The corporate governance arrangements of publicly traded companies have been transformed over the past four decades. Various observers have suggested that Delaware, where more than half of U.S. public companies are incorporated, has done much to influence corporate governance changes. This Article considers the nature and extent of Delaware's contribution to the development of corporate governance, indicating in so doing that this contribution was substantial but not decisive. Delaware had only a marginal impact on changes affecting key corporate governance topics such as executive pay and shareholder activism. On the other hand, with boards a series of well-known Delaware court decisions in the mid 1980s fortified the status of independent directors and provided incentives for boards to be attentive. Also, Delaware court rulings helped to bring to an end the hectic takeover activity of the 1980s, which in turn likely prompted a shift in emphasis away from the market for corporate control in favor of "internal" corporate governance mechanisms.
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I. INTRODUCTION

With the Francis G. Pileggi Lecture there is something of a tradition of marking anniversaries of significant Delaware cases. Ronald Gilson began the trend in 1999 with Unocal Fifteen Years Later (And
TRANSFORMATION OF CORPORATE GOVERNANCE

What We Can Do About It. Stephen Bainbridge's 2005 Pileggi Lecture was Unocal at 20: Director Primacy in Corporate Takeovers. Hillary Sale, who focused on In re Caremark International Inc. Derivative Litigation in her 2006 lecture, noted that it had been a decade since Chancellor William T. Allen authored the decision.

At the time I gave the Pileggi Lecture upon which this Article is based (October 2014), it had been fifteen years since Professor Gilson's Unocal lecture. It has now been thirty years since Unocal Corp. v. Mesa Petroleum Co. and a series of other landmark judgments handed down the same year that were the focal point of the most remarkable period of judicial activity in U.S. corporate law. It has also been forty years since the launch of the Delaware Journal of Corporate Law. Correspondingly, it would seem to be a propitious moment to use the Pileggi Lecture to mark the anniversary of a significant Delaware case.

This Article will indeed look backwards. The focus, however, will not be on a particular notable case. Instead, the scope will be broader. The corporate governance arrangements of publicly traded companies have been transformed over the past four decades, illustrated by the fact that the term "corporate governance" was largely unknown beforehand. What will be considered in this Article is the nature and extent of Delaware's contribution to the development of corporate governance, with particular reference to judgments of the Delaware courts.

Various observers have argued that Delaware has had a major impact on corporate governance. Martin Lipton and Paul Rowe, in a 2002 reply to Professor Gilson's Pileggi Lecture, suggested that

1Ronald J. Gilson, UNOCAL Fifteen Years Later (And What We Can Do About It), 26 DEL. J. CORP. L. 491 (2001).
5See Gilson, supra note 1.
"unprecedented takeover activity of the early 1980s required Delaware to devise a new model of corporate governance." In a 2004 article, Hillary Sale observed that "for many years people have regarded Delaware as the place from which corporate governance practices emanated." A Wall Street Journal report the same year said of the Delaware Court of Chancery, "Decisions from the Delaware court have had great influence on corporate governance . . . ." Norman Veasey, former Chief Justice of the Delaware Supreme Court, concurred in 2005, saying that "Delaware judges have had a substantial role in shaping best practices in corporate governance." Steven Ramirez asserted in 2007 that "historically, corporate governance in the United States has been left to the states, and Delaware has appropriated the role of providing corporate governance standards for about half of all American publicly held companies." Delaware obviously has not had the field to itself. The federal Securities and Exchange Commission ("SEC") brought corporate governance on to the official reform agenda initially in the mid 1970s. The Sarbanes-Oxley Act of 2002 ("SOX"), which Congress enacted in response to high-profile corporate scandals involving companies such as WorldCom and Enron, contained numerous provisions relevant to corporate governance. The Dodd-Frank Act of 2010, despite focusing primarily on the regulation of banks, contained a subtitle entitled "Strengthening Corporate Governance" applicable to all issuers falling under the SEC's jurisdiction. Private actors such as the Business Roundtable and the American Law Institute weighed in as debates concerning corporate governance began in earnest in the late 1970s and

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10Martin Lipton & Paul K. Rowe, Pills, Polls and Professors: A Reply to Professor Gilson, 27 DEL. J. CORP. L. 1, 3 (2002).
15Cheffins, supra note 9, at 47.
17For a succinct summary of the legislation, see Alton B. Harris & Andrea S. Kramer, Corporate Governance: Pre-Enron, Post-Enron, in CORPORATE AFTERSHOCK: THE PUBLIC POLICY LESSONS FROM THE COLLAPSE OF ENRON AND OTHER MAJOR CORPORATIONS 49, 72-74 (Christopher L. Culp & William A. Niskanen eds., 2003).
the 1980s. Institutional shareholders also lobbied for corporate governance changes, urging companies in the late 1980s to dismantle anti-takeover devices and pressing companies thereafter to enhance the monitoring capabilities of boards and increase usage of equity-based executive compensation.

For various reasons, the timing is opportune to reflect upon Delaware's contribution to the development of corporate governance. First, assuming that there is not another batch of Enron/WorldCom-style corporate governance scandals brewing and that a fresh financial crisis is not imminent, the governance arrangements of U.S. public companies are unlikely to change substantially over the next few years. Second, those seeking to understand corporate governance will benefit from awareness of the forces that supported the evolution of governance practices. There is within the extensive discourse on corporate governance a tendency to focus exclusively on the present, which can obscure key features of important governance mechanisms. Third, debates continue to the present day about the implications of various legal rules relevant to the historical development of corporate governance, such as § 203 of the Delaware General Corporation Law ("DGCL"). This antitakeover provision, the constitutionality of which is a matter of some controversy today, may have helped to reconfigure corporate governance by contributing to the end of a 1980s takeover wave. Fourth and finally, while Delaware has been referred to in

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19Cheffins, supra note 9, at 49-52.
20Brian R. Cheffins, Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500, 65 BUS. LAW. 1, 9 (2009).
22See James D. Cox, How Delaware Law Can Support Better Corporate Governance, in PERSPECTIVES ON CORPORATE GOVERNANCE 335, 335 (F. Scott Kieff & Troy A. Paredes eds., 2010).
25See infra Part V.C.
historically oriented literature on U.S. corporate governance,26 there has yet to be a systematic appraisal of Delaware's contribution to the corporate governance transformation that U.S. public companies have experienced over the past forty years. This Article endeavours to provide that.

The assessment offered here indicates that any analysis of the historical development of corporate governance would be seriously incomplete without taking Delaware into account. Still, Delaware has not been a consistently dominant player. Delaware's impact has instead varied from substantial to marginal, depending on the corporate governance topic involved. Moreover, in the areas where Delaware has been influential, its contribution has generally been to reinforce trends already present rather than move matters in a radically different direction. This is hardly surprising, given that Delaware courts have done much more to influence corporate governance than the Delaware legislature, and that courts have, as compared to legislative bodies, restricted scope to overhaul the law applicable to particular activities.

Parts II and III of this Article set the scene for the ensuing assessment of Delaware's contribution to the transformation of U.S. corporate governance. Part II describes how the corporate governance model that currently prevails in U.S. public companies differs from that in place prior to "corporate governance" becoming part of the corporate lexicon in the 1970s, and in so doing introduces the corporate governance topics the Article focuses on, namely the board of directors, takeovers, shareholder activism, and executive compensation. Part III discusses the key Delaware corporate law players—the legislature and the courts—and identifies institutional features that might be expected to influence the impact each has had on U.S. corporate governance.

Parts IV to VII of the Article examine Delaware's contribution to the transformation of corporate governance in particular contexts. Part IV focuses on the board. Key points made here are that rulings by Delaware courts reinforced a trend that moved independent directors to the corporate governance forefront and provided incentives for boards to be attentive and to put in place suitable internal reporting and compliance mechanisms. Part V discusses takeovers, noting that rulings by the Delaware courts likely helped to curtail freewheeling takeover tactics popularized in the 1980s, and, in so doing, possibly fostered a shift in emphasis away from an "external" mechanism potentially bolstering managerial accountability (the market for corporate control) in favor of

"internal" corporate governance mechanisms. Parts VI and VII analyze shareholder activism and executive pay respectively and show that in these areas of corporate governance, Delaware's influence was less pronounced than was the case with boards or takeovers.

II. THE TRANSFORMATION OF CORPORATE GOVERNANCE

A. The Received Legal Model and a Changing Corporate Landscape

U.S. corporate governance may have been transformed over the past four decades—but this occurred without a major change to the formal allocation of power and responsibility within corporations. Melvin Eisenberg's well-known 1976 book The Structure of the Corporation illustrates the point.\(^2\) He sought in his book "to develop new and more highly articulated models of corporate structure . . . ."\(^2\) As a departure point he described the "well known" outlines of "the received legal model" of the corporation, saying, "[u]nder this model, the board of directors manages the corporation's business and makes policy; the officers act as agents of the board and execute its decisions; and the shareholders elect the board . . . ."\(^2\) While Eisenberg stressed that "the received legal model" did not accurately describe at the time how corporations functioned in practice,\(^3\) the model remains intact. For instance, provisions in the 1967 DGCL that vest the board with the authority to manage the company, provide for the appointment of corporate officers and give shareholders the power to elect directors have not been altered materially in the decades since.\(^4\)

William Bratton and Michael Wachter remarked in 2008 upon the continuity of "the received legal model" while at the same time saying that since Eisenberg wrote in 1976, "the corporate landscape changed dramatically.\(^5\) They summarized the changes as follows:

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\(^3\)Eisenberg, supra note 27, at 6.

\(^4\)Id. at 1.

\(^5\)Id. at 3-5.

\(^6\)Del. Code Ann. tit. 8, §§ 141(a), 142(a)-(b), 211(b) (2006).

\(^7\)Bratton & Wachter, supra note 27, at 145.
Hostile takeovers came and went, bringing to the fore new conflicts between the management and shareholder interest. Institutional shareholders emerged as active governance players, disrupting power relationships. . . . Management incentives became a primary structural concern while internal controls became a primary legal concern. Through all of this, the board's makeup, processes, and performance loomed ever larger.\textsuperscript{33}

The changes were accompanied by a new nomenclature. Eisenberg's \textit{The Structure of the Corporation} dealt extensively with core corporate governance topics such as the composition and structure of the board of directors, shareholder voting rights, and the significance of institutional investors such as pension funds and mutual funds as shareholders.\textsuperscript{34} Nevertheless, reflecting the fact that "corporate governance" was only just emerging as part of the corporate lexicon in the mid 1970s,\textsuperscript{35} Eisenberg did not deploy the term even once in his book.\textsuperscript{36} Linguistic habits would soon change substantially. By the end of the 1990s, "corporate governance" had become the term of art most typically used to characterize the analysis of boards, executive pay, and shareholder involvement in publicly traded companies.\textsuperscript{37}

Bratton and Wachter's summary of the transformation of the corporate landscape in the decades following the 1976 publication of \textit{The Structure of the Corporation} is correct as far as it goes. Their assessment of what changed nevertheless is too succinct to provide a suitable basis for evaluating Delaware's contribution to the transformation of corporate governance in U.S. public companies. Correspondingly, the remainder of this Part provides a more detailed historical overview, with boards being the first topic.

\textsuperscript{33}Id.

\textsuperscript{34}See Eisenberg, supra note 27, at 9, 18, 144, 289. Indeed, a 1978 review of the book indicated "Eisenberg's criticisms and proposals are of central importance to an understanding of corporate governance." Donald E. Schwartz, In Search of Corporate Soul, 87 \textit{Yale L.J.} 685, 687 (1978) (book review).

\textsuperscript{35}See Cheffins, supra note 9, at 47-49.


B. Boards

Changes to the composition of boards designed to foster directorial monitoring of executives accompanied corporate governance's emergence as part of the corporate lexicon. The most obvious role for boards to play from a governance perspective is to keep executives in check, and individuals independent from management stand out as the most obvious candidates to foster managerial accountability. Eisenberg suggested in *The Structure of the Corporation* that this sort of independence was not a strong point of public company boards, saying, "[t]he most striking of the compositional elements is the degree to which the typical board includes persons who are economically or psychologically dependent upon or tied to the corporation's executives, particularly its chief executive." By the mid 1970s, however, enhancing the independence of directors was emerging as a core element of a fledgling corporate governance reform agenda. A by-product was that the proportion of directors of public companies who were at least nominally "independent" increased from one-quarter in 1970 to three-quarters in 2005.

The changes to the composition of the board were accompanied by structural alterations oriented around board committees. While only about one-fifth of large companies had an audit committee during the late 1960s, board committees of this sort were ubiquitous by 1980 and were mandatory for all public companies by the early 2000s. There was a similar, if somewhat belated, trend with nominating committees charged with responsibility to vet and select director candidates. The proportion of public companies with such a committee increased from 20% at the end of the 1970s to 95% by the early 1990s. The pattern was similar with compensation committees vested with responsibility for setting executive pay.

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39 Eisenberg, supra note 27, at 144-45.
41 See Gordon, supra note 26, at 1474-75.
42 See id. at 1491-92; Eisenberg, supra note 27, at 207 (data on 1960s).
43 See id. at 1492, n. 105, 1498; see also Roy J. Harris, Jr., 'Independent' Panels of Corporate Boards to Tap New Directors Are Proliferating, *Wall St. J.*, Feb. 15, 1979, at 14 (indicating that the proportion of public companies with nominating committees increased from 19% in 1977 to 37% in 1978).
44 See Gordon, supra note 26, at 1492-93.
Changes concerning board composition and structure were accompanied by increased attentiveness by outside directors. The boards of publicly traded companies of the late 1960s and early 1970s reputedly were largely passive management-dominated "rubber stamps." Myles Mace, in a widely cited 1971 study of boards of public companies, reported that only a few boards asked discerning questions, evaluated and measured the performance of top management in a meaningful way, or would contemplate dismissing an underperforming chief executive officer ("CEO") in the absence of a serious crisis.

Matters seemingly changed substantially over the next two decades. Ira Millstein, a prominent advocate of corporate governance reform, contrasted in a 1993 interview the public company board of that era with its 1949 forerunner. He said the difference was "day and night," partly because "directors oversee management" rather than being "parsley on the fish." A 1995 New York Times article with the headline A Quiet Board Room Revolution: Power Shifts to Outside Directors implied the same sort of change. Ronald Gilson said in the law review article based on his 1999 Pileggi Lecture that "[d]irectors are now energized." Jay Lorsch, a Harvard Business School professor and author of a 1989 book on boards entitled Pawns or Potentates, suggested in 2001 that during the 1980s directors "were probably more like the pawns. Today they are more like the potentates." Law professors Marcel Kahan and Ed Rock argued the following year that the available evidence indicated outside directors "exert more power in the boardroom than they did previously" and "are not mere lackeys of management." Boardroom failings occurring concurrently at Enron and WorldCom indicated independent boards did not guarantee proper

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48 Id. Irving Olds, chairman of the board of U.S. Steel between 1940 and 1952, has been credited with initially characterizing directors as "parsley." ARTHUR FLEISCHER, JR., GEOFFREY C. HAZARD, JR. & MIRIAM Z. KLIPPER, BOARD GAMES: THE CHANGING SHAPE OF CORPORATE POWER 3 (1988).
50 Gilson, supra note 1, at 513.
52 The Professor: Jay Lorsch, DIRECTORS & BOARDS, Fall 2001, at 18.
governance, but the lapses involved occurred in a context where expectations of boards had grown considerably.

C. Takeovers

While the structure, composition, and operation of boards began changing substantially in the 1970s, for another facet of corporate governance—the market for corporate control—the 1980s were pivotal. During the 1960s, when Henry Manne coined the term "market for corporate control," hostile takeovers taking the form of tender offers were used quite often to secure control of medium-sized public companies. Large firms, in contrast, were rarely targeted. This changed in the 1980s as bidders relied on aggressive, innovative financial and legal techniques to offer generous premiums to shareholders of a wide range of target companies to secure voting control.

