcement by the SEC and the Department of Justice (DOJ) has also had a seminal influence in shaping the obligations of public company managers and advisers. The federal courts, the SEC, and occasionally the DOJ have liberally exercised their authority to define and punish misconduct by corporate directors,¹³⁸ officers,¹³⁹ general counsel,¹⁴⁰ corporate financial advisers,¹⁴¹ and public company auditors.¹⁴² These federal authorities have often taken the lead in defining and punishing wrongful conduct by these parties. In these respects, Congress,¹⁴³ the SEC

¹³⁶485 U.S. 224 (1988).

¹³⁷In *Basic*, the Court held that companies involved in the early stages of merger negotiations might have to make public disclosure thereof as necessary to avoid half-truths or false denials, even if such publicity were destructive to the immediate interests of the company's shareholders. *Id.* at 236-41. See also Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1087-89 (1990).

¹³⁸See, e.g., *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628 (S.D.N.Y. 2004).

¹³⁹See, e.g., Press Release, U.S. Dep't of Justice, Former Enron Chief Financial Officer Andrew Fastow Pleads Guilty to Conspiracy to Commit Securities and Wire Fraud, Agrees to Cooperate with Enron Investigation (Jan. 14, 2004), available at http://www.usdoj.gov/opa/pr/2004/January/04_crm_019.htm.

¹⁴⁰See, e.g., Press Release, U.S. Dep't of Justice, Former McAfee General Counsel Indicted for Stock Options Backdating (Feb. 27, 2007), available at http://www.usdoj.gov/usao/can/press/2007/2007_02_27_roberts.indictment.press.html (describing indictment of former general counsel of McAfee, Inc. in connection with stock options backdating in 2000 and 2002).

¹⁴¹See, e.g., Federal Court Approves Global Research Analyst Settlement, Litigation Release No. 18,438 (Oct. 31, 2003), available at <http://www.sec.gov/litigation/litreleases/lr18438.htm> (describing federal court's approval of the historic \$1.4 billion settlement of SEC enforcement actions against ten of nation's top investment banks).

¹⁴²See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101, 116 Stat. 745, 750 (2002) (establishing a "Public Company Accounting Oversight Board"); see also Press Release, U.S. Dep't of Justice, KPMG to Pay \$456 Million for Criminal Violations in Relation to Largest-Ever Tax Shelter Fraud Case (Aug. 29, 2005), available at http://www.usdoj.gov/opa/pr/2005/August/05_ag_433.html (discussing KPMG's involvement in a tax fraud that provided for over \$2.5 billion in evaded taxes).

¹⁴³Congress enacted standards for public company auditors' responsibilities in detecting and reporting fraud in the Private Securities Litigation Reform Act. See, e.g., Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 302(a)(5)(B), 116 Stat. 745, 777 (2002) (codified at 15 U.S.C. § 78j-

(both through rulemaking¹⁴⁴ and enforcement actions¹⁴⁵), and the federal courts have established a broad array of corporate governance-related rules and standards—ones which are at least as authoritative and efficacious as those in state corporate law.¹⁴⁶

2. Listing Standards from the Exchanges and the NASD

Even prior to SOX's enactment, the stock exchanges and the National Association of Securities Dealers (NASD) were imposing increasingly stringent governance standards on listed companies.¹⁴⁷ After SOX, these federally initiated forms of "self-regulation" have grown in scope and become more exacting in their requirements. For example, the NASD and the exchanges upgraded their requirements for having independent directors on listed companies' boards and special committees—including audit, nominating, and compensation committees.¹⁴⁸ In addition, they adopted

D) (amending section 10A of the Securities Exchange Act which details the audit requirements of issuers of financial statements by independent public accountants). *See also id.* § 307 (codified at 15 U.S.C. § 7245) (promulgating rules governing conduct by general counsel); Corporate and Criminal Fraud Accountability Act of 2002, 18 U.S.C. § 1514A (2002) (providing for whistleblower protection for employees of publicly traded companies).