Takeover activity fell into abeyance as the 1990s got underway. Merger activity surged later in the decade but the free-wheeling deal-making of the 1980s did not return. Corporations carrying out strategically motivated acquisitions drove the 1990s merger wave rather than "raiders" seeking out targets underperforming due to poor management. Hostile takeovers did continue to occur and the success rate for those launched was much the same as in the 1980s.

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55 For a more skeptical assessment, see Replacing the Board: The Case for Outsourcing Company Boards, ECONOMIST, Aug. 16, 2014, at 56 (arguing that the Enron and WorldCom scandals and alleged failings of bank boards prior to the 2008 financial crisis indicated that boards had changed little over the past hundred years). See Henry G. Manne, Mergers and the Market for Corporate Control, 73 J. POL. ECON. 110 (1965).


57 See id.

58 See id.

60 See John Pound, After Takeovers, Quiet Diplomacy, WALL ST. J., June 8, 1992, at A10.

61 See Cheffins, supra note 57, at xxiii.


Acquisitions of this type were, however, considerably less prevalent\textsuperscript{64} and less controversial than had been the case in the 1980s.\textsuperscript{65}

D. Shareholder Activism

Increased activism by shareholders has been an additional feature of the transformation of corporate governance occurring since the mid 1970s. A dramatic reorientation of stockholding in U.S. public companies set the scene. In the decades immediately following World War II the prospects for shareholder activism were bleak because retail investors, lacking both the appetite and aptitude to intervene in corporate affairs, collectively owned the vast majority of shares.\textsuperscript{66} For instance, Bayless Manning, in a 1958 review of J.A. Livingston's \textit{The American Stockholder},\textsuperscript{67} said Livingston's account of "[a] virtually omnipotent management and impotent shareholdership" would surprise few.\textsuperscript{68}

The outlook for shareholder intervention became more promising when, during the closing decades of the twentieth century, institutional shareholders steadily displaced retail investors as owners of shares in public companies.\textsuperscript{69} With activism, however, progress would be halting.\textsuperscript{70} While Eisenberg identified institutional investors in \textit{The Contestable are U.S. Public Corporations?} 24 J. CORP. L. 837, 855 (1999) (providing annual data on hostile takeovers for 1988-1998).

\textsuperscript{64}See Gregg A. Jarrell, \textit{A Trip Down Memory Lane: Reflections on Section 203 and Subramanian, Herscovici, and Barbetta}, 65 BUS. LAW. 779, 785 (2010) (citing data from Thomson Financial SDC Platinum showing that both the number of hostile bids and the percentage of bids which were hostile were considerably lower between 1990 and 1993 than between 1986 and 1989); Michael Ryngaert & Ralph Scholten, \textit{Have Changing Takeover Defense Rules and Strategies Entrenched Management and Damaged Shareholders? The Case of Defeated Takeover Bids}, 16 J. CORP. FIN. 16, 19 (2010) (reporting that based on a sample of defeated takeover bids, the number of hostile bids was considerably higher per annum in the 1980s than it was in the 1990s); Omesh Kini, William Kricak & Shehzad Mian, \textit{The Nature of Discipline by Corporate Takeovers}, 59 J. FIN. 1511, 1515 tbl.1 (2004) (indicating that for a sample of successful tender offers occurring between 1979 and 1998, the percentage that was hostile was significantly higher in the 1980s than the 1990s); G. William Schwert, \textit{Hostility in Takeovers: In the Eyes of the Beholder}, 55 J. FIN. 2599, 2609, 2611 tbl.3 (2000) (setting out data on the number of hostile takeover bids between 1975 and 1996); Bevis Longstreth, \textit{Reflections on the State of Corporate Governance}, 57 BROOK. L. REV. 113, 114 (1991) (providing statistics on the proportion of bids that were hostile for 1982, 1989, and 1990).

\textsuperscript{65}See Kahan & Rock, supra note 53, at 899.

\textsuperscript{66}See Cheffins, supra note 57, at xix.

\textsuperscript{67}J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER (1958).


\textsuperscript{69}See Cheffins, supra note 57, at xix.

\textsuperscript{70}See, e.g., Stuart Michier, \textit{Weak Force: Shareholder Activism, Despite Hoopla, Leaves Most CEOs Unscathed}, WALL ST. J., MAY 24, 1993, at A1 ("To hear some people tell it, corporate chieftains are on the run. . . . But in contrast to the 1980s takeover binge, which cut
Structure of the Corporation as providing at least some hope of a check on management, citing the growing proportion of shares they owned and "their power and sophistication" to make his point, he conceded that their default setting was "promanagement." While by the early 1990s public pension funds had emerged as vocal advocates of corporate governance reform, the reluctance of other "mainstream" institutional investors—most prominently mutual funds and private pension funds—to take a "hands on" corporate governance role compromised shareholder activism's impact. Over the past decade, though, the support mainstream institutional shareholders have increasingly afforded to "activist" hedge funds specializing in buying up sizeable stakes in target companies and agitating for change has meant that the activist agenda has had an increasingly pronounced influence in the boardroom.

E. Executive Pay

A major overhaul of executive pay is a final noteworthy legacy of the transformation of corporate governance occurring over the past forty or so years. From the late 1930s through to the mid 1970s the pay executives received declined both on an inflation-adjusted basis and relative to other occupations. Linking pay to performance, moreover, was not a priority. As Eisenberg said in 1976 in The Structure of the Corporation, "insofar as monetary rewards are concerned direct compensation is commonly much more significant to managers than through hundreds of companies like a sharp scythe, shareholder activism seems more like a scalpel—and a dull one at that."

71 Eisenberg, supra note 27, at 56-57.
72 See Cheffins, supra note 9, at 54.
73 See Cheffins, supra note 57, at xx.
75 See Wilbur G. Lewellen, Executive Compensation in Large Industrial Corporations 162-74 (1968); Michael J. Dutka, Executive Compensation and Selected Professional Incomes, in CHIEF EXECUTIVE OFFICER COMPENSATION 76, 78, 95-97 (Harold L. Watts ed., 1978); David Kraus, The 'Devaluation' of the American Executive, HARV. BUS. REV., May-June 1976, at 84, 85.
gains in their shareholder capacities, and direct compensation is usually not tied to earnings.\textsuperscript{77}

Matters began changing significantly in the late 1980s and early 1990s. Pressure built on companies to stop paying their executives like "bureaucrats" and to strengthen the link between pay and performance.\textsuperscript{78} Companies responded by using much more equity-based compensation—most prominently stock options—and pay/performance sensitivity increased tenfold for CEOs between 1980 and 1998.\textsuperscript{79} This trend was accompanied by sky-rocketing managerial pay.\textsuperscript{80} The dramatic surge in executive compensation generated sufficient controversy to prompt the SEC in the early 1990s to bolster substantially disclosure requirements\textsuperscript{81} and to persuade Congress in 2010 to provide to shareholders via the Dodd-Frank Act an advisory "say on pay" vote at least once every three years and to require public companies to establish compensation committees staffed by independent directors.\textsuperscript{82}

\textbf{F. Explaining the Transformation}

What prompted the transformation of the corporate governance landscape occurring over the past four decades? Delaware, as we will see, played a significant role. There was, however, much else going on. A couple of factors have already been identified. One was the corporate scandals such as Enron and WorldCom that prompted a federal regulatory response.\textsuperscript{83} Changing patterns of share ownership was another. Institutional investors were not ideal shareholder activists\textsuperscript{84} but were better resourced than the retail investors they progressively replaced. They also became more strongly motivated to take corrective action due to the increased prevalence of share ownership stakes.

\textsuperscript{77}EISENBERG, supra note 27, at 31.
\textsuperscript{78}See Cheffins, supra note 57, at xvii; Michael C. Jensen & Kevin J. Murphy, CEO Incentives—It's Not How Much You Pay, But How, HARV. BUS. REV., May-June 1990, at 138.
\textsuperscript{81}See Cheffins, supra note 57, at xvii-xviii.
\textsuperscript{83}See supra notes 16-17 and related discussion.
\textsuperscript{84}See supra note 73 and related discussion.
sufficiently large to preclude exercising the "Wall Street Rule," which entails selling out promptly when a company is underperforming.\footnote{See Cheffins, supra note 9, at 52; George Melloan, Business World: Big Funds Swing More Weight in Proxy Wars, WALL ST. J., April 18, 1989, at A25; Pat Widder, Corporate Makeovers: Big Business Trends Point to a New Age of Owner-Managers, Chi. TRIB., June 25, 1989, at E1.}

Dramatic changes affecting the manner in which U.S. public companies conducted business also likely contributed to the transformation of corporate governance. As the twentieth century drew to a close, senior executives were in charge of larger companies than their mid-twentieth-century predecessors, measured in terms of revenue, stock market capitalization, and number of employees.\footnote{See Cheffins, supra note 37, at 9-11.} With more at stake for investors, managerial accountability would have moved up the priority list.\footnote{See id. at 11.} Due to deregulation, changes in employment relations, and improved access to finance, executives of the 1980s and 1990s also had greater managerial latitude than their predecessors.\footnote{See id. at 11-14; Neil Fligstein & Tack-Jin Shin, The Shareholder Value Society: A Review of the Changes in Working Conditions and Inequality in the United States, 1976 to 2000, in SOCIAL INEQUALITY 401, 402-03 (Kathryn M. Neckerman ed., 2004); Brian R. Cheffins, Corporate Governance Since the Managerial Capitalism Era, BUS. HIST. REV. (forthcoming) (manuscript at 30-32) [hereinafter Corporate Governance], available at http://ssrn.com/abstract=2618480.} This enhanced discretion could potentially be exercised in a manner prejudicial to shareholders. In this new milieu, enhanced corporate governance could provide a salutary check on public company executives.\footnote{See Cheffins, supra note 37, at 14; Cheffins, Corporate Governance, supra note 88, at 30, 34.}

Despite numerous lapses, such as the high-profile corporate scandals occurring in the early 2000s,\footnote{See supra note 17 and related discussion.} a case can be made that, due to improved corporate governance, standards of managerial accountability in U.S. public companies have now largely caught up with changes to the business environment. Law professor Ed Rock argued, for instance, in a 2013 article that "the central problem of U.S. corporate law for the last eighty years—the separation of ownership and control—has largely been solved."\footnote{Edward B. Rock, Adapting to the New Shareholder-Centric Reality, 161 U. PA. L. REV. 1907, 1909 (2013).} Others are less sanguine. Nell Minow, a persistent advocate of corporate governance reform, argued in the wake of the 2008 financial crisis that the crisis proved that the "need for better corporate governance
has never been more clear or more pressing.\textsuperscript{92} More recently, Carl Icahn, a high-profile activist investor, called for a radical shake-up of governance arrangements:

Too many companies in this country are terribly run and there's no system in place to hold the chief executives and boards of these inadequately managed companies accountable. . . . Our current system of corporate governance protects mediocre chief executives and boards that are mismanaging our companies and this must be changed.\textsuperscript{93}

Corporate governance mechanisms no doubt could be more robust in U.S. public companies.\textsuperscript{94} Nevertheless, there undeniably have been major changes over the past four decades. Moreover, it seems inconceivable the old order will be re-established. Correspondingly, it is an appropriate time to assess Delaware's contribution to the transformation of corporate governance. We will begin by considering why the judiciary, rather than the legislature, is the appropriate focal point with such an inquiry, but will also identify institutional limitations likely to compromise the courts' impact on corporate governance trends.

III. DELAWARE'S CORPORATE GOVERNANCE "PLAYERS"

It is not surprising that various observers have suggested Delaware has had a substantial influence on corporate governance trends.\textsuperscript{95} Approximately 60\% of all U.S. public companies are incorporated under Delaware corporate law, including 80\% of public companies that incorporate outside their headquarters state.\textsuperscript{96} Moreover, Delaware has for many decades provided a de facto "national" U.S. corporate law court

\textsuperscript{92}Corporate Constitutions, ECONOMIST, Oct. 30, 2010 [hereinafter Corporate Constitutions], at 84 (quoting Nell Minnow).


\textsuperscript{94}It is unclear how beneficial more robust corporate governance would in fact be. See, e.g., Corporate Constitutions, supra note 92, at 84 ("[O]ne should not expect too much from corporate governance. Good corporate governance on its own will not protect companies from taking excessive risks.").

\textsuperscript{95}See supra notes 10-14 and related discussion.

\textsuperscript{96}Lucian Ayre Bebchuk & Assaf Hamdani, Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters, 112 YALE L.J. 553, 567 tbl.2, 578 tbl.5 (2002).
system, with judges in other states often citing and following Delaware jurisprudence. When, however, the nature of Delaware's key corporate governance "players"—the legislature and the courts—are borne in mind it quickly becomes evident that expectations concerning Delaware's impact on corporate governance need to be kept in check.98

A. Delaware General Assembly

As law professor Lawrence Hamermesh has observed the DGCL is "[a]t the formal apex of the structure of Delaware corporate law."99 It might seem to follow that the Delaware General Assembly, comprised of the Delaware Senate and House of Representatives,100 would be the lead player in Delaware's contribution to the development of corporate governance. This, however, would be an incorrect inference to draw. The last major revision of the DGCL occurred in 1967,101 which was before corporate governance had become the subject of meaningful debate.102 In the years since the statute has been modified only incrementally.103 The basic organization and content has remained unchanged,104 even in the wake of the Enron and WorldCom scandals that prompted a swift legislative response from the federal government in the form of SOX.105 Correspondingly, the Delaware legislature was

100DEL. CONST. art. II, § 1.
102See Cheffins, supra note 9, at 2-3 and related discussion.
103See, e.g., William J. Carney & George B. Shepherd, The Mystery of Delaware's Continuing Success, 2009 U. ILL. L. REV. 1, 62 ("[C]hanges to the DGCL between 1992 and 2005 were] quite modest and [did not lead] to radical changes in corporate practice.").
104Hamermesh, supra note 99, at 1752.
destined to be little more than a bit player as corporate governance developed over the past forty years.

The DGCL has not been entirely irrelevant in the corporate governance context. However, even with potentially relevant amendments, with respect to promoting more robust corporate governance they have had a mixed effect. 2009 amendments to §§ 112 and 113 of the DGCL that authorized Delaware corporations to adopt bylaws making it easier for a shareholder to rely on the corporation's proxy machinery to secure election of a dissident slate of directors were congruent with a governance agenda oriented around bolstering director accountability and enhancing shareholder rights. On the other hand, the 1986 enactment of § 102(b)(7), which authorizes Delaware corporations to include a provision in their certificates of incorporation that limits or eliminates for directors personal liability arising from breaches of the duty of care, cut against the standard corporate governance agenda because inattentive directors were less likely to face adverse personal consequences. Likewise, Delaware's principal legislative response to the takeover boom of the 1980s—the 1988 antitakeover statute codified in § 203 of the DGCL that encumbered the ability of a successful takeover bidder to cash out shareholders who did not accept the bidder's tender offer—was criticized on the basis that it would compromise a market for corporate control that enhanced managerial accountability.

The Delaware legislature in fact always was an unlikely candidate to transform corporate governance. A 1981 article by law professor George Dent foreshadowed this. Dent maintained that "[t]he theory of corporate governance underwent a revolution in the 1970s" because of wide acceptance of the proposition that boards of directors should be made up largely of outside directors who would not seek to manage the corporation but instead would monitor management's performance. He acknowledged the theoretical possibility that market forces could

109 See Kahan & Rock, supra note 53, at 894.
110 See Subramanian, Herscovici & Barbetta, Delaware's Antitakeover Statute, supra note 24, at 698 (discussing opposition to enactment of the provision); Jarrell, supra note 64, at 782 (explaining why the author opposed Delaware's adoption of § 203 in hearings preceding its enactment).
112 Id. at 623.
prompt widespread adoption of this monitoring model of the board but maintained that legal reform would be required for it to reach its full potential.\textsuperscript{113} He said, though, that it was highly improbable that the shift would occur because of amendments to state corporate law because that would entail a departure from a persistent trend among state legislatures to refrain from using corporate legislation to impinge on managerial prerogatives by imposing mandatory governance requirements.\textsuperscript{114}

Dent identified "the race to the bottom" phenomenon, which he characterized as "[an] alleged attempt by many states to reduce regulations in order to attract corporations to incorporate there," as a factor that plausibly contributed to a reticence on the part of the states to regulate by way of corporate law statutes.\textsuperscript{115} He noted that the reluctance of states to use corporate law to impose affirmative requirements on management could also be attributed to a belief that affording corporations wide flexibility under corporate legislation was sound public policy.\textsuperscript{116} Whatever the underlying motivation, there could be little doubt that the Delaware legislature subscribed to the managerially-deferential regulatory philosophy Dent cited. Ernest Folk, who was closely involved with the enactment of the 1967 version of the DGCL, said in 1968 of Delaware's approach, "[w]e do not seek to protect shareholders or creditors or others; rather we limit their rights and remedies. We constantly enlarge the rights and freedom of management."\textsuperscript{117} Or as Brett McDonnell observed in 2007, "Delaware legislators . . . will be particularly attentive to managerial interests."\textsuperscript{118} Given this pro-managerial orientation, the Delaware legislature was unlikely to amend the DGCL to impose substantial affirmative governance obligations on directors and officers governed by the statute.

Drafting style was another aspect of Delaware's statutory philosophy that made it unlikely that amendments to the DGCL would make a substantial contribution to the development of corporate governance.\textsuperscript{119} See id. at 638.\textsuperscript{120} See id. at 642.\textsuperscript{121} Dent, supra note 111, at 642 & n.111 (citing William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 YALE L.J. 663, 666 (1974) (coining the phrase "race to the bottom").\textsuperscript{122} Id. at 643.\textsuperscript{123} Ernest L. Folk, III, Some Reflections of a Corporation Law Draftsman, 42 CONN. B.J. 409, 415 (1968); see also Comment, Law for Sale: A Study of the Delaware Corporation Law of 1967, 117 U. PA. L. REV. 861, 865-68 (1969) (discussing Folk's role in the lawmaking process).\textsuperscript{124} Brett H. McDonnell, Recent Skirmishes in the Battle over Corporate Voting and Governance, 2 J. BUS. & TECH. L. 349, 352 (2007).
governance. On this count, a statutory dichotomy Leo E. Strine, Jr., then Vice Chancellor, now Chief Justice of the Delaware Supreme Court, developed in a 2001 law review article is instructive. He said there were two paradigmatic models for corporate law statutes, with one being a "Mandatory Statutory Model" which was "quite detailed and prescriptive" that "would limit choices and require certain procedures" and "dictate how things should happen." Legislative provisions prescribing governance arrangements plausibly could be accommodated quite readily under this model.

Chief Justice Strine's other paradigmatic model was the "Delaware Model," oriented around a statute that "provides corporate boards with a substantial amount of leeway to govern their corporations as they see fit," and to that end is "largely enabling and provides a wide realm for private ordering." The bias against prescriptive measures means this model would be much less amenable to the imposition of governance standards than the Mandatory Statutory Model. Chief Justice Strine's "Delaware Model" nomenclature leaves no doubt about where he thought the DCGL fits in. If there was any doubt, observations by other distinguished observers make the point clear. According to William Allen, Chancellor of the Delaware Court of Chancery from 1985 to 1997, "[t]he Delaware law proudly proclaims itself to be an enabling statute." Or as Professor Hamermesh said in offering in 2006 a self-proclaimed Delaware native's articulation of the policy foundations of Delaware corporate law, "[t]here has been a strong tendency in Delaware corporate policymaking to broaden . . . room for private ordering." It follows that due either to a potential pro-managerial bias or a disinclination to be detailed and prescriptive, there was little reason to expect the Delaware legislature to make statutory reforms that would transform corporate governance as the 20th century drew to a close. So it proved.

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120 See id.
121 See id.
122 See id.
124 Hamermesh, supra note 99, at 1750-51, 1783; see also Sean J. Griffith & Myron T. Steele, On Corporate Law Federalism: Threatening the Thaumatrope, 61 BUS. LAW. 1, 8-9 (2005) ("The [Delaware and model act] approach to regulating corporate governance . . . is to enact an enabling statute with very few mandatory terms, thus preserving the largest possible space for private ordering.").
125 See Hamermesh, supra note 99, at 1783.
B. The Courts

The fact that the Delaware legislature was an unlikely candidate to help to foster the corporate governance transformation U.S. public companies experienced from the mid 1970s onwards did not foreclose the possibility of a notable Delaware contribution. Instead, as we will see now, in various ways Delaware courts were well positioned to play a significant role. In particular, the division of labor between Delaware's legislature and its courts, a willingness on the part of the Delaware judiciary to impinge on managerial prerogatives in at least some circumstances, and a growing public profile of Delaware judges set the stage nicely for Delaware's courts. Still, expectations concerning the impact of Delaware's courts on corporate governance have to be tempered due to constraints judges face as standard-setters in the legal realm.

1. The Division of Labor Between the Legislature and the Courts

Under what Chief Justice Strine calls the "Delaware Model" of corporate law, boards have "a substantial amount of leeway to govern their corporations as they see fit." Still, the discretion is judicially circumscribed. As Chief Justice Strine said when describing the model, "[a]side from the corporate electoral process mandated by the Delaware statute, the ultimate protection provided to investors by Delaware law is the guarantee that its courts will hold directors responsible for living up to their fundamental fiduciary duties of care and loyalty." The scope that Delaware courts have to define and apply directorial duties in turn creates scope for the judiciary to contribute significantly to the development of corporate governance arrangements in public companies. As Robert Thompson has observed, "[f]iduciary duty is the principal means by which the Delaware judiciary decides questions of corporate governance."

Even though the DGCL is theoretically the apex of Delaware corporate law, it would not be anomalous in any way for Delaware courts to play a greater role in shaping corporate governance than the Delaware legislature. According to Marcel Kahan and Ed Rock, "[t]he most noteworthy trait of Delaware's corporate law is the extent to which

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126 Strine, supra note 119, at 1260.
127 Id.
important and controversial legal rules are promulgated by the judiciary, rather than enacted by the legislature."\textsuperscript{129} This is an arrangement to which the Delaware legislature assents. As Professor Hamermesh has said of Delaware, "the legislative preference for flexibility and private ordering is ultimately dependent on what we believe to be a well-founded view that the courts will police overly opportunistic behavior on the part of those in control."\textsuperscript{130} Judicial dominance in setting corporate governance standards follows in turn. As Myron Steele, a former Chief Justice of the Delaware Supreme Court, said in a 2005 article co-written with Sean Griffith, "[s]tate 'regulation' of corporate governance is a function performed primarily by judges, and the judiciary's basic tool for regulatory intervention is the background principle of fiduciary duty."\textsuperscript{131}

The treatment of independent directors under Delaware law illustrates the division of labor. While independent directors are a crucial element of corporate governance,\textsuperscript{132} the DGCL does not refer once to them.\textsuperscript{133} Hence, to the extent that Delaware law has shaped the role of independent directors, it has been due to judicial action.\textsuperscript{134} Consider, for instance, the formulation of the definition of directorial independence under Delaware law. The process has been left to the courts, which have used a contextual approach to define independence rather than adopting "bright line,"\textit{ex ante} standards such as the presence or absence of a material relationship with the company.\textsuperscript{135} Chief Justice Strine, writing as Vice-Chancellor of the Chancery Court, explained why in a 2003 case, saying:

\begin{quote}
Even the best minds have yet to devise across-the-board definitions that capture all of the circumstances in which the independence of directors might reasonably be questioned. By taking into account all circumstances, the Delaware approach undoubtedly results in some level of indeterminacy, but with the compensating benefit that
\end{quote}

\textsuperscript{129}Kahan & Rock, supra note 98, at 1591.
\textsuperscript{130}Hamermesh, supra note 99, at 1784; see also Veasey & Di Guglielmo, supra note 13, at 1413 ("T]here is no discernible movement in Delaware to develop a codified model [of governance].").
\textsuperscript{131}Griffith & Steele, supra note 124, at 9.
\textsuperscript{132}See supra note 38 and related discussion.
\textsuperscript{133}Rodrigues, supra note 40, at 465 (indicating that the DCGL refers only to the narrower concept of "interested directors").
independence determinations are tailored to the precise situation at issue.\textsuperscript{136}

2. A Willingness to Intervene

While the division of labor between the legislature and the courts meant that under Chief Justice Strine's Delaware Model Delaware's judges were more likely than its legislators to contribute to the development of corporate governance, it could not be taken for granted that the Delaware judiciary would capitalize on the opportunity. Theoretically, a pro-managerial orientation could have imposed a substantial check on the judiciary's contribution to the promotion of more robust corporate governance, in that Delaware judges might have been reluctant to issue rulings that would impinge upon managerial prerogatives. The possibility of bias of this sort was topical in the mid 1970s just as corporate governance was beginning to be part of the corporate lexicon.

William Cary famously argued in a 1974 \textit{Yale Law Journal} article that Delaware was prevailing in a counter-productive corporate "race for the bottom."\textsuperscript{37} In so doing, he claimed Delaware's judges were part of a "tight little club" implementing the "public policy" of Delaware to create a "favorable climate' for management" by watering "the rights of shareholders vis-à-vis management down to a thin gruel."\textsuperscript{38} Cary drew attention to various cases to substantiate his argument,\textsuperscript{39} including \textit{Graham v. Allis-Chalmers Manufacturing Company}.\textsuperscript{40} Cary said of this 1963 case, where the directors of a company embroiled in a price-fixing scandal were found not to have breached their duty of care, that "a state less hospitable than Delaware might have imposed upon directors the duty of installing an internal control system to prevent repeated antitrust violations."\textsuperscript{141} To the extent Cary's indictment of Delaware jurisprudence was correct, the state's judges were unlikely candidates to

\textsuperscript{136} \textit{In re Oracle Corp. Derivative Litig.}, 824 A.2d 917, 941 (Del. Ch. 2003); see also Donald C. Clarke, \textit{Three Concepts of the Independent Director}, 32 DEL. J. CORP. L. 73, 105 (2007) (saying the Delaware judiciary had, on various occasions, stressed the advantages of a case-by-case analysis on the issue).

\textsuperscript{137} Cary, \textit{supra} note 115, at 666.

\textsuperscript{138} \textit{Id.} at 666, 670, 692.

\textsuperscript{139} \textit{Id.} at 672-84.

\textsuperscript{140} 182 A.2d 328 (Del. Ch. 1962), aff'd, 188 A.2d 125 (Del. 1963).

\textsuperscript{141} Cary, \textit{supra} note 115, at 684.
issue rulings imposing the sort of constraints on directors and senior officers that would reshape corporate governance.\textsuperscript{142}

Cary's criticism of Delaware judges was strongly contested at the time he made it.\textsuperscript{143} Even if it is true that various Delaware cases of the 1950s,\textsuperscript{144} 1960s,\textsuperscript{145} and early 1970s\textsuperscript{146} Cary cited betrayed, in his words, a tendency to "adhere to minimal standards of director responsibility,"\textsuperscript{147} any such predisposition seemingly had largely dissipated as corporate governance came onto the agenda in the late 1970s and 1980s. Sidney Silverman, a New York lawyer, referred to three 1977 Delaware decisions as widely acknowledged "high water marks of enlightened judicial treatment on the subject of corporate governance.\textsuperscript{148}" Law professor Daniel Fischel argued in 1982 that Delaware courts were taking "a far more activist role in regulating corporate internal affairs.\textsuperscript{149}" He cited cases such as \textit{Singer v. Magnavox Company}\textsuperscript{150} and \textit{Zapata Corporation v. Maldonado}\textsuperscript{151} as evidence that Delaware courts had "gone a long way toward limiting the discretion of managers and controlling shareholders while increasing the power of minority shareholders."\textsuperscript{152} Forbes, citing these same two cases, was prompted to ask why "have so many decisions in the Delaware Supreme Court been going against corporations recently?\textsuperscript{153}

Fischel suggested that the change in approach was a counter-reaction by Delaware courts to the judicial bias charges Cary and similar critics levied.\textsuperscript{154} Jack Coffee, in a 1987 article, concurred.\textsuperscript{155} While he

\begin{itemize}
  \item \textsuperscript{142}See \textit{id. at 672} (proposing that based on an analysis of Delaware case law, the judiciary is unlikely to disturb the low standards imposed on boards).
  \item \textsuperscript{143}See, e.g., S. Samuel Arsh, \textit{Reply to Professor Cary}, 31 \textit{BUS. LAW.} 1113 (1976).
  \item \textsuperscript{144}E.g., Am. Hardware Corp. v. Savage Arms Corp., 136 A.2d 690, 693-94 (Del. 1957) (discussed by Cary, \textit{supra} note 115, at 675-77).
  \item \textsuperscript{145}E.g., Cheff v. Mathes, 199 A.2d 548, 553, 556 (Del. 1964) (discussed by Cary, \textit{supra} note 115, at 673-75); Hariton v. Avo Elecs., Inc., 188 A.2d 123, 125 (Del. 1963) (discussed by Cary, \textit{supra} note 115, at 679).
  \item \textsuperscript{146}E.g., Sinclair Oil Corp. v. Leven, 280 A.2d 717, 720 (Del. 1971) (discussed by Cary, \textit{supra} note 115, at 680); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 884 (Del. 1970) (discussed by Cary, \textit{supra} note 115, at 681-82).
  \item \textsuperscript{147}Cary, \textit{supra} note 115, at 672.
  \item \textsuperscript{148}Sidney B. Silverman, \textit{An Outsider Looks at Chancery}, \textit{DEL. LAW.}, Spring 1984, at 50, 51. He did not identify the cases.
  \item \textsuperscript{149}Daniel R. Fischel, \textit{The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law}, 76 \textit{NW. U. L. REV.} 913, 944 (1982).
  \item \textsuperscript{150}380 A.2d 969 (Del. 1977).
  \item \textsuperscript{151}430 A.2d 779 (Del. 1981).
  \item \textsuperscript{152}Fischel, \textit{supra} note 149, at 923; see also id. at 914 ("[T]he Delaware Supreme Court has strengthened considerably the power of minority shareholders vis-à-vis management.").
  \item \textsuperscript{153}Anthony Baldo, \textit{Delaware Rocks the Boat}, \textit{FORBES}, Apr. 8, 1985, at 126.
  \item \textsuperscript{154}See Fischel, \textit{supra} note 149, at 923.
  \item \textsuperscript{155}John C. Coffee, Jr., \textit{The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards}, 8 \textit{CARDOZO L. REV.} 759, 765
\end{itemize}
stressed that Delaware judges were unlikely to have been materially biased prior to Cary's 1974 article, he suggested Cary's claims "may well have made Delaware judges more sensitive, at least for a time, to issues of fairness." 156 Regardless of the precise reason for whatever change of heart Delaware judges underwent, 157 the reticence they might have formerly had to intervene in corporate affairs or impinge on managerial prerogatives would not preclude Delaware courts from issuing decisions that would help to foster the transformation of corporate governance that began in the mid 1970s.