¹⁴⁴Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 47,276, Exchange Act Release No. 8185, Investment Company Act Release No. 25,919 (Aug. 5, 2003) (codified in 17 C.F.R. § 205 (2003)). For discussion, see Lisa H. Nicholson, *Sarbox 307's Impact on Subordinate In-House Counsel: Between a Rock and a Hard Place*, 2004 MICH. ST. L. REV. 559, 566-75.

¹⁴⁵*In re Sterling Homex Corp. Sec. Litig.*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,904 (S.D.N.Y. 1977); *In re Cooper Cos.*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,472 (1994); *In re W.R. Grace & Co.*, Exchange Act Release No. 39,157, 67 SEC Docket 1240 (Sept. 30, 1997).

¹⁴⁶*See* Thompson, *supra* note 129, at 107 (remarking that state corporate law's response to the 2001-2003 spate of frauds was remarkably muted).

¹⁴⁷*See, e.g.*, Audit Committee Disclosure, Exchange Act Release No. 34-42,266 (Jan. 31, 2000) (codified in scattered sections of 17 C.F.R.); NAT'L ASS'N CORP. DIRS., REPORT OF THE NACD BLUE RIBBON COMMISSION ON AUDIT COMMITTEES: A PRACTICAL GUIDE (2000) (recommending ways for audit committees to become more effective); Blue Ribbon Comm. on Improving the Effectiveness of Corp. Audit Comms., *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, 54 BUS. LAW. 1067, 1072-76 (1999) (listing recommendations for strengthening, improving effectiveness, and providing for greater accountability of audit committees); Seligman, *supra* note 129, at 52 (noting that in 1977, the SEC, through a rule change in the NYSE listing requirements, mandated that listed companies have audit committees composed solely of independent directors).

¹⁴⁸*See* NYSE, Inc., Listed Company Manual § 303A (2008) (providing corporate governance rules approved by SEC). For a discussion of the layering of federal statutory, SEC, and listing standards' provisions affecting the structure of reporting companies' boards of directors, see Holly J. Gregory, *Weil, Gotshal & Manges LLP—Comparison of Sarbanes Oxley, SEC and Listing Rule Provisions Related to the Composition and Functioning of the Board of Directors of a Publicly Traded-Company (as of June 20, 2007)*, in DIRECTORS' INSTITUTE ON CORPORATE GOVERNANCE, at 353 (PLI Corp. Law & Practice, Course Handbook Series No. B-1694, 2008).

objective and more stringent standards for defining whether directors met the standard of "independence" for serving on such committees.¹⁴⁹

Delaware has broadly endorsed independent director ratification as a mechanism to "cure" conflict transactions. This applies to takeover situations, self-dealing transactions, executive compensation awards, and even judgments to quash derivative suits.¹⁵⁰ (In contrast, the cleansing force of independent director ratification is given only partial effect in controllers' self-dealing transactions, but Delaware may be softening this standard.)¹⁵¹ Notwithstanding the pro-managerial tilt in Delaware corporate law, one would expect that the jurisprudential test for director independence would be a stringent one—in light of the centrality of independent director ratification in Delaware corporate law. Instead Delaware has tolerated a relatively lax standard of director independence—one which arguably has ignored many kinds of inhibitions to directors' capacity for objectivity.¹⁵² In this crucially important area of state corporate law—that is, in defining meaningful, enforceable criteria for "independent" directors—federal laws and standards have outstripped Delaware's. The federally initiated independence

¹⁴⁹The New York Stock Exchange and the NASD have promulgated highly influential standards governing the criteria for "independent" directors. See NYSE, Inc., Listed Company Manual §§ 303A.01-.02 (2008); NYSE, CORPORATE GOVERNANCE RULE PROPOSALS REFLECTING RECOMMENDATIONS FROM THE NYSE CORPORATE ACCOUNTABILITY AND LISTING STANDARDS COMMITTEE AS APPROVED BY THE NYSE BOARD OF DIRECTORS (2002), http://www.nyse.com/pdfs/corp_gov_pro_b.pdf. The NYSE has proposed a change that would require companies to "disclose affirmative reasons for its findings that its independent directors are, in fact, 'independent.'" *Stock Exchanges: NYSE Seeks Rule Change on Director Independence*, 9 Corp. Governance Rep. (BNA) 6 (Jan. 2, 2006). This change was proposed to address the concern that some listing companies were using only the specific tests for independence and neglecting their obligation to make their own assessment of a director's independence. *Id.* Material relationships include "commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others." NYSE, Inc., Listed Company Manual § 303A.02(a) cmt. (2008).