3. Delaware Courts Move into the Limelight

A growing public profile was an additional factor that bolstered the Delaware judiciary's contribution to the development of corporate governance. As debates about corporate governance gathered pace in the late 1970s and early 1980s, it was well known that Delaware courts had a nationwide impact on the development of corporate law. 158 Nevertheless, Delaware judges were not in the limelight in the way they would be soon. A 1984 Wall Street Journal article on the Delaware Court of Chancery labelled the court as "sedate" and "militantly informal, and small." 159 The Baltimore Sun referred to the Chancery Court in 1985 as "unassuming," noting that its courtrooms were "two smallish rooms furnished from the 1950s," "tucked away behind City

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156 Coffec, supra note 155, at 765.
157 Ralph Ferrara and Marc Steinberg attributed the change of heart to awareness on the part of Delaware judges that they should take on an increasingly protective role because a 1977 decision of the U.S. Supreme Court, Santa Fe Industries v. Green, 430 U.S. 462, meant that the likelihood of federal regulation in the area of managerial malfeasance had been reduced. Ralph C. Ferrara & Marc I. Steinberg, A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism, 129 U. PA. L. REV. 263, 277-78 (1980).
158 See, e.g., Donald E. Schwartz, The Delaware Chancery Court: A National Court of Corporate Law, DEL. LAW., Spring 1984, at 54, 54.
159 Mary Williams, Delaware's Sedate Chancery Court Is a Major Corporate Battleground, WALL ST. J., May 10, 1984, at 33.
The New York Times said of the same court in 1986 that it was "little-known".161

While a "little-known" court might be poorly positioned to have a substantial influence on the development of corporate governance, the Delaware judiciary's circumstances were changing fast. The Baltimore Sun quoted in its 1985 article a lawyer who had quit practice to set up a newsletter on Delaware court developments as saying, "[i]t's incredible, the interest developing in these courts."162 The New York Times noted similarly in its 1986 article:

The clout wielded by the Delaware courts has never been more visible than over the 18 months, when the justices handed down rulings that in some cases made takeovers more difficult to carry out and in others imposed more responsibilities—and potential financial liability—on directors.163

Delaware courts continued to garner media attention thereafter. Cases associated with newsworthy, high-profile transactions were particularly likely to receive media coverage.164 Newsweek noted in 1989 that while given Delaware's size the Court of Chancery was "the unlikely focus of a major takeover fight," its "five judges have become the arbiters of corporate warfare, deciding the fate of megacompanies and the movement of billions of dollars."165 Decisions from Delaware generated headlines in national newspapers in the late 1980s such as "Ruling Seen Curtailing 'Poison Pills'"166 and "Ruling Gives Managers Another Ace in the Hole."167

Media coverage of key Delaware decisions attracted considerable attention. As a transactional lawyer said in a 1997 article by Ed Rock on

the emergence of corporate norms, "[w]e're not afraid of what the Delaware courts say. We're afraid of what the press says."\textsuperscript{168} The publicity afforded to Delaware judgments would soon extend to Delaware judges. For instance, Delaware Supreme Court Justice Andrew Moore was quoted at length in a \textit{Chicago Tribune} story prior to a much-publicized July 1989 Delaware court hearing concerning a hostile bid by Paramount for Time Inc.\textsuperscript{169} He took the opportunity to argue that in the wake of \textit{Smith v. Van Gorkom}, a 1985 Delaware Supreme Court case where outside directors were held personally liable for failing to exercise due care in relation to a takeover bid,\textsuperscript{170} the world for directors changed. According to Moore, "[t]he director who believes his role is to come to the meeting once a month and never challenge (management) or ask the hard questions, those directors are going to end up with a problem."\textsuperscript{171} The Time/Paramount litigation also provided the platform for extensive profiles of Chancellor Allen in the \textit{New York Times} and the \textit{Washington Post}.\textsuperscript{172} The \textit{New York Times} subsequently referred to Allen when he retired as Chancellor in 1997 as "a giant figure in corporate law."\textsuperscript{173}

Delaware judges raised their public profile still further through extra-judicial outreach. Allen kicked the process off by publishing a number of law review articles on corporate law during his time as Chancellor.\textsuperscript{174} Ed Rock, in his 1997 article on corporate norms, characterized one such article as a "relatively explicit attempt—delivered from the podium rather than the bench—to induce better behavior by managers."\textsuperscript{175} Norman Veasey, for his part, wrote about corporate governance on various occasions during his 1992 to 2004 tenure as Chief Justice of the Delaware Supreme Court.\textsuperscript{176} By the mid 2000s, Delaware

\textsuperscript{166}Rock, supra note 164, at 1068.
\textsuperscript{169}488 A.2d 858 (1985).
\textsuperscript{171}Widder, supra note 169.
\textsuperscript{175}Rock, supra note 164, at 1070 (discussing William T. Allen, \textit{Independent Directors in MBO Transactions: Are They Fact or Fantasy?}, 45 BUS. LAW. 2055 (1990)).
\textsuperscript{176}See generally E. Norman Veasey, \textit{Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—Or Vice Versa?}, 149 U. PA. L. REV. 2179 (2001); E.
judges were collectively renowned as prolific authors on corporate law matters and as speakers and participants in conferences for academics and practitioners.\textsuperscript{177}

4. Institutional Constraints

Though a willingness to intervene and an increasingly public profile meant that in certain respects Delaware's judiciary was well situated to have an impact on corporate governance, various generic features of courts that disadvantaged them as standard-setters were also relevant.\textsuperscript{178} For instance, while a legislative body has substantial scope to set its own agenda judges can only act after litigants have commenced court proceedings. Also, while a statute promulgated by a legislative body can readily be given a broad regulatory ambit, judicial orders technically only bind litigants. In addition, while a legislature can at least theoretically open up a whole field of endeavor for re-examination, sweep away existing legal doctrines and introduce a thoroughgoing, coherent revision of the law, for judges constraints of doctrine and precedent can impede major change.

In the case of Delaware's judiciary, various factors ameliorate at least partially the institutional constraints courts face as standard-setters. First, even though judges normally only get to issue rulings of lasting import when parties commence lawsuits, state and federal courts have had since 1984 the right to certify questions of Delaware law to the Delaware Supreme Court and the Securities and Exchange Commission has had the same option available to it since 2007.\textsuperscript{179} Second, corporate law cases involving publicly traded companies—the sort of litigation most likely to have a bearing on corporate governance—are filed often in Delaware courts. Robert Thompson and Randall Thomas examined all complaints filed in the Delaware Court of Chancery in 1999 and 2000 and found 640 were filed per year that dealt with corporate matters.\textsuperscript{180}

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\textsuperscript{177}Kahan & Rock, supra note 98, at 1603-04; Hamermesh, supra note 99, at 1759-60.

\textsuperscript{178}On these features of courts, see CHEFFINS, supra note 38, at 191; David L. Shapiro, Courts, Legislatures, and Paternalism, 74 VA. L. REV. 519, 551-53 (1988).


The vast majority of these involved publicly traded corporations, the type of companies for which corporate governance is primarily relevant.

Third, while formally rulings by a court only bind the litigants, the Delaware judiciary often has a broader audience in mind when they craft their judgments. Delaware judges, mindful of the state's pre-eminent status in the corporate law realm, treat offering guidance on appropriate directorial and managerial conduct as part of their job description. Hence, when they hear corporate law cases they will typically be more willing than other judges to go beyond the confines of the matter at hand when giving reasons for judgment so as to articulate norms applicable to boards and executives. The Delaware judiciary's enthusiasm for offering extracurricular commentary on corporate law topics provides additional opportunities to express views on matters litigants have not specifically raised.

Fourth and finally, legal doctrine and case law precedent likely do less to tie the hands of the Delaware judiciary dealing with corporate-oriented litigation than is the judicial norm. Given that corporate law cases brought in Delaware are often characterized by a high degree of fact specificity and given that many such cases will be governed by broadly cast fiduciary duty principles, Delaware judges often have as a practical matter substantial scope to be innovative. For instance, with cases that William Cary cited to substantiate his claim that Delaware judges were biased in favor of management many were no longer good law twenty years after he published his article. Likewise, Marcel Kahan and Ed Rock have said doctrines Delaware courts have developed to complement core fiduciary duties "show the great comfort on the part of Delaware's judiciary . . . for having the courts expand the scope of judge-made law to address novel problems, rather than waiting for the legislature to act."

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181Thompson and Thomas do not state specifically what percentage of the claims filed involved public companies but they report most of the claims filed alleged breaches of fiduciary duty and more than 90% of these claims related to publicly traded companies. Id.
182Brian R. Cheffins, Teaching Corporate Governance, 19 LEGAL STUD. 515, 517 (1999).
183See Rodrigues, supra note 40, at 488.
184Strine, supra note 119, at 1280; Kahan & Rock, supra note 98, at 1599; Rock, supra note 164, at 1016.
185See supra notes 174-77 and accompanying text.
186Griffith & Steele, supra note 124, at 11.
188Kahan & Rock, supra note 98, at 1594.
While the institutional constraints affecting courts may not be as binding for Delaware courts as they are for other judges, they still operate, and do so in a way that means the scope Delaware judges have to engage in standard setting has distinct limits. Consider, for instance, control of the agenda, or lack thereof. A 2001 article in Fortune discussing the question whether shareholders could unilaterally pass a bylaw despite opposition from the board said the matter was open at that juncture because of the lack of a decision on point "from the big kahuna of American corporate law, Delaware's five-judge Court of Chancery," explaining "you can't have a decision without a case, and the court hasn't received one."\textsuperscript{89} Delaware judges, not surprisingly, are fully aware of the situation. Chancellor Allen and Chief Justice Strine, writing in 2002 with Jack Jacobs, then a Vice Chancellor of the Delaware Court of Chancery, acknowledged that "[t]he case-by-case mode of decisionmaking [sic] forces judges to answer only the questions posed to them by the parties, within the limited context of a record that the parties themselves create."\textsuperscript{190}

Moreover, while a large number of corporate law-related complaints are filed annually in Delaware the opportunities Delaware courts have to issue opinions that could potentially influence corporate governance remain limited. The available evidence suggests complaints filed are highly skewed in favor of one type of case, these being class actions challenging actions directors took in relation to acquisitions.\textsuperscript{191} This filing bias limits the areas of corporate governance where pronouncements of Delaware judges can have an impact.

Opportunities for Delaware judges to resolve cases are also not as numerous as the aggregate filings data implies. It is commonplace for multiple filings to occur in relation to the same impugned transaction and the consolidation that typically results reduces considerably the number of instances where a Delaware court will be called on to adjudicate.\textsuperscript{192} Furthermore, a decision can only have an impact on corporate governance if "users" of Delaware law become aware of it, and on only a minority of occasions where a Delaware court makes a corporate law


\textsuperscript{91}See Thompson & Thomas, supra note 180, at 168.

\textsuperscript{92}See id. at 168, 169 tbl.2 (indicating that of the 1,048 complaints filed in their dataset involving claims of breach of fiduciary duty, as a result of consolidation there were 348 "lead complaints").
ruling will an opinion be crafted for distribution on the Delaware Court of Chancery website and on Lexis and Westlaw.\textsuperscript{193} Cases where directors of a Delaware public company are named as defendants are perhaps the most likely to have corporate governance ramifications and in a typical year there are unlikely to be more than twenty Delaware court decisions of this type reported on Lexis or Westlaw.\textsuperscript{194}

Constraints of doctrine and precedent remain salient as well for Delaware judges. They indeed may have greater scope to maneuver than other judges. Nevertheless, they shy away from identifying rulings issued as marking a dramatic shift in approach and instead commonly explain their decisions in terms of existing case law.\textsuperscript{195} Correspondingly, development of Delaware's decisional corporate law tends to be incremental in nature.\textsuperscript{196} This is no accident. Chancellor Allen explicitly acknowledged in a 1995 article that "judges are not agents of change."\textsuperscript{197} He, together with then-Vice Chancellors Jacobs and Strine, elaborated in their 2002 article, saying that "[m]ost judges worry about the legitimacy of their policymaking authority."\textsuperscript{198} Correspondingly, "[r]eticence to express an adjudicative decision as a policy choice comes naturally with the acceptance of the judicial role."\textsuperscript{199}

Given the constraints of doctrine and precedent, Delaware judges are not surprisingly reluctant to acknowledge explicitly the role they can potentially play as promoters of good corporate governance.\textsuperscript{200} Even when they do concede they make a contribution, they avoid hyperbole. For instance, Chancellor Allen, interviewed for a 2001 issue of Directors & Boards focusing on major players in the transformation of corporate governance occurring in the United States over the previous quarter

\textsuperscript{193}See Armour, Black & Cheffins, supra note 97, at 1355.

\textsuperscript{194}See id. at 1354 fig.1 (providing annual data on the number of lawsuits involving Delaware public companies decided by Delaware courts where directors were named defendants in a lawsuit arising under corporate law and an opinion was disseminated on Westlaw, Lexis, or the Delaware Court of Chancery website).

\textsuperscript{195}See Nadelle Grossman, Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform, 12 FORDHAM J. CORP. & FIN. L. 393, 429 (2007); Roy Harris, Delaware Rules, CFO MAGAZINE, Aug. 2006, at 54, 57; see also Veasey & Di Guglielmo, supra note 13, at 1415 ("[T]he courts have at least seven key obligations [including the] render[ing of] decisions that are stable in the overall continuum . . . .").


\textsuperscript{198}Allen, Jacobs & Strinc, supra note 190, at 1070.

\textsuperscript{199}Id.

century, acknowledged that he had "played some role in bringing to people's attention what they ought to do," but said that he "was way down on the list of forces acting on directors to get them to know what their duty was."\textsuperscript{201} This does not mean, as we will see in the remainder of this Article, that Delaware judges have been merely peripheral to the development of corporate governance. Nevertheless, institutional features of courts must be borne in mind when formulating expectations concerning their contribution.

IV. THE BOARD OF DIRECTORS

Corporate governance's emergence as a significant topic in the 1970s and 1980s was accompanied by major changes to the composition, structure, and functioning of boards in public companies.\textsuperscript{202} Delaware court decisions did not set this process in motion. In the 1980s and 1990s, however, rulings by Delaware judges indicating that decisions made by independent directors would be subjected to less intense scrutiny than otherwise would be the case consolidated the position of such directors and committees staffed by them.\textsuperscript{203} As Marcel Kahan and Ed Rock said in 2005, rather than using "the stick of mandated requirements, Delaware law use[d] the carrot of granting greater legal protections to properly constituted boards."\textsuperscript{204} Judgments handed down by Delaware courts also provided guidance to directors of public companies by drawing attention to practices well-functioning boards would be prudent to adopt. We will now consider in turn these contributions to corporate governance, focusing initially on decisions that had an impact on the structure and composition of boards.

A. Structure and Composition

1. General Trends

During the 1970s the proportion of board seats of publicly traded companies "insiders" (typically executives) held fell considerably.\textsuperscript{205} As

\textsuperscript{201}William Allen, The Judge, DIRECTORS & BOARDS, Fall 2001, at 42, 43.
\textsuperscript{202}See supra Part II.B.
\textsuperscript{204}Kahan & Rock, supra note 98, at 1608.
\textsuperscript{205}See Gordon, supra note 26, at 1473 n.9 (citing data indicating that the proportion of inside directors fell from 41% in 1970 to 33% in 1980); Barry D. Baysinger & Henry N. Butler, Revolution Versus Evolution in Corporate Law: The ALI's Project and the Independent
the end of the decade approached, most public companies had in place an audit committee and a compensation committee staffed primarily if not exclusively by outside directors.206 A substantial minority of such firms also had nomination committees despite such committees being rare as late as the 1960s.207

These trends reflected an emerging consensus about the desirability of oversight by outside directors and of a board environment offering ample scope for disinterested decision making.208 The New York Stock Exchange, which had since 1956 obliged listed companies to have at least two independent directors, amended its listing rules in 1977 to require all listed companies to have an audit committee comprised of such directors.209 Also, the Business Roundtable, a group established in 1974 to represent the views of 180 CEOs of major corporations, issued in 1978 a statement on "[t]he Role and Composition of Directors of the Large Publicly Owned Corporation" that indicated boards of public companies should typically be composed of a majority of non-management directors and should establish audit, compensation, and nomination committees dominated by outside directors.210

The increased emphasis on independent monitoring in the board context generated skepticism in some quarters. The doubters suggested "efforts to revive the board of directors [were] simply anachronistic,"211 characterized proposals to bolster the role of independent directors as akin to illusory "Potemkin village"-style reform,212 and referred to "the independent director movement" as "silly stuff."213 Nevertheless, various

Director, 52 GEO. WASH. L. REV. 557, 571 tbl.1 (1984) (indicating that the "executive component" of boards of public companies fell from approximately 65% in 1970 to approximately 54% in 1980); Marshall L. Small, The Evolving Role of the Director in Corporate Governance, 30 HASTINGS. L.J. 1353, 1356 (1979) (reporting that the number of industrial companies with a board composed of a majority of outside directors increased from 63% in 1967 to 83% in 1977).

206See William C. Greenough & Peter C. Clapman, The Role of Independent Directors in Corporate Governance, 56 NOTRE DAME L. REV. 916, 921 (1981) (discussing audit committees); Small, supra note 205, at 1358 (describing the increasing use of audit committees and compensation committees).

207See Small, supra note 205, at 1358.

208See id. at 1357, 1360.

209See Thompson, supra note 128, at 794-96.


rulings by Delaware courts would soon make it clear that, as Chief Justice Strine said in 2002, "the independent director carrie[d] much water in American corporation law." The Delaware courts thereby helped to solidify independent directors and board committees comprised of such individuals as core elements of the U.S. system of corporate governance.

2. Board Committees

In 1981, the Delaware courts provided their initial boost for committees composed of independent directors by approving the use of such committees for terminating derivative litigation stockholders might bring. In Zapata v. Maldonado the Delaware Supreme Court followed the lead Auerbach v. Bennett, a 1979 New York decision, had set and ruled that a court would be strongly inclined to dismiss a derivative suit if a special litigation committee struck by the board recommended against the case proceeding and the corporation demonstrated the independence, good faith, and reasonable diligence of the committee. Zapata was less deferential to independent litigation committees than Auerbach, as the Delaware Supreme Court said a court should review the substantive decision of the committee using its own independent judgment before ruling on a motion to dismiss. Nevertheless, Zapata helped to elevate the importance of the independent director in the corporate governance realm.

In the 1983 case of Weinberger v. UOP, Inc. the utility of independent directors was underscored in a different context, namely a "freezeout" where a corporation's controlling shareholder aims to acquire
the remaining shares. In the case, UOP shareholder plaintiffs successfully challenged steps taken by majority shareholder Signal Companies Inc. to cash out UOP's other shareholders but the Delaware Supreme Court indicated that "the result . . . could have been entirely different if UOP had appointed an independent negotiating committee of . . . outside directors to deal with Signal at arm's length." Subsequent Delaware cases confirmed that with mergers involving a corporation and its controlling shareholder a well-functioning committee of independent directors could in resultant litigation shift the burden of proof in a direction favorable to the controlling shareholder. Delaware companies took the hint and began regularly establishing independent negotiating committees to address potentially contentious facets of merger transactions.

3. Composition of the Board

Cases such as Zapata and Weinberger did not speak directly to the overall composition of boards. Instead, a board dominated by inside directors could theoretically establish the types of committees identified in Zapata and in Weinberger when the situation called for it and staff the committee with sitting directors who merely qualified as independent with respect to the matter in question or with directors freshly appointed with committee duty in mind. Other Delaware cases, however, had significant implications for how entire boards were configured. Delaware Supreme Court Justice Randy Holland, in a 2008 lecture where he stressed that "Delaware courts [emphasize] the importance of independent directors in safeguarding the interests of shareholders by preserving the integrity of the corporate governance process," explicitly acknowledged the point, saying that a series of rulings relating to takeovers made in the 1980s created incentives for corporations to have a majority of independent directors on their boards.

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222 See Rodrigues, supra note 40, at 476-77.
223 Weinberger, 457 A.2d at 709 n.7.
225 See Rodrigues, supra note 40, at 477 n.165; Allen, supra note 216, at 2058.
226 See Rodrigues, supra note 40, at 492.
227 Holland, supra note 134, at 685-86; see also Rodrigues, supra note 40, at 481.
The Delaware Supreme Court's 1985 decision in *Unocal Corporation v. Mesa Petroleum Co.* provided the departure point. Unocal's board, confronted with an unwelcome takeover bid by Mesa Petroleum, controlled by well-known corporate raider T. Boone Pickens, countered by authorizing a self-tender offer that was discriminatory in the sense that shares Mesa tendered would not be accepted. Mesa sued, challenging the self-tender offer on the basis that the board had violated fiduciary duties owed to Mesa and other Unocal shareholders. The Delaware Supreme Court ultimately ruled in favor of Unocal's board. In so doing, however, it indicated that, due to the conflict of interest a target board faces when a hostile takeover bid occurs, directors taking defensive action would only be able to rely on the protection the business judgment rule affords to a board if they had reasonable grounds for believing there was a danger to corporate policy or effectiveness and the defense adopted was reasonable in relation to the threat posed.

Part V will discuss *Unocal's* implications for the market for corporate control. For present purposes, the key point is that the Delaware Supreme Court indicated that the likelihood of defensive steps taken meeting the standard of review set down would be materially enhanced if a majority of a target company's board consisted of outside independent directors. The implicit logic was that a board of this nature merited "bonus points" because concerns about self-interest on the part of the board would be at least partly assuaged.

The Delaware Supreme Court soon drew upon this feature of *Unocal* in another 1985 decision, *Moran v. Household International Inc.* In this case, the first where Delaware courts were called upon to assess the validity of a poison pill, the Supreme Court noted approvingly that a majority of the target company's directors were independent, that the directors deliberated extensively before adopting...
the pill, and that most of the independent directors supported adoption. These favorable circumstances helped to ensure that the board could satisfy the Unocal framework, meaning the introduction of the poison pill was upheld as an exercise of business judgment.

The Unocal reasoning concerning independent directors was deployed subsequently by Delaware courts in other 1980s cases, most prominently in Paramount Communications v. Time Inc. This high-profile 1989 decision of the Delaware Supreme Court, also discussed in more detail in Part V, indicated boards of Delaware companies had ample scope to "just say no" to unwanted takeover bids. The court specifically cited the fact that twelve of Time's sixteen directors qualified as outside and independent in rejecting Paramount's contention that, under the Unocal framework, Time's board had failed to consider adequately whether Paramount's hostile takeover offer was a threat to corporate policy. The case correspondingly indicated that the board of a Delaware target company had wide discretion to reject a hostile tender offer so long as the board was composed primarily of independent directors and opted after reasonable investigation to oppose the bid.

Jeffrey Gordon, in a 2007 study of the "rise" of the independent director between 1950 and 2005, explained how Unocal and decisions such as Paramount following its logic contributed to the trend he documented:

The lesson to a planner was clear. The price of the power to "just say no" to a hostile bidder was a board that consisted of a majority of independent directors and a process that

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237 Moran, 500 A.2d at 1348 n.2, 1356.
238 Id. at 1356.
239 Paramount Commc'ns Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1990); see also Polk v. Good, 507 A.2d 531, 537 (Del. 1986) (discussed on this point in Donald E. Pease, Outside Directors: Their Importance to the Corporation and Protection from Liability, 12 DEL. J. CORP. L. 25, 38-40 (1987)).
240 Paramount, 571 A.2d at 1150-53.
242 Paramount, 571 A.2d at 1154. For commentary on this aspect of the judgment, see Marc I. Steinberg, Nightmare on Main Street: The Paramount Picture Horror Show, 16 DEL. J. CORP. L. 1, 21 (1991).
243 See Marcel Kahan, Paramount or Paradox: The Delaware Supreme Court's Takeover Jurisprudence, 19 J. CORP. L. 583, 587 (1994).
would call on those directors to exercise (at least the appearance of) independent judgment.244

4. Regulatory Consolidation

A dozen or so years after *Paramount*, scandal-induced federal regulatory initiatives would consolidate trends concerning independent directors that Delaware courts had helped to foster. Chief Justice Strine, when he indicated in 2002 that the independent director carried much water in U.S. corporate law, was speculating on the implications of the Enron debacle for regulatory reform.245 Writing prior to the enactment of SOX later that year, he predicted that Enron would "ignite a fiery debate centered upon the so-called 'independent director'" and said state-based policymakers would not block their ears to arguments for reform.246 In fact, with respect to the composition of the board, federal policymakers would take the lead in a way that illustrated the limits of what Chief Justice Strine refers to as the Delaware Model of corporate law as a source of corporate governance reform.

Despite Chief Justice Strine's 2002 prediction, the Delaware state legislature essentially stood pat with respect to corporate governance in the wake of Enron, WorldCom, and other corporate governance scandals.247 This perhaps was not surprising because in Delaware there is a general tendency to "trust" directors and because considerable emphasis is placed on stability and on change being primarily judicially-led and incremental.248 Still, the contrast with the federal response was striking.

The governance scandals of the early 2000s and the resulting outcry prompted swift and substantial changes to the federal regulation of board composition and structure as part of what was for U.S. corporate governance "something like a hundred year flood of reform."249 SOX, when it was enacted in 2002, required the SEC to direct national stock exchanges to adopt listing rules precluding the listing of any company that did not have an audit committee comprised entirely of independent

245 Strine, *supra* note 214, at 1384.
246 Id. at 1373.
248 *Supra* notes 117-18, 124, 195-201 and related discussion.
249 Thompson, *supra* note 128, at 791; see also Henn, *supra* note 105, at 213-14 (emphasizing the swiftness of the federal government's response).
The same year, following prompting by the SEC, the New York Stock Exchange and NASDAQ promulgated listing rules that the SEC approved in 2003 that intruded further upon Delaware's corporate governance "space" by dealing with aspects of board structure and composition upon which Delaware law was silent. The NYSE's revised listing rules required listed companies to have boards with at least a majority of "independent" directors and to have compensation and nominating committees staffed entirely by independent directors, with independence being defined by the board in accordance with factors the listing rules prescribed. NASDAQ's listing rule amendments were similar, if less prescriptive in some respects, but the Dodd-Frank Act of 2010 subsequently required the SEC to direct all major stock exchanges to preclude listing by companies lacking a compensation committee staffed by independent directors.

Though with respect to boards federally-driven post-Enron/WorldCom reforms were a "sea change" from a regulatory perspective, the reforms made largely conformed to corporate governance norms already in place. As of 2000, it was commonplace for larger public companies to have a majority of independent directors and to have audit, nomination, and compensation committees staffed entirely by independent directors. Delaware case law from the 1980s

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251 See Thompson, supra note 128, at 791-93, 796; see also Elizabeth Cosenza, The Holy Grail of Corporate Governance Reform: Independence or Democracy?, 2007 BYU L. REV. 1, 9 n.30 (explaining the chronology).


253 On pertinent differences between the revised NYSE and NASDAQ listing rules, see Clarkc, supra note 136, at 89-91; William B. Chandler III & Leo E. Strine, Jr., The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State, 152 U. PA. L. REV. 953, 965 n.22 (2003).


255 See Gordon, supra note 26, at 1482.


257 Chhaochharia & Grinstein, supra note 250, at 1217-18 tbls.1-2 (showing 90% of S&P 500 companies had boards with a majority of independent directors as of 2000, 62% had
was a significant element of the corporate governance norm structure that yielded these outcomes, meaning that despite the post-Enron/WorldCom wave of federal regulation, Delaware jurisprudence contributed substantially to changes to board structure and composition as the 20th century drew to a close.

B. Attentiveness

1. Smith v. Van Gorkom

Delaware case law relating to directors was significant from a governance perspective not only because it influenced board composition and structure but also because it provided those in the boardroom with incentives to be attentive when acting on behalf of the corporation and to establish internal reporting mechanisms that could help to uncover conduct that was potentially detrimental to the corporation. With respect to the attentiveness of directors, given various bold claims that have been made concerning the governance impact of Smith v. Van Gorkom, this case provides the obvious departure point. As was the case with Unocal and Moran, the Delaware Supreme Court delivered this judgment in the watershed year of 1985.

Van Gorkom has been described as "[t]he first key governance case." It has been suggested similarly that in handing down its decision the Delaware Supreme Court "engaged in its own reform of corporate governance" and that the decision "stands as the apogee in the reach of judicial corporate governance via fiduciary duty . . . ." Ira Millstein, the prominent corporate governance advocate, even argued at a 2000 roundtable marking the case's fifteenth anniversary that it was "the Brown vs. Board of Education in corporate governance." This, as Millstein acknowledged might be the case, was an overstatement. More broadly, Van Gorkom was important, but likely not as important as it appeared at the time.

an independent audit committee, 45% had an independent nomination committee, and 79% had an independent compensation committee); see also Fairfax, supra note 256, at 137.

488 A.2d 858 (Del. 1985).


260 Sale, supra note 4, at 464.


262 Elson & Thompson, supra note 7, at 580.

263 Roundtable: The Legacy of Smith v. Van Gorkom', DIRECTORS & BOARDS, Spring 2000 [herinafter Roundtable], at 28, 44.

264 Id.
In *Van Gorkom*, Trans Union's board, acting under a tight deadline, recommended after a two-hour board meeting that a merger proposal the company's CEO had negotiated be submitted to the shareholders for approval. The board's endorsement of the proposed merger was not tainted in any way by self-dealing or by a conflict of interest. The price offered also incorporated a sizeable control premium. Nevertheless, the Delaware Supreme Court held Trans Union's directors were not protected by the business judgment rule because they had been grossly negligent and correspondingly should be held liable. The damages agreed upon in a subsequent settlement exceeded the policy limit of Trans Union's directors' and officers' insurance policy, which meant that for Trans Union's outside directors this was one of only a tiny handful of occasions where an outside director of a publicly traded company faced "out-of-pocket" liability in a case arising under corporate or securities law. With instances where directors of public companies had been held liable without engaging in self-dealing having been "few and far between," the case reputedly "exploded a bomb" that "shook the foundations of the corporate world." The *Chicago Tribune* said of the case that it would "have a

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266 See *id.* at 608.


270 The Pritzker family, which bought Trans Union, ultimately paid most of the outside directors' damages and Trans Union's CEO paid the rest. See *id.*; see also Black, Cheffins & Klausner, *supra* note 54, at 1067 (discussing the "out-of-pocket" liability angle).


chilling—some say therapeutic—effect on corporate governance" and had left "[s]ome of Chicago's leading corporate faces . . . red with shock, anger and embarrassment" (Trans Union was Chicago-based despite being incorporated in Delaware).\footnote{42}

Widespread take-up by Delaware companies of the option created by the 1986 enactment of § 102(b)(7) of the DGCL to include a provision in their charters precluding director liability for breaches of the duty of care did much to cancel out the increased risk of out-of-pocket liability \textit{Van Gorkom} implied\footnote{275}. Nevertheless, the case has been credited with sensitizing the business community to the fact that boards had meaningful deliberative responsibilities.\footnote{276} A 1988 review of a book on directors said that as a result of \textit{Van Gorkom}, "American directors suddenly began to document and deliberate as never before."\footnote{277} Various observers reflecting on the case's fifteenth anniversary remarked on how primitive the procedures of the Trans Union board were compared with the standards of their day and attributed the change partly to \textit{Van Gorkom}.

\footnote{Charles Elson even suggested in a 1997 article where he identified the ten most prominent corporate law cases of all time that \textit{Van Standard (and the End of Revlon Duties?)}, 49 BUS. LAW. 1593, 1597 (1994) ("\textit{Van Gorkom} sent shock waves through the corporate world . . . ."); Christopher J. Bebel, \textit{Why the Approach of Heckmann v. Ahmanson Will Not Become the Prevailing Greenmail Viewpoint: Race to the Bottom Continues}, 18 TEX. TECH L. REV. 1083, 1111 (1987) ("The \textit{Van Gorkom} decision has shocked the business community . . . .").


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See Elson & Thompson, supra note 7, at 583; Black, Cheffins & Klausner, supra note 54, at 1090-91; Radin, supra note 267, at 27. The enactment of § 102(b)(7) has been described as a response to \textit{Van Gorkom} (see, e.g., Sale, supra note 4, at 466), but the case likely was only one of a number of factors contributing to reform. See Radin, supra note 267, at 27; James L. Griffith, Jr., \textit{Director Oversight Liability: Twenty-First Century Standards and Legislative Controls on Liability}, 20 DEL. J. CORP. L. 653, 688 (1995).
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See Roundtable, supra note 263, at 30, 40; Macey, supra note 265, at 607.
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Gorkom had more impact on director behavior than any other judicial ruling made during the second half of the twentieth century.  