¹⁵⁰See *Marciano v. Nakash*, 535 A.2d 400, 404 (Del. 1987); *Cooke v. Oolie*, No. 11,134, 2000 WL 710199, at *13 (Del. Ch. May 24, 2000), reprinted in 26 DEL. J. CORP. L. 609, 627 (2001). For criticism of this approach, see J. Robert Brown, Jr., *Disloyalty Without Limits: "Independent" Directors and the Elimination of the Duty of Loyalty*, 95 KY. L.J. 53, 98-100 (2006).

¹⁵¹*Kahn v. Lynch Comm'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994). See also *Stevelman*, *supra* note 43, at 911-12 (arguing that freezeout transactions by controllers should be governed by the entire fairness standard unless there was an auction or market check prior to independent directors' approval of the controllers' bid). Delaware's broad acceptance of independent director ratification, in the face of its lax standard for independence, is a sore spot, an area where Delaware corporate law is vulnerable to the charge of insufficiently addressing agency costs.

¹⁵²See, e.g., *Beam ex. rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1051-55 (Del. 2004); *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 923-25, 947 (Del. Ch. 2003); *Orman v. Cullman*, 794 A.2d 5, 26-31 (Del. Ch. 2002); *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 356-61 (Del. Ch. 1998), *aff'd in part, rev'd in part sub nom.* *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

requirements promulgated by the NASD and the exchanges¹⁵³ are superseding Delaware's criteria for defining director independence and ensuring their service consistent with shareholders' best interests.¹⁵⁴

3. Shareholder Activist Initiatives

In recent years, the dynamics of shareholder activism in the area of corporate governance reform have changed substantially. Highly motivated, organized institutional investors (including activist hedge funds and public and private pension funds) have successfully employed mass publicity and (federal) proxy-based shareholder proposal campaigns to press for change.¹⁵⁵ Organizations like RiskMetrics (formerly Institutional Shareholder Services) and The Corporate Library have sought to capitalize on such institutional investor activism.¹⁵⁶ These forces are operating outside of the traditional framework of state corporate law—that is, without amendment to the DGCL and separate and apart from the judicial development of fiduciary standards. In prior periods, corporate directors, officers, and their advisers could more

¹⁵³See Gregory, *supra* note 148, at 355-76 (summarizing "the corporate governance requirements relating to the composition and function of the board of directors of companies" subject to the listing standards).

¹⁵⁴Delaware is mostly likely tolerating this because it may stand to lose chartering business from seeming too rigid in defining independence criteria. In effect, Delaware is ducking the issue: in the face of these federally initiated standards, Delaware's jurisprudence has neither conformed nor upgraded its own criteria for concluding that directors are disinterested and appropriately situated to opine on the fairness of conflicted transactions involving corporate insiders. In practice, however, as public companies alter their boards and committees to comply with the listing standards' independence requirements, the composition of public companies' boards and key board committees will change to reflect the letter and hopefully the spirit of the exchanges' new, objective director independence criteria. See, e.g., Brown, Jr., *supra* note 150, at 100; Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73, 103-04 & n.126 (2007); Lisa M. Fairfax, *Sarbanes-Oxley, Corporate Federalism, and the Declining Significance of Federal Reforms on State Director Independence Standards*, 31 OHIO N.U. L. REV. 381, 395 (2005).

¹⁵⁵For a discussion of the influence of activist hedge funds, see Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681, 696-700 (2007); Alon Brav et al., *The Returns to Hedge Fund Activism* (European Corp. Governance Inst. Working Paper, Paper No. 098, 2008), available at <http://ssrn.com/abstract=1111778>.