While Van Gorkom no doubt was important, its significance for corporate governance has been exaggerated at least to some degree. The decision did initially catch the attention of directors unlike any other case, but this notoriety was based on liability fears that should have been rendered largely moot for Delaware companies with the enactment of § 102(b)(7). By 2000, in the absence of additional noteworthy instances of personal liability of outside directors, the name recognition of the case had diminished considerably. Moreover, given that Van Gorkom provided a road map of steps boards could take to help to meet the relevant legal standards, such as consult investment bankers and review systematically key terms of a proposed transaction, the case may well have done more to foster the introduction of formalistic procedures to "paper" transactions than to elicit genuinely increased attentiveness by directors. Given these caveats, to the extent that directors became more diligent post-Van Gorkom, the case likely was only one of several factors that encouraged them to do so.

2. The Disney Litigation

Shareholder derivative litigation arising from the Walt Disney Company's mid 1990s hiring of Michael Ovitz as a senior executive and his abrupt dismissal on very generous terms shortly thereafter provided

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280Cf. Kahan & Rock, supra note 53, at 900 ("Van Gorkom may have been a major case ceteris paribus, but turned out largely insignificant mutatis mutandis.").
281See Roundtable, supra note 263, at 34; Macey, supra note 265, at 625.
282See Roundtable, supra note 263, at 34-35 (discussing fear of personal liability as an explanation for Van Gorkom's notoriety); Lawsuits Take Appeal from Director's Job, CHI. TRIB., Dec. 28, 1986, at F4 (describing how the personal liability of the directors "frightened directors all over the country");
283See Elson & Thompson, supra note 7, at 586.
285Manning, supra note 272, at 9, 13.
286Charles M. Elson, The Duty of Care, Compensation, and Stock Ownership, 63 U. CIN. L. REV. 649, 682-87 (1995); see also Jonathan R. Macey & Geoffrey P. Miller, Trans Union Reconsidered, 98 YALE L.J. 127, 141 (1988) (indicating that the authors, like "the majority of commentators," believed the benefits of increased deliberation would be small due to a formalistic response).
Delaware courts with a fresh opportunity to adjudicate upon incentives directors of public companies had to be attentive. The litigation that culminated in what some heralded as "the corporate governance 'case of the century'" elicted some forceful judicial rhetoric. Ultimately, however, the outcome in the case muted its impact considerably.

While initial preliminary rulings in the Disney litigation preceded the Enron and WorldCom scandals, additional preliminary rulings and the trial and subsequent appeal which culminated the protracted litigation, occurred after. Various observers anticipated that the Delaware judiciary would respond to the scandals and the ensuing federal intervention in the states' corporate governance space signalled by SOX by requiring more from directors. The ongoing Disney litigation was an obvious weathervane for a possible change in approach. A 2003 preliminary ruling by Chancellor William B. Chandler III in the Disney litigation seemed to show a willingness to find breaches of duty in the case and indicated that the plaintiffs could potentially by-pass the liability bar Disney's § 102(b)(7) charter provision imposed by proving a breach of a duty of good faith oriented around an intentional or conscious disregard of duty. This ruling prompted former Chancellor William Allen to say "[i]t would not be unreasonable to assume that the Delaware courts are responding to the Enron and WorldCom headlines and the intrusion, so to speak, of the federal government into the internal governance of corporations." Expectations, however, that the Disney litigation would provide the departure point for an ambitious new stance on director liability ultimately went unfulfilled.

Chancellor Chandler in his 2003 judgment in the Disney litigation referred to the Disney board as "ostrich-like" and accepted for the purposes of that stage of the proceedings the plaintiff's allegation that the

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288 H. Stephen Grage Jr. & John E. Haupert, Governance Lessons from the Disney Litigation, BUS. L. TODAY, Sept. 2011, at 1; see also Duggin & Goldman, supra note 273, at 247 ("[T]he most celebrated, and widely-reported, corporate governance trial in American history . . . .").


290 In re Walt Disney Co. Derivative Litig. 907 A.2d 693 (Del. Ch. 2005), aff'd, 906 A.2d 27 (Del. 2006).


292 Fairfax, supra note 273, at 418.

board behaved "blindly." At trial he indicated that Disney's directors had not complied with boardroom best practice and implied the case was an instance where "an imperial CEO" (Michael Eisner) was operating largely unchecked by a "supine or passive board." Nevertheless, Chancellor Chandler held at trial that whatever deficiencies may have been present with respect to deliberations by the Disney board, the plaintiffs' case should be dismissed because there had not been gross negligence or a conscious disregard of duty. This ruling was upheld on appeal.

Chancellor Chandler did take the opportunity in his judgment following the Disney trial to provide guidance to board members on how they could meet what he called "[a]spirational ideals of good governance practices" that went "beyond the minimal legal requirements" satisfied by the Disney board. For instance, he implied that a board should not leave a CEO, as Disney's board seemingly had done with Eisner, to enthrone "himself as the omnipotent and infallible monarch of his personal Magic Kingdom." Chancellor Chandler also urged directors to inform themselves fully using all available resources before making crucial decisions affecting the company and to document fully their deliberations.

While in the Disney litigation the Delaware courts criticized aspects of the company's corporate governance and in so doing provided guidance on good practice, the outcome in the case nevertheless muted the litigation's subsequent impact. With corporate boards watching the Disney litigation fearfully, a ruling in favor of the plaintiffs likely would have sent a "chilling message" to directors and "shock waves through the nation's boardrooms." Instead, the outcome was a

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296 Disney, 907 A.2d at 760, 772.
297 Disney, 906 A.2d at 35-36, 75.
298 Disney, 907 A.2d at 745 n.399 (discussed on this point by Bahri, supra note 291, at 1097).
299 Disney, 907 A.2d at 763.
300 Id. at 764-65.
"relief" that helped to ease fears of directors becoming skittish about Delaware courts and growing liability risks. The case also indicated that litigation in Delaware courts was not a promising route for challenging governance arrangements compromised by a domineering CEO and led some to wonder whether Delaware courts were prepared in controversial cases to develop and apply meaningful corporate governance standards. This does not mean that the case was wrongly decided nor that the outcome, given the institutional constraints under which Delaware courts operate, was particularly surprising. Nevertheless, the absence of director liability meant the Disney litigation was not the landmark corporate governance event it potentially could have been.

C. Monitoring: Caremark

While with the Disney litigation the absence of directorial liability likely reduced its impact, a 1996 ruling by Chancellor Allen in derivative litigation involving health care provider Caremark indicates that an adverse outcome for directors was not mandatory for a case to have important corporate governance implications. In re Caremark International Incorporated Derivative Litigation, which has been described "as one of the most significant decisions in Allen's remarkable tenure as Delaware Chancellor," also illustrates that while case law precedents reduce the scope for judicial creativity in the corporate governance realm, the constraint is not binding in all circumstances.

304Stephanie Kirchgassner, Relief over Milestone Disney Ruling, FIN. TIMES, Aug. 11, 2005, at 25.
307Steinberg & Bivona, supra note 220, at 230; see also Griffith, supra note 294, at 71 ("[The Court of Chancery's 2005 opinion made the court look as if it was no longer seeking to forge new ground in corporate law jurisprudence . . . .").
309Supra Part III.B.4.
310In re Caremark Int'l Derivative Litig., 698 A.2d 959 (Del. Ch. 1996); Hill & McDonnell, supra note 308, at 862 ("Caremark . . . became highly influential notwithstanding the court's pronouncement that the directors were almost certainly not liable for breach of duty.").
311Cox, supra note 22, at 343.
312See supra notes 183, 197-99 and accompanying text.
In Caremark Chancellor Allen was called upon to approve a settlement in a derivative suit arising from allegations that Caremark had been exposed to substantial liability risk because inadequate board oversight and the absence of appropriate internal compliance mechanisms had provided Caremark employees with broad scope to engage in illicit kickback schemes and billing practices. Chancellor Allen signed off on the settlement, which provided for undertakings by Caremark concerning the manner it would conduct its business in the future but no damages payments. In so doing, he issued a judgment that distinguished between potential director liability for board decisions resulting in a loss to the corporation and for unconsidered inaction. In relation to the latter, Chancellor Allen indicated that directors could find themselves in breach of duty if they failed to assure themselves that reporting systems were in place that were reasonably designed to provide timely, accurate information that would permit management and the board to reach informed judgments concerning the corporation's performance and compliance with the law.

While there was no finding of director liability in Caremark and while Chancellor Allen indicated that only "an utter failure" to establish a reasonable information and reporting system would establish the absence of good faith required for there to be directorial liability, in corporate governance circles the case was hailed as a significant extension of the responsibilities of directors. Practitioners in turn relied on Chancellor Allen's judgment to urge boards of public companies to upgrade substantially existing internal reporting and compliance programs. A sizeable increase in the size and scope of reporting and compliance systems reputedly followed. It is unclear whether these developments prompted more effective board oversight or reduced violations of the law. Nevertheless, it would seem that Caremark had a significant

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313 For a helpful overview of the background to the case, see H. Lowell Brown, The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era, 26 DEL. J. CORP. L. 1, 16-20 (2001).
314 Caremark, 698 A.2d at 965-66, 972.
315 Id. at 967-68.
316 Id. at 970.
317 Id. at 971.
320 Elson & Gyves, supra note 45, at 701.
321 Compare Bahri, supra note 291, at 1089 ("[Caremark] heightened the level of attention directors pay to their oversight responsibilities . . . ."), with Elson & Gyves, supra
impact on governance arrangements without the shock factor of director liability.

Caremark was also doctrinally innovative and correspondingly shows Delaware judges could quite readily sidestep seemingly inconvenient case law precedent to issue rulings that influenced corporate governance. The Delaware Supreme Court explicitly acknowledged for the first time in 1963 in *Graham v. Allis-Chalmers* that directors seeking the protection of the business judgment rule would be held to a duty of care as well as a duty of loyalty. The case also indicated, however, that directors of Delaware companies were not obliged in a general way to monitor a corporation's compliance with the law and had no obligation to ferret out wrongdoing absent some cause for suspicion.

*Graham*, which involved a claim that directors should be held liable for failing to monitor adherence by subordinates to antitrust law, potentially could, as a Delaware Supreme Court decision, have been binding as a matter of *stare decisis* on Chancellor Allen. He sidestepped the case, however, by indicating it only stood for the proposition that a corporation's directors could rely on the honesty and integrity of the officers and employees unless there were grounds for suspicion. He also said that even if the holding in *Graham* in fact was that directors were not obliged to ensure that appropriate information and reporting systems were in place, due partly to the Delaware Supreme Court having recognized in cases such as *Van Gorkom* and *Paramount* the "seriousness" of the role of the board in managing corporations, the Supreme Court would not have accepted this proposition during the mid 1990s.

In *Stone v. Ritter*, a 2006 case, the Delaware Supreme Court confirmed Chancellor Allen's prediction, acknowledging in so doing that he had narrowly construed *Graham* and endorsing his characterization of the law by saying that Caremark "articulate[d] the necessary conditions

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324 See Brown, *supra* note 313, at 27.
325 *Graham*, 188 A.2d at 127.
326 In re Caremark Int'l Derivative Litig., 698 A.2d 959, 969 (Del. Ch. 1996); see also Brown, *supra* note 313, at 27 (discussing the same point); Elson & Gyves, *supra* note 45, at 700 (discussing the same).
predicating [assessing] director oversight liability...". Chancellor Allen's judgment in Caremark was not vindicated entirely in Stone v. Ritter. Chancellor Allen said that while the obligation of directors to monitor a corporation's affairs to protect against violations of the law was part of the duty of care, there would only be a breach of duty in this context in the absence of good faith. In Stone v. Ritter, the Delaware Supreme Court similarly treated the duty to monitor as falling within a duty of good faith, but characterized good faith as a component of the duty of loyalty rather than the duty of care, and in so doing may have partly undermined the duty to monitor by introducing a scienter requirement. Nevertheless, Chancellor Allen's Caremark judgment stands out as an example of a Delaware court ruling that had a significant impact on the development of corporate governance despite potentially inconvenient prior jurisprudence and an absence of directorial liability.

V. TAKEOVERS

The market for corporate control, which encompasses the process by which outside teams take control of companies from incumbent directors and managers, has been in operation in the United States since at least the start of the twentieth century. It went into overdrive, however, in the 1980s. This "Deal Decade" was exemplified by bidders who relied on aggressive, innovative financial and legal techniques to secure voting control of larger-than-ever target companies by offering generous terms to the shareholders of the targets. Delaware courts were in the center of the action, primarily due to adjudicating cases where legal challenges followed after boards of targeted Delaware-

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329 Caremark, 698 A.2d at 967-68; see also Christopher M. Bruner, Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law, 41 WAKE FOREST L. REV. 1131, 1157 (2006).
330 Stone, 911 A.2d at 370 ("[I]mposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations."); see also Pan, supra note 327, at 732-33 (discussing the implications).
331 Cf. Market for Corporate Control, OECD (Mar. 7, 2003), archived at http://perma.cc/N4PA-Q3AZ ("[T]he term 'market for corporate control' refers to the process by which ownership and control of companies is transferred from one group of investors and managers to another.").
333 See supra note 59 and related discussion; Cheffins, supra note 9, at 52; Kahan & Rock, supra note 53, at 873 ("M&A activity increased from $44 billion in 1980 to $247 billion in 1988. A substantial portion of the deals during this period were hostile takeovers or defensive transactions undertaken in response to hostile takeovers.").
incorporated public companies took defensive measures to derail unwelcome takeover approaches. As David Skeel said in his 2005 book *Icarus in the Boardroom*, "Raiders made their bids, the target company resisted, and then everyone packed up their bags and went to Delaware, where many of the target companies were incorporated, to see if the defenses would be permitted."\(^3\)

When shareholders used litigation to challenge the deployment of defensive tactics, as we will see now, Delaware's judiciary did not give boards *carte blanche*, but generally upheld steps taken. The stance taken by Delaware courts may well have ultimately helped to bring the Deal Decade to a close. To the extent this was the case, rulings by Delaware courts likely contributed to an increased emphasis on potentially key "internal" corporate governance mechanisms, namely the board of directors, shareholder activism and incentivized executive pay.

A. The Cases

1. Takeover Defenses—Contending Schools of Thought

Ronald Gilson suggested in his 1999 Pileggi Lecture that "the hostile takeover wave of the 1980s subjected the traditional structure of corporate law to the equivalent of a stress test."\(^3\)\(^5\) On the one hand, when a takeover bid was made to gain control of a public company for the target board evaluation of the terms was "the quintessential business judgment."\(^3\)\(^6\) The situation, however, also created for directors—particularly executives on the board facing potential dismissal if the bid succeeded—an inherent conflict of interest.\(^3\)\(^7\)

With respect to how the Deal Decade stress test should play out, there were two contending points of view. One school of thought, which had lawyer Martin Lipton as its most prominent proponent, was that board decisions relating to hostile takeover bids should be governed by the business judgment rule in the same manner as board decisions concerning other acquisition proposals.\(^3\)\(^8\) The opposing point of view was that decisions concerning the fate of a tender offer, a popular hostile takeover technique that involves a bidder extending an offer directly to


\(^{336}\) Gilson, supra note 1, at 495.

\(^{337}\) Id.

shareholders to buy their shares, should be reserved solely for the shareholders as owners of their shares. This school of thought included academics such as Professor Gilson, Frank Easterbrook, and Daniel Fischel, who characterized the hostile bid as an important corporate governance device that served to enhance managerial accountability.

2. 1985

In a series of three takeover cases handed down during the "watershed year" of 1985—Unocal, Moran v. Household International Inc., and Revlon Inc. v. MacAndrew & Forbes Holdings, Inc.—the Delaware Supreme Court chose a middle ground between the two contending points of view on takeover defenses. Revlon indicated that if events meant the sale of a target company was inevitable, a board should act as auctioneer and could only deploy takeover defenses to maximize the price for the shareholders. Otherwise, director action in response to a takeover bid would be subject to what became known as "the Unocal 'intermediate standard of review.'"