¹⁵⁶For recent commentary on the role of corporate governance rating agencies and, in particular, RiskMetrics' (previously known as Institutional Shareholder Services) role as an advisor to shareholders in voting proposals, see Tamara Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case For Increased Oversight and Control*, 14 STAN. J.L. BUS & FIN. (forthcoming 2009); Robert Daines et al., *Rating the Ratings: How Good are Commercial Governance Ratings?* (Stanford Law & Econ. Olin Working Paper No. 360, 2008), available at <http://ssrn.com/abstract=1152093>.

easily insulate themselves from shareholders' demands and expectations.¹⁵⁷ And the Delaware courts' interpretation of the business judgment rule has facilitated directors' insulation from shareholders' demands.¹⁵⁸

Nevertheless, such shareholder activism may be achieving a new critical mass. In a recent speech, Martin Lipton argued just this. According to Mr. Lipton, leading activist institutional investors have become so adept at forcing their agendas on public companies that they are destroying the older framework of state corporate governance for public companies.¹⁵⁹ If Mr. Lipton is correct, then Delaware's preeminence in corporate law may truly be in jeopardy.

In actuality however, the chances are good that Mr. Lipton has overstated the case for an incipient "revolution" in public company corporate governance. Moreover, if such a revolution is on the way, it is not a war that Delaware can win by fighting choice of forum battles. To the contrary, in regard to both the intellectual integrity and accepted preeminence of its corporate law, Delaware has much to lose from forcing the forum issue.

V. CHOICE OF FORUM: HORIZONTAL THREATS TO DELAWARE'S PREEMINENCE

Professors Eisenberg and Miller have recently evaluated the phenomenon of Delaware companies becoming subject to corporate and commercial lawsuits in non-Delaware forums.¹⁶⁰ While their results are preliminary, the professors present evidence of some degree of claims flight even in M&A

¹⁵⁷For judicial notation of that fact, including acknowledgment of the high-profile influence of Institutional Shareholder Services in affecting votes in reporting companies, see, e.g., *Hewlett v. Hewlett-Packard Co.*, No. 19,513-NC, 2002 WL 818091, at *8 (Del. Ch. Apr. 30, 2002), *reprinted in* 28 DEL. J. CORP. L. 326, 340 (2003) (stating that "it was widely known that Institutional Shareholder Services, Inc. . . . played a critical role [in the proposed HP-Compaq merger,] because several institutions usually follow [Institutional Shareholder Services'] recommendations").

¹⁵⁸See, e.g., *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 356-61 (Del. Ch. 1998), *aff'd in part, rev'd in part sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

¹⁵⁹Martin Lipton, Keynote Address at The 2008 Directors Forum of The University of Minnesota Law School: Shareholder Activism and the "Eclipse of the Public Corporation": Is the Current Wave of Activism Causing Another Tectonic Shift in the American Corporate World? 5-8 (June 28, 2008) (discussing shareholder activism and its effect on public company boards of directors).

¹⁶⁰Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975 (2006) [hereinafter Eisenberg & Miller, *Ex Ante Choices of Law and Forum*]; Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts* (NYU Law & Econ. Research Paper No. 08-13, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1114808 [hereinafter Eisenberg & Miller, *The Flight to New York*].

lawsuits involving Delaware public companies.¹⁶¹ This Part first analyzes the practical incentives and legal doctrines that shape plaintiffs' forum choices in Delaware corporate lawsuits. It then analyzes Delaware's strategic deployment of choice of forum doctrine to corral high-profile cases in its courtrooms.

A. Incentives to File Suit Outside of Delaware

Why might plaintiffs be motivated to file Delaware corporate law claims in foreign forums?

First, plaintiffs and their counsel might reasonably be concerned that Delaware judges have an anti-plaintiff/pro-corporate bias. As "race for the bottom" believers postulate, such bias would foreseeably result from the fact that corporate managers, and not shareholders, select the state of incorporation. Furthermore, such anti-plaintiff sentiment was openly expressed by the Court of Chancery, for example, in *In re The Topps Co. Shareholders Litigation*¹⁶² and *In re Cox Communications Inc. Shareholders Litigation*.¹⁶³ The concern about plaintiffs' perception of bias is sufficiently palpable that the Court of Chancery openly addressed it in the *Topps* decision. In a lengthy footnote in *Topps*, the court stated defensively that "[t]here is no rational basis to believe that stockholder-plaintiffs cannot secure important relief in the Delaware courts."¹⁶⁴ Of course, if such a fear was truly irrational, the Court of Chancery would not have felt compelled to address it at length.

Delaware judges' general disfavor towards shareholder litigation would also reflect the general popular disfavor towards class action litigation. This disfavor has been reflected not only in the media, but also in Congress's enactment of the Class Action Fairness Act of 2005,¹⁶⁵ the Private Securities Litigation Reform Act of 1995,¹⁶⁶ and SLUSA.¹⁶⁷

¹⁶¹Eisenberg & Miller, *Ex Ante Choices of Law and Forum*, *supra* note 160, at 1983. See also Larry E. Ribstein, *Delaware, Lawyers, and Contractual Choice of Law*, 19 DEL. J. CORP. L. 999, 1025 (1994) (concluding that choice-of-law statutes "have potentially wide-ranging implications").

¹⁶²924 A.2d 951, 961 (Del. Ch. 2007) ("Random results may be good for plaintiffs' lawyers who can use the uncertainty factor that comes with disparate forums to negotiate settlements of cases that might otherwise be dismissed as unmeritorious.").

¹⁶³879 A.2d 604, 640-42 (Del. Ch. 2005). See also Stevelman, *supra* note 43, at 857-59 (discussing the cash-out merger in *Cox* and the Delaware Court of Chancery's decision). Both *Cox* and *Topps* are discussed at greater length below.

¹⁶⁴See *Topps*, 924 A.2d at 961 n.39.

¹⁶⁵Pub. L. No. 109-2, 119 Stat. 9 (2005) (codified in scattered sections of 28 U.S.C.).

¹⁶⁶Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

Especially in light of Delaware's concern about federal preemption, it would be reasonable for shareholder-plaintiffs to worry that Delaware judges would favor corporate defendants and look to dismiss shareholders' complaints whenever possible.

The early professional training of most Delaware corporate judges would also reinforce this bias. Prior to their tenure on the Court of Chancery or Delaware Supreme Court, most Delaware judges were members of corporate/defense-side Wilmington law firms. Hence, they would have received their formative training in corporate-oriented, defense-friendly settings. Such a pro-corporate/pro-defense orientation would be reinforced if the judges were interested in returning to these lucrative corporate law practices after their tenure on the bench. The same would be true if they intended to seek an academic appointment at a law school because academic opinion has largely disfavored most shareholder litigation.¹⁶⁸

It is also possible that non-Delaware corporate law firms are seeking to draw litigation out of Delaware and into their own state's courts. It stands to reason that New York's and other large cities' major corporate law firms—especially firms commonly involved in negotiating M&A deals—would be increasingly unwilling to share fees with their Delaware counterparts. Even before the current economic downturn, competition between "big city" law firms had become much more intense.¹⁶⁹ As noted by the court in *Topps*, New York and other states are seeking to compete with Delaware's share of business and commercial litigation.¹⁷⁰ Like several other states, New York has established a specialized business and commercial court to attract more corporate cases into the state's courtrooms.¹⁷¹ These trends signal that the

¹⁶⁷Pub. L. No. 105-353, 112 Stat. 3227 (1998).

¹⁶⁸For a more measured view of contemporary derivative suits, see Thompson & Thomas, *supra* note 49, at 134 ("Shareholder litigation is the most frequently maligned legal check on managerial misconduct within corporations."); see also Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1749 (2004) ("Contrary to earlier studies, we do not find evidence that that [sic] these cases are 'strike suits' yielding little benefit."). For an openly derisive account of the plaintiffs' bar and the effects of shareholder litigation, see, e.g., Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1855-56 (2004).

¹⁶⁹On the economic downturn's effect on corporate law firms, see Jonathan D. Glater, *Billable Hours Giving Ground at Law Firms*, N.Y. TIMES, Jan. 30, 2009, at A1. For commentary on increased competition among large law firms, see generally Marc Galanter & William Henderson, *The Elastic Tournament: A Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867 (2008) (reviewing legal competition and large law firm growth while explaining that there is an expected change in the makeup of large law firms).

¹⁷⁰See *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 964 n.43 (Del. Ch. 2007).