In Unocal, the Delaware Supreme Court explicitly rejected the proposition that boards should remain passive in the takeover context, a point substantiated by the fact that the court upheld the target board's

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339 Moore, supra note 233, at 871.
340 Gilson, supra note 1, at 495; Bainbridge, supra note 2, at 793-95; Ronald J. Gilson & Reinier Kraakman, Takeovers in the Boardroom: Burke Versus Schumpeter, 60 BUS. LAW. 1419, 1424, 1426 (2005).
342 500 A.2d 1346 (Del. 1985).
343 506 A.2d 173 (Del. 1986). The oral decision in this case was issued November 1, 1985 and the written opinion was distributed on March 13, 1986. Id. at 173. Lipton and Rowe have characterized Revlon as being part of "key choices Delaware made in 1985." Lipton & Rowe, supra note 10, at 11.
344 Gilson, supra note 1, at 496; see also The Case of the Poison Pill, ECONOMIST, Dec. 9, 2004, at 72.
346 Gilson, supra note 1, at 496.
347 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 n.10 (Del. 1985); see generally Moore, supra note 233, at 881-82 (discussing why the court was not inclined to require the board to be passive).
use of a self-tender offer as a takeover defense. Being aware, however, that there was an "omnipresent specter" of potentially self-interested entrenchment when a board adopts defensive measures in the takeover context, the Delaware Supreme Court did not go to the opposite extreme and treat adoption of defensive tactics as being fully protected from review under the business judgment rule. Instead, the Supreme Court deployed for the first time a standard of review standing between the traditional business judgment rule and the fairness test associated with the duty of loyalty. Under this intermediate standard, the business judgment rule would only be applied to the adoption and deployment of a defensive measure if the board showed there were reasonable grounds for believing that there was a danger to corporate policy and effectiveness and the defensive tactic was reasonable in relation to the threat posed.

In Household, the Delaware Supreme Court deployed the Unocal intermediate standard of review to rule in favor of defendant directors who had deployed a "preferred share purchase rights plan," a species of poison pill. Of the key 1985 takeover decisions, this is the one that arguably had the greatest practical impact because it helped to prompt widespread adoption of poison pills. Martin Lipton invented the rights plan poison pill in 1982, with the first adoption taking place in 1983. A mere seven companies adopted a poison pill in 1984 and only forty did so the following year. Not even 5% of publicly traded Fortune 500 companies had such a mechanism in place when Household was decided.

The legality of poison pills was being tested in various courts at the time and the resulting ambiguity at least partly explained the slow

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348 Unocal, 493 A.2d at 956-57.
349 Id. at 954; Moore, supra note 233, at 883.
350 Unocal, 493 A.2d at 954-55.
351 Id. at 955; Moore, supra note 233, at 883 (discussing the novelty of the intermediate standard).
352 This characterization comes from Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1152 (Del. 1990).
354 See Lipton & Rowe, supra note 233, at 12.
355 Martin Lipton, Twenty-Five Years After Takeover Bids in the Target's Boardroom: Old Battles, New Attacks and the Continuing War, 60 BUS. LAW. 1369, 1372 & n.9 (2005).
take-up.\textsuperscript{359} \textit{Household} was destined to set the tone both as the first challenge to a poison pill in Delaware and as a decision of the Delaware Supreme Court.\textsuperscript{360} The judicial blessing of the poison pill in \textit{Household} was said to be a "seminal event"\textsuperscript{361} that "unleashed a flood of poison pill adoptions."\textsuperscript{362} The number of companies adopting pills did indeed accelerate markedly to 302 in 1986, 142 in 1987, and 332 in 1988.\textsuperscript{363} The trend, moreover, extended to the very largest companies. As of 1986, 35\% of publicly traded \textit{Fortune} 500 companies had implemented a pill and 60\% had done so by the end of 1989.\textsuperscript{364}

3. Paramount

\textit{Unocal} and \textit{Household} made it clear that boards of Delaware companies were not required to be passive in the takeover context and instead had at least a threshold role as a gatekeeper.\textsuperscript{365} Nevertheless, hostile takeover bids continued throughout the remainder of the 1980s, with the Delaware Supreme Court acknowledging in 1989 that the continuing "spate of takeover litigation . . . readily demonstrates that

\begin{itemize}
  \item[359]See id.
  \item[360]See supra notes 235-37 and related discussion (identifying \textit{Household} as the first such case in Delaware); Gelvin Stevenson, \textit{A Poison Pill That's Causing a Rash of Lawsuits}, BUS. WK., Apr. 1, 1985, at 54, 58: "This is probably the single most important corporate law case to come before the courts in years." [quoting Irving Shapiro, a former chairman of the Business Roundtable]
  \item[361]\ldots Legal challenges [to the pill] have proliferated . . . . But the [\textit{Household}] case in Delaware is the crucial one. Because so many companies are incorporated there, and because the court is widely respected, "its decision will set the tone for rulings in other state and federal courts. . . ." [quoting Jerry Peppers, a securities lawyer]
  \item[363]Michael C. Jensen, \textit{Takeovers: Their Causes and Consequences}, 2 J. ECON. PERSP. 21, 43 (1988); \textit{see also} John Gorman, \textit{How Lethal is Household's Poison Pill?}, CHI. TRIB., Oct. 11, 1985 (indicating that "numerous corporations" adopted a pill after the Delaware Court of Chancery decided the case); Larry Fish, \textit{Poison Pills: More to Come Experts Warn Court Decision Not Final Word}, CHI. TRIB., Nov. 24, 1985, at D9 ("Corporate directors now have a clearer license to prescribe 'poison pills' to ward off unfriendly takeover attempts, after a key court decision last week.").
  \item[364]Wingerson & Dorn, supra note 357, at 236.
  \item[365]Davis, supra note 358, at 587.
  \item[366]Lipton, supra note 355, at 1372, 1374.
\end{itemize}
such 'poison pills' do not prevent rival bidders from expressing their interest in acquiring a corporation. There were also a few instances in the late 1980s where the Delaware Court of Chancery struck down takeover defenses, which suggested that courts were becoming less trustful of target boards seeking to derail unwelcome bids. The Delaware Supreme Court's 1989 ruling in Paramount was associated with a reversal on both counts and may have had significant corporate governance ramifications beyond the market for corporate control.

The case arose when Paramount Communications, which had responded to news of an agreed-upon but not finalized merger between Time Inc. and Warner Communications Inc. by making a hostile tender offer to Time's shareholders, sued the directors of Time after they pressed ahead with a restructured Time/Warner acquisition scheme rather than consider the last-minute Paramount bid. The Delaware Supreme Court ruled in favor of the Time directors, applying Unocal in so doing. It has been said that "with the court's 1989 opinion in Time-Warner, Delaware finally went anti-takeover." More precisely, the Delaware Supreme Court afforded boards, as compared with prior post-Unocal cases, considerably greater discretion to determine whether there were reasonable grounds for believing that there was a danger to corporate policy and effectiveness and to assess whether defensive measures taken were reasonable in relation to the threat posed.

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366 Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1287 (Del. 1989). Consistent with this observation, it appears that the rate of hostile takeover activity actually increased in the years immediately following the introduction of poison pills. See Matthew D. Cain, Stephen B. McKeon & Steven Davidoff Solomon, Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeovers 19-20 (unpublished manuscript), archived at http://perma.cc/ULS7-DLFZ.


368 Loewenstein, supra note 345, at 105; Tim Smart, For Managers, Delaware Isn't the Haven it Used to Be, BUS. WK., Dec. 19, 1988, at 33 ("In recent months (Delaware's) courts have issued a torrent of stern warnings about entrenched managements' efforts to keep their jobs at all costs and have even dispensed some poison-pill antidotes to corporate raiders.").


370 Two other groups of plaintiffs who were Time shareholders also challenged the steps Time had taken. See id. at 1141-42.

371 Id. at 1153 (holding that Time's response was not "overly broad"). The court also rejected a claim by the shareholder plaintiffs that Revlon duties had been triggered because a change of control was inevitable. Id. at 1150-51.


373 Steinberg, supra note 242, at 20; see also Floyd Norris, Managers Win One, N.Y. TIMES, July 16, 1989, available at http://www.nytimes.com/1989/07/16/us/managers-win-one.html (saying of the Delaware Court of Chancery's judgment in Paramount, which the Delaware Supreme Court upheld, "[i]n the area of corporate takeovers, courts in Delaware, the
the business judgment rule correspondingly coming into operation in a considerably wider range of circumstances, boards had much greater scope to "just say no" in the takeover context than many had thought was the case. 374

Subsequent events demonstrated Paramount was not an anomaly. Instead it would turn out to be the most prominent facet of a general trend where Delaware courts "drifted fairly steadily toward even greater deference to directors in the takeover context." 375 The Delaware Supreme Court ruled against the board of Paramount in a high profile 1993 case where the board failed to give equal consideration to a hostile bidder in a bidding contest with a preferred merger partner. 376 Two years later, however, in Unitrin Inc. v. American General Corp. the same court indicated that boards could deploy defensive tactics so long as the measures in question were not "draconian" and a proxy contest for board control was not "mathematically impossible or realistically unattainable." 377

While Paramount was part of a broader jurisprudential trend, various contemporary observers tagged the case as a corporate governance milestone. 378 One commentator said "[t]he decision may be
the most significant that the Delaware Supreme Court has ever handed down. It fundamentally affects corporate governance, delineating the expansive authority that boards of directors possess.\(^379\) Another argued that "[i]n the history of corporate governance, the *Paramount* decision is what Babe Ruth is to home runs."\(^{380}\) A third predicted the *Paramount* "decision may be one of the signal economic events of the 1990s."\(^{381}\) These claims presupposed that *Paramount* would do much to marginalize the hostile takeover bid and that this transformation of the market for corporate control would have significant corporate governance implications. To what extent did matters unfold in this manner? We consider these points next.

### B. The Deal Decade's Demise and Corporate Governance

*Paramount* coincided both chronologically and functionally with the end of the Deal Decade. Merger and acquisition activity tailed off dramatically as soon as the 1980s drew to a close and while the U.S. experienced a new merger wave during the mid and late 1990s the hostile takeover's role was much less prominent than it had been in the 1980s.\(^{382}\) The side-tracking of hostile takeovers, as we will see now, had significant corporate governance consequences. As Part III.C describes, the contribution of *Paramount* and Delaware law more generally to the hostile takeover bid's (partial) retreat is less clear.

With the disciplinary effects of takeovers receding, the demise of the Deal Decade promptly sparked concerns regarding the sufficiency of mechanisms fostering managerial accountability in public companies. For instance, the *New York Times* noted in February 1990 that "[m]any of the raiders who once struck terror in the hearts of chief executives are on the sidelines . . . ," attributing their retirement partly to the recent bankruptcy filing of Drexel Burnham Lambert Inc., whose popularization of the junk bond had provided "the financial fuel for corporate raiders and hostile takeovers . . . ."\(^{383}\) The raiders' move to the sidelines had, according to the *Times*, potentially disturbing implications for U.S. public companies:

\(^{379}\) *id.*


\(^{381}\) Gordon, *supra* note 374, at 1932.

\(^{382}\) See *supra* notes 60-65 and related discussion.

Many see the firm's disappearance as another sign that the pressures that have kept American business on its toes in the 1980s are on the wane. Unless other catalysts for change emerge or replace those debt-financed raiders, the argument goes, corporate America could slack off again, further damaging its global competitive position.\(^{384}\)

The *New York Times* was by no means alone in expressing concerns about the governance ramifications of the takeover retreat. The *Washington Post*, having noted in a 1990 article that "the takeover artists have all but disappeared" indicated that there was apprehension "that, without the raiders standing in the shadows, a key force has disappeared that had served to keep U.S. business lean, energetic and resourceful."\(^{385}\) Similarly, a *Newsweek* columnist discussing Drexel Burnham Lambert's 1990 demise referred to outside directors and institutional shareholders and then observed "[t]he threat of a takeover, however distant, substituted for these more explicit controls on management. The threat is now vanishing."\(^{386}\) Bevis Longstreth, a lawyer and former SEC commissioner, argued the same year that "[m]ajor changes are occurring in managerial control . . . that weaken managerial accountability to shareholders," emphasizing that while takeovers were the most effective form of corporate accountability mechanism "the value of this tool has been eroded."\(^{387}\)

The 1990 *New York Times* article drew upon a study authored by several executives from the consulting firm McKinsey to identify a potential solution to the problem the demise of the corporate raider posed, quoting the study as saying "[m]ost of what raiders do could be done as well or better by corporate managements themselves."\(^{388}\) But

\(^{384}\) *Id.*


\(^{387}\) Bevis Longstreth, *Takeovers, Corporate Governance, and Stock Ownership: Some Disquieting Trends*, J. PORTFOLIO MGMT., Spring 1990, at 54, 54, 55; see also Pound, *supra* note 60 ("Gone is oversight through all-or-nothing takeover activity"); Peter J. Henning, *Corporate Law After the Eighties: Reflections on the Relationship Between Management, Shareholders, and Stakeholders*, 36 ST. LOUIS U. L.J. 519, 603 (1992) ("The decline in the market for corporate control and the increase in institutional ownership of stock refocuses the tension between shareholders and management away from the hostile offer as a means of disciplining management and towards reforming the system of corporate governance."); *Getting Rid of the Boss*, ECONOMIST, Feb. 6, 1993, at 11 (encouraging shareholder activism and greater vigilance by boards because with the demise of the takeover decade, "American bosses were becoming accountable to no one").

\(^{388}\) Bartlett, *supra* note 383.
what would motivate executives to take steps to unlock shareholder value if the threat of being taken over had all but disappeared? The New York Times identified two possibilities. Boards were one, with the logic being "[w]hether companies follow through in the 1990s with the lessons gleaned from the 1980s may depend on the assertiveness of directors."389 Institutional shareholders were the other, with the New York Times citing business school professor Jay Lorsch as saying "the onus for change would fall on institutional investors, like pension funds and mutual funds."390

Alfred Rappaport, a pioneer of a nascent shareholder value movement that would become highly influential in the 1990s,391 similarly identified institutional shareholders as a potential substitute for the diminished market for corporate control. He argued in a 1990 Harvard Business Review article that "[w]hat most public companies lack, and what institutions must work to create, is a governance system that provides effective monitoring of and checks on managerial authority."392 In describing what this governance system would look like, Rappaport drew attention to a device that could be deployed to enhance managerial accountability the New York Times did not mention, this being executive pay. He criticized compensation arrangements in place at that time on the basis that the focus was on accounting-based targets rather than shareholder returns and argued "[t]he most direct way to persuade managers to act like shareholders is to increase their equity stake . . . ."393

Across each of these dimensions—boards, shareholders, and executive pay—significant changes would indeed occur promptly in the wake of the demise of the Deal Decade. For instance, as we have already seen, outside directors became "energized" in the 1990s, at least as compared to previous decades.394 The trend became evident very shortly after the retreat of the takeover bid. The Wall Street Journal proclaimed in March 1991, "[o]utside directors are in."395 The Washington Post said

389 Id.
390 Id.; see also Leo Herzcl & Richard W. Scherpo, Delaware Supreme Court Boosts Powers of Takeover Targets Boards, FIN. TIMES, Mar. 22, 1990, at 16 (arguing that due in part to legal changes the takeover market was in decline and observing "[i]n the future, the chief constraint on managers' self-interested behavior may have to be more aggressive institutional shareholders and independent boards of directors").
391 Cheffins, supra note 57, at xiii-xiv.
393 Id.
394 See supra notes 47-53 and related discussion.
the following year that "corporate directors [were] pushing CEOs harder than ever before to justify their decisions on strategy and operations."\(^{396}\)

CEO turnover was the most prominent manifestation of changes in the boardroom in the early 1990s. In 1991, the *Wall Street Journal* drew attention to a growing tendency of public companies' boards to dismiss chief executives, referring to the forced resignation of the chairman and CEO of Goodyear Tire and Rubber Co. as "just the latest casualty of the executive-suite exodus, 1990s style."\(^{397}\) Over the next two years, board-driven executive turnover would occur at prominent companies such as Westinghouse, American Express, General Motors, IBM, and Kodak.\(^{398}\)

Institutional shareholders did much to prompt the change in approach in the boardroom. The California Public Employees Retirement System (Calpers), the United States' largest pension fund for public employees,\(^{399}\) got the ball rolling in 1990 when it secured the backing of the board in lobbying against succession plans of General Motors' departing CEO Roger Smith.\(^{400}\) Richard Koppes, then general counsel at Calpers, said subsequently "this was one of the real turning points in the evolution of corporate governance."\(^{401}\) At Calpers' urging, General Motors adopted a corporate bylaw the following year mandating that a majority of GM's board consist of independent directors.\(^{402}\) The change was largely symbolic, in the sense that fifteen of GM's twenty directors were already classified as independent, but was still considered to be a breakthrough for activist institutional shareholders.\(^{403}\)

Shareholder instigation of change at the board level was not restricted to Calpers and GM. With the spate of CEO dismissals that occurred in the early 1990s, institutional shareholder lobbying frequently


\(^{398}\)Martin Dickson, *Big Blue Soothes its Big Investors*, FIN. TIMES, Sept. 24, 1993, at 14


\(^{401}\)Kristic, supra note 400, at 32.