¹⁷¹A testament to this is the energy the New York courts are devoting to upgrading the state's business courts, as noted by Vice Chancellor Strine in his *Topps* decision. See *id.* (citing Rochelle C. Dreyfuss, *Forums of the Future: The Role of Specialized Courts in Resolving Business*

Delaware courts and Delaware corporate lawyers are facing greater competition in the area of their core competence: high-profile M&A and fiduciary loyalty litigation involving Delaware public companies.

Competition between Delaware and non-Delaware plaintiffs-side law firms may also be propelling some corporate cases into other jurisdictions.¹⁷² Law reforms intended to reduce strike suits have made it more difficult for shareholder-plaintiffs to win financial recoveries, even in meritorious cases. If plaintiffs' firms are scrambling to stay profitable, they might rationally be less amenable to consolidating their cases within a single forum. The result would be a splintering of corporate shareholder claims into parallel proceedings in different forums, i.e., precisely what Delaware is concerned about.

The changing complexion of M&A deals may also be redirecting some lawsuits to other jurisdictions. In recent years, banks and private equity firms have acquired tremendous clout in M&A practice. Unlike managers of Delaware corporations, these constituencies have no particular nexus to or affinity for Delaware or its corporate law—and no preference for litigating in Delaware. Delaware has no special expertise in the area of banking law or general commercial litigation.¹⁷³ If the credit-related and contractual dimensions of M&A disputes increasingly predominate over fiduciary issues, this could erode the preference for litigating in Delaware.¹⁷⁴

Two more points are important to the discussion at this point. First, it is not necessarily true that plaintiffs determine the forum for litigating corporate lawsuits. Although this article generally assumes that plaintiffs are initially determining forum, corporate defendants have considerable room to maneuver in determining which forum will hear Delaware corporate lawsuits. As was the case with Examen, Inc.'s motion for declaratory injunction filed in the Court of Chancery (as described above), prospective defendants may seek a declaratory injunction regarding the interpretation of a particular corporate law rule, charter, or bylaw provision. They may also commence litigation to enforce or contest the enforceability of a corporate transaction or takeover defense. In addition, defendants will commonly have

Disputes, 61 BROOK. L. REV. 1 (1995); Kahan & Kamar, *supra* note 23, at 710; Judith S. Kaye, *Refinement or Reinvention, The State of Reform in New York: The Courts*, 69 ALB. L. REV. 831, 839-40 (2006).

¹⁷²See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.). For popular commentary, see Eleanor Clift, *Capitol Letter: Waiting for the Next Shoe to Drop*, NEWSWEEK, Feb. 8, 2002, <http://www.newsweek.com/id/63423>.

¹⁷³Eisenberg & Miller, *Ex Ante Choices of Law and Forum*, *supra* note 160, at 1983, 2002-09.

¹⁷⁴For analysis of the legal and financial issues which have roiled recent private equity transactions, see Davidoff, *Private Equity*, *supra* note 27.

power to remove shareholder claims from state to federal court under either diversity or supplemental jurisdiction. Once in federal court the defendants may seek to transfer the litigation from one circuit to another in a different state. Finally, corporate defendants may succeed in altering the locus of shareholder litigation as a result of a *forum non conveniens* motion.

In sum, it is erroneous to assume that plaintiffs have ultimate control over deciding where corporate litigation proceeds. In fact, given their greater financial resources and the above described legal means, it is arguable that corporate defendants routinely have the upper hand in controlling the locus of corporate litigation. This has profound normative implications for corporate law. For example, corporate defendants' power to call forum may blunt the equilibrating force that would otherwise result from plaintiffs' having alternative forum choices. It would also blunt the force of claims that shareholder-plaintiffs are unfairly engaging in "forum shopping."

The final point of relevance here is that even where shareholder-plaintiffs file suits governed by Delaware corporate law outside of Delaware, they may be doing so because it is simply less costly or otherwise more practically convenient for them. They may not have an express intention to avoid litigating in Delaware.

B. *Alternative Tribunals, Alternative Procedural Rules*

1. In General

As mentioned previously, although the IAD mandates that the incorporating state's corporate laws will apply in the adjudication of corporate law claims irrespective of where they are litigated, it does not mandate applying the incorporating state's rules of civil procedure. This means that plaintiffs' lawyers would rationally consider the impact of other jurisdictions' procedural rules before determining where to file a complaint. Delaware judges surely anticipate this. Logically, they would consider the potential of "claims flight" in applying their own rules of procedure and corporate laws. In this manner, regulatory competition (irrespective of its ultimate effects) operates not only at the front-end legislating/chartering stage, but also at the "back-end" of corporate law in settling up through litigation (i.e., the development of judicial standards through shareholder litigation).

2. Juries

As a court of equity, trials in the Court of Chancery are decided by the bench. In contrast, in some other jurisdictions, Delaware shareholder-

plaintiffs would have their complaints heard by juries, as is often the case in civil litigation. This potentiality was broached in *Rapoport v. Litigation Trust of MDIP Inc.*¹⁷⁵ In *Rapoport*, Vice Chancellor Parsons opined that "Delaware corporate citizens often find it advantageous to be based in a state where business disputes can be resolved without a jury trial"¹⁷⁶ The vice chancellor did not further explain the rationale for his opinion. Most likely he meant that potential corporate defendants, in his view, preferred to avoid the potential for a jury trial. This may or may not be true as a general matter. There is in fact scant evidence, however, that juries are biased against corporate defendants. Researchers have generally been impressed by the professionalism of juries. They have found them to be neither punitive toward corporations nor overly generous towards plaintiffs as a general matter.¹⁷⁷

3. *In re Cox* and Plaintiff-Attorneys' Fees

The decision in *In re Cox Communications, Inc. Shareholders Litigation*,¹⁷⁸ decided by the Court of Chancery in 2005, illustrates the interconnectedness of substantive corporate law standards and the rules of civil procedure. In this respect, it illuminates how the limits of the IAD would influence forum choice.

Just as important, the decision in *Cox* illustrates the Court of Chancery's own ambivalent/modulated treatment of plaintiffs' lawyers. In specific, the Court of Chancery excoriated the conduct of the plaintiffs' lawyers in the *Cox* Communications freezeout transaction, although it ultimately approved the award of a reasonable fee to them. This modulated treatment of the plaintiffs' lawyers in the *Cox* decision most likely reflects the Court of Chancery's desire to reduce the incentive for plaintiffs' lawyers to try for higher fees in settlements that might be approved elsewhere.¹⁷⁹ In this respect, *Cox* illuminates how Delaware's own doctrine is rendered more moderate by the shareholder-plaintiffs' option to litigate in other states or in federal court.

¹⁷⁵No. 1035-N, 2005 WL 3277911 (Del. Ch. Nov. 23, 2005).

¹⁷⁶*Id.* at *7 (quoting *Asten v. Wangner*, No. 15,617-NC, 1997 WL 634330, at *3 (Del. Ch. Oct. 3, 1997)).

¹⁷⁷For discussion and citation to studies of juries' decisions in civil cases noting the widespread misconception of pro-plaintiff bias, see Bassett, *supra* note 5, at 388-91.

¹⁷⁸879 A.2d 604 (Del. Ch. 2005).

¹⁷⁹In *Cox* itself there were claims filed not only in Delaware, but also in Georgia, which is where the headquarters of *Cox* Communications was located. See *id.* at 608 & n.6 (observing that in all, thirteen complaints were filed in Delaware and three in Georgia).

Both of these points—the interconnectedness of substance and procedure in corporate law, and the modulating effect of plaintiffs' having choices in regard to forums—are central to this article's thesis. Because they are both illuminated by the *Cox* decision, that decision is discussed in further detail immediately below.

In *Cox*, the court surveyed the fiduciary doctrines pertaining to freezeout transactions and concluded that they are confusing and inefficient.¹⁸⁰ According to the opinion, adherence to the entire fairness standard of review for freezeouts encourages plaintiffs' lawyers to file nonmeritorious suits to obtain fees from controllers.¹⁸¹ The court reasoned that controllers pay the fees (as part of settlements) in order to avoid the larger costs associated with discovery under the entire fairness standard of review.¹⁸² Thus, in *Cox*, the court drew a direct link between (what it regarded as) dysfunctional substantive doctrine (i.e., adherence to the entire fairness standard) and dysfunctional procedural standards (i.e., allowing fee reimbursement when plaintiffs filed complaints against negotiable freezeouts). To promote the integrity of its fiduciary standards and to deter abusive filings by plaintiffs' lawyers, the court endorsed a new fee reimbursement standard for freezeouts. Under the new standard, plaintiffs' lawyers cannot anticipate receiving any fees when they file complaints against freezeout transactions that are still negotiable.¹⁸³ According to *Cox*, the new fee limit should apply even if a special committee obtained a higher price from the controller while the litigation was pending—as was true in *Cox* itself.¹⁸⁴ In *Cox*, the court expressly stated its view that the commencement of the litigation had contributed little or nothing to the better price obtained for the minority shareholders.¹⁸⁵

The discussion above is intended to illustrate the Court of Chancery's view of the interconnectedness of procedural standards (e.g., discovery and fee reimbursement standards) and substantive fiduciary law standards. This interconnectedness reveals the threat to Delaware arising from the potential out of state adjudication of Delaware corporate lawsuits. Because the IAD does not make Delaware's procedural rules stick, the impact of different procedural rules (in out-of-state adjudication) in Delaware corporate lawsuits

¹⁸⁰*Id.* at 642-48.

¹⁸¹*Id.* at 605-06.

¹⁸²Defendants pay these sums, purportedly, because they rationally wish to avoid the even greater costs and burdens of discovery.

¹⁸³*Cox*, 879 A.2d at 640-42.

¹⁸⁴*Id.* at 640 (discounting plaintiffs' argument that they were solely responsible for the increased final merger price).

¹⁸⁵*Id.* at 640-41.

is of concern to the Delaware courts. It represents a genuine loss of control on their part. The loss of control may be felt directly: from other courts adjudicating the claim. Or it may be felt indirectly, in Delaware's need to adjust *ex ante* to the potential for claims flight. Either way, the loss of control would, reasonably be experienced as a kind of diminishment to be eliminated if possible.

Returning to the specifics in *Cox*, the outcome of the fee dispute illuminates how Delaware is modulating its own treatment of plaintiffs' lawyers in order to discourage claims flight.¹⁸⁶ In *Cox*, the Court of Chancery excoriated the conduct of plaintiffs' lawyers in filing complaints against negotiable freezeouts. Nevertheless, it signed off on the plaintiffs' lawyers fee of \$1.275 million—roughly \$500 per hour, plus expenses.¹⁸⁷ Why did it do so, after having rebuked them so forcefully? It is possible that, as a matter of legal process, the court believed that it was only fair to apply the new, more conservative fee standard after giving notice to the plaintiffs' bar. But probably not; it is not uncommon for the Court of Chancery to update its standards and apply the newly updated standard to the case before it. More likely, the court was sensitive not to go too far in alienating the plaintiffs' lawyers who had brought the case before them.

Indeed, that is precisely the point. If Delaware alters its fee doctrine or other procedural rules in a manner that seems punitive or excessively harsh to shareholder-plaintiffs and their lawyers, then claims will go elsewhere—possibly to Delaware's detriment. Claims flight could also result if Delaware's fiduciary standards were applied in a way that seemed excessively harsh to plaintiffs. Shareholder-plaintiffs and their lawyers might hope that other courts would be unwilling to strictly construe corporate laws that seemed excessively partisan.

And, again, the "open door" of forum choice creates a feedback loop. The IAD's shortcomings (its failure to encompass procedural rules as part of corporate choice of law), in tandem with the modern, liberal rules of personal jurisdiction, influences Delaware's own decision making in corporate lawsuits, as *Cox* illuminates. If Delaware corporate law is perceived to be excessively pro-defendant, plaintiffs will have a strong incentive to litigate elsewhere. If it is perceived to be overly generous to shareholder-plaintiffs, corporations will look to other states in chartering, and to other tribunals in defending against Delaware corporate lawsuits.¹⁸⁸ The Delaware

¹⁸⁶*Id.* at 641-42.

¹⁸⁷*Cox*, 879 A.2d at 642.

¹⁸⁸For discussion of defendants' ability to alter the site of litigation through motions based on *forum non conveniens*, removal (to federal court), and transfer of venue, see Bassett, *supra* note 5, at