\(^{403}\)White & Schwadadel, supra note 400.
helped to provide the impetus for board action.\textsuperscript{404} Shortly thereafter the Council of Institutional Investors ("CII"), an association of public pension funds Calpers launched in the mid 1980s, and TIAA-CREF, a pension fund for educators, promulgated and publicized policy statements intended to function as best practice benchmarks for boards.\textsuperscript{405}

Putting pressure on boards represented an expansion of the agenda of institutional shareholders. When institutional investors began pursuing a corporate governance agenda during the Deal Decade, the market for corporate control was the initial target.\textsuperscript{406} Institutional investors often disposed of substantial blocks of shares in takeovers, typically at a sizeable profit, and fund managers mindful of their responsibilities to clients and beneficiaries to secure healthy risk-adjusted returns, wanted to protect the option to sell stock in response to a premium-priced bid.\textsuperscript{407} Correspondingly, public pension funds campaigned, albeit not with much success, against poison pills and other mechanisms management proposed that might inhibit takeovers.\textsuperscript{408}

The demise of the Deal Decade prompted institutional shareholders interested in governance to consider a change in approach.\textsuperscript{409} There was awareness as the 1980s ended that relying on the market for corporate control to correct corporate governance defects was unlikely to be a viable strategy going forward.\textsuperscript{410} Institutional shareholders, left to fend for themselves when hostile takeovers subsided, correspondingly contemplated substitute strategies to deploy to foster managerial accountability.\textsuperscript{411} Putting pressure on boards was one such step.

The expansion of the governance agenda of institutional shareholders extended additionally to the promotion of shareholder

\textsuperscript{404} Getting Rid of the Boss, supra note 387; Potts & Swoboda, supra note 396; Steve Lohr, Big Business in Turmoil, N.Y. TIMES, Jan. 28, 1993, at A1.
\textsuperscript{405} John C. Wilcox, A 10-Year Quest for Director Accountability, DIRECTORS & BOARDS, Fall 1997, at 46, 49.
\textsuperscript{406} See Cheffins, supra note 9, at 52.
\textsuperscript{407} Id. at 53; A.A. Sommer, Jr., Corporate Governance in the Nineties: Managers vs. Institutions, 59 U. CIN. L. REV. 357, 360 (1990).
\textsuperscript{411} Id.; Steinberg, supra note 242, at 30-31.
cooperation and interaction. For instance, Calpers kicked off in 1989 debates that ultimately prompted the SEC to amend in 1992 its rules on the solicitation of proxies to relax restrictions on communication between shareholders. Executive pay also came into institutional shareholders' sights. Graef Crystal, a compensation consultant who became an academic, suggested in 1991 that "institutions are discovering that executive compensation is the soft underbelly of corporate governance." Institutional shareholders followed up by pressuring companies to strengthen the independence of compensation committees. They also lobbied companies to overhaul existing executive compensation arrangements to replace a traditional bias in favor of "pay-for-size" with compensation schemes oriented around pay-for-performance. The message got through as a dramatic increase in equity-based compensation—most prominently the awarding of stock options—would soon increase markedly CEO pay-to-performance sensitivity (as well as executive pay levels).

This change in practice did much to prompt executives of the 1990s to assimilate the norm that they should strive to maximize shareholder value.

C. Did Delaware Courts Bring the Deal Decade to an End?

Academics generally concur that "internal" corporate governance mechanisms such as the board of directors, shareholder activism, and incentivized executive compensation grew in prominence at the beginning of the 1990s because the "external" market for corporate control waned as a means for enhancing managerial accountability. To the extent this interpretation of events is correct, it can be argued

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412 See Cheffins, supra note 9, at 54; Wilcox, supra note 405, at 47.
414 Id.
416 See supra notes 79-80 and accompanying text; Gordon, supra note 26, at 1530-31.
417 Gordon, supra note 26, at 1529-30; Bratton & McCahery, supra note 187, at 689; Mary A. O'Sullivan, What Opportunity is Knocking? Regulating Corporate Governance in the United States, in GOVERNMENT AND MARKETS: TOWARD A NEW THEORY OF REGULATION 335, 351 (Edward J. Balleisen & David A. Moss eds., 2010).
418 See, e.g., Kahan & Rock, supra note 53, at 881-84, 896-97, 915; O'Sullivan, supra note 417, at 350 ("With the demise of the financial (takeover) market, institutional investors turned to different means to enforce their demands for higher returns . . . ."); Mark R. Hason, Robert Parrino & Laura T. Starks, Internal Monitoring Mechanisms and CEO Turnover: A Long-Term Perspective, 56 J. FIN. 2265, 2265 (2001) (making the point empirically by indicating that CEO turnover levels were similar in the 1980s and 1990s).
plausibly that Delaware case law affording incumbent management substantial latitude to fend off takeovers had a major collateral effect on corporate governance, namely helping to prompt a switch in emphasis from external to internal governance. Various commentators have indeed made this point.419

Delaware case law logically could only prompt a switch in emphasis in favor of internal corporate governance mechanisms if the jurisprudence in fact sideswiped the hostile takeover bid. This is a plausible conjecture. As we have seen, the Delaware Supreme Court's endorsement of the poison pill in Household likely helped to foster widespread adoption of this prominent form of takeover defense.420 A Washington Post columnist said in the immediate aftermath of Paramount that the case "signified that, as a practical matter, corporate chieftains had finally succeeded in barricading themselves against most hostile takeover offers."421 Numerous observers remarking on the abrupt fall in hostile takeover activity as the 1990s began concurred with this assessment.422 As the Economist said in 1993, "Time's bosses were free 'to just say no' to unwanted offers. Paramount's bid failed, Time's shareholders lost a fortune and hostile bids all but disappeared."423

While it is certainly plausible that a collateral effect of Delaware case law concerning takeovers was to foster a switch in emphasis in favor of internal corporate governance mechanisms, the point cannot be taken for granted. For instance, with the market for corporate control deep freeze that occurred as the 1990s began, changing market conditions were of key importance.424 A marked tightening of credit markets was of particular significance. Crucially, the junk bond market

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419Kahan & Rock, supra note 53, at 878, 896 ("Merger and acquisition activity declined sharply around the time of the Time-Warner decision . . . . [M]arket participants principally adjusted to Delaware takeover law through adaptive devices."); Daniel P. Sullivan & Donald E. Conlon, Crisis and Transition in Corporate Governance Paradigms: The Role of the Chancery Court of Delaware, 31 LAW & SOC'Y REV. 713, 753 (1997) ("The Chancery's ruling in Time catalyzed the current crisis in current corporate governance. . . . [Together with other rulings, it] opened up lines of debate that, for the first time in more than 30 years, did not take their cue from the hostile takeover offer.").

420See supra notes 360-64 and related discussion.


422See, e.g., Longstreth, supra note 387, at 55; Grundfest, supra note 409, at 858-59.


424This was well known to observers seeking to explain at the time why the threat hostile bids posed had receded. See, e.g., Bartlett, supra note 383.
that helped to provide the "financial fuel" for corporate raiders deteriorated in tandem with Drexel Burnham Lambert's 1990 disappearance.425 The market for junk bond issuances collapsed as investors reacted adversely to a sharp spike in defaults by companies that were struggling in the midst of a nascent economic recession to service the high-yield debt associated with junk bonds.426 Bank lending, which helped to underpin many of the successful tender offers of the 1980s, also contracted markedly.427 Banks only returned to acquisition lending after the recession ended and even then they would only work with public companies executing strategic mergers as opposed to financial buyers with a raider orientation.428

Even to the extent that law helped to bring the Deal Decade to a close, Delaware jurisprudence was only one component of a legal matrix that worked to the disadvantage of hostile bidders. Anti-takeover legislation was another important facet. Some 35 states enacted anti-takeover laws during the late 1980s and early 1990s.429 This meant that for a prospective bidder targeting a non-Delaware company the legal regime was typically as inhospitable as it was in Delaware and quite often was more so.430 As of the late 1980s, approximately half of publicly traded companies did not operate under Delaware corporate law431 and thus were not governed directly by the Delaware case law

425 See supra note 383 and related discussion; Day & McCartney, supra note 385; Lohr, supra note 404; Gilson & Kraakman, supra note 410, at 871.
430 Steinberg, supra note 242, at 29 (comparing Delaware with other states by reference to shareholder protection); Subramanian, supra note 429, at 1862 ("[W]hile the typical antitakeover statutes may have (at most) mild substantive bite for most companies, the severe antitakeover statutes substantially shut down the market for corporate control as a disciplinary device."); Lucian A. Bebchuk & Alma Cohen, The Costs of Entrenched Boards, 78 J. Fin. Econ. 409, 413 (2005) (saying that some states, unlike Delaware, adopted statutory measures specifically endorsing the adoption of poison pills and indicating that since 1990 there had not been under any state’s law a single court decision invalidating or requiring the redemption of a standard poison pill).
431 Paul M. Barrett, Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers, Wall St. J., Dec. 9, 1987, at 41 (reporting that 45% of NYSE companies were incorporated under Delaware law).
credited with side-tracking hostile bids. Those offering a legally oriented explanation for the sideswiping of the hostile takeover in the early 1990s often drew attention to the promulgation of state antitakeover laws as well as to Delaware case law developments and likely appropriately so.

Delaware enacted its own anti-takeover legislation in 1988 with what became § 203 of the DGCL. Section 203 was a "business combination" provision that precluded a bidder who failed to acquire with a tender offer 85% or more of the shares of the target from buying out the remaining shareholders until three years had gone by unless the target's board gave advance clearance or the board gave its approval after the fact with the backing of two-thirds of the votes of disinterested shareholders. To what extent did this measure derail takeovers? Was this an instance where, contrary to the general trend, Delaware legislation was more important than case law from a corporate governance perspective?

There is some evidence to suggest that Delaware's adoption of § 203 was significant. T. Boone Pickens, the noted corporate raider, argued at the time the provision was being enacted that the measure would "sound the death knell" for hostile bids. Moreover, only a tiny handful of bidders would in fact achieve the § 203 85% threshold in a single tender offer after the provision was enacted. This implied the provision was "incredibly effective" at reducing the threat of hostile takeovers for Delaware companies. Indeed, § 203 has been referred to as "by far the most important antitakeover law in the United States." It would seem to follow that to the extent that Delaware law sideswiped the market for corporate control § 203, not Delaware case law, was the true culprit.

In fact, the general consensus is that § 203 was a side-show. Jack Coffee argued when § 203's enactment was being debated that it was "a
deliberately and sensibly weak' law."\(^440\) Dale Oesterle said in a 1988 commentary on § 203 that of the anti-takeover "business combination" measures various states had adopted Delaware's was the mildest and drew attention to the fact that Delaware, unlike numerous other states, had not "layered" its anti-takeover statute with other forms of anti-takeover legislation.\(^441\) Academics subsequently assessing the impact of § 203 said it "lacked substantive bite"\(^442\) and was "largely moot by the time it was enacted."\(^443\)

Why, despite Pickens' stark assessment, would § 203 turn out to be largely moot? The broad discretion Delaware companies would acquire under Delaware case law to adopt and deploy poison pills was pivotal. In the key circumstance where an otherwise successful bidder could be caught out by § 203, this being where the bidder secured voting control without acquiring at least 85% of the shares, the target company's board could simply stop matters from reaching that point by using the pill to derail the bid before a majority stake was obtained.\(^444\) Therefore, § 203 became largely superfluous in practical terms for managers of potential targets concerned about a takeover bid.

Given that a poison pill could render § 203 moot it would seem to follow that the Household decision, by sparking widespread adoption of poison pills,\(^445\) played a decisive role in side-tracking the hostile bid. Given that the Deal Decade still had a few years to run when this 1985 decision was handed down, history suggests otherwise. While Household bolstered the popularity of poison pills it was only when the Delaware Supreme Court made its 1989 ruling in Paramount that it became clear how wide the discretion was boards had to use poison pills to "just say no."\(^446\) But, does that mean Paramount and cases of a similar

\(^440\) Barrett, supra note 431; see also Herszel & Sherpo, supra note 390 ("[Delaware] passed one relatively mild compromise measure early in 1988.").

\(^441\) Dale Arthur Oesterle, Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced, 13 DEL. J. CORP. L. 879, 880, 883 (1988). However, Oesterle did point out that a "business combination" statute such as Delaware's was more intrusive than some other types of antitakeover legislation. Id. at 881-82. On the "layering" point see also Subramanian, supra note 429, at 1827-28 (providing evidence in tabular form showing that while Delaware only enacted a "business combination" antitakeover statute, numerous states enacted various types of antitakeover measures).

\(^442\) See Subramanian, supra note 429, at 1845

\(^443\) Kahan & Rock, supra note 53, at 894.

\(^444\) Subramanian, Herscovici & Barbetta, Delaware's Antitakeover Statute, supra note 24, at 705.

\(^445\) See supra notes 360-64, 420 and related discussion.

\(^446\) See Subramanian, Herscovici & Barbetta, Delaware's Antitakeover Statute, supra note 24, at 705.
ilk ultimately were decisive in legal terms for Delaware companies? The answer is that the jurisprudence mattered, but not in isolation.

A key potential limitation with a poison pill is its impermanence—the board of a corporation that has adopted a pill can subsequently remove it. In the context of a hostile takeover, the most obvious way for this to happen will be for a bidder to commence a proxy contest for board control promising in the event of success that the reconfigured board will dismantle takeover defenses in place. Given this possibility a poison pill can be thought of, in isolation, as "relatively harmless."

While the prospect of post-proxy contest dismantling mutes the potency of poison pills, the odds against this occurring lengthen markedly if a target company has a "staggered" board. While due to §211(b) of the DGCL the default rule is that directors of Delaware companies will stand for election at each annual shareholder meeting, §141(d) provides that a corporation may by way of its charter or a by-law approved by the shareholders group the directors into classes with each class (there typically will be three) being elected at successive annual meetings. When board elections have been staggered in this way, a bidder otherwise well situated to win a proxy contest where board seats are at stake could be forced to wait for two consecutive annual shareholder directorial elections to replace a majority of the incumbent directors.

A staggered board which has been adopted by way of a bylaw will be "ineffective" in the takeover context because a bidder who is able to acquire a sufficiently large number of shares to win a shareholder vote can orchestrate without board involvement shareholder passage of a bylaw dismantling the staggered board. In contrast, a staggered board incorporated in a corporation's charter will be "effective" because charter amendments must be proposed by the board, meaning that even with full shareholder backing a bidder cannot unilaterally declassify the board.

447 See Bebchuk, Coates & Subramanian, supra note 361, at 905, 907 (noting as well that efforts to eliminate for a bidder the option of pursuing a proxy contest by way of "no hand" "slow hand" and "dead hand" poison pills failed due to decisions of the Delaware courts in the late 1990s; citing Carmody v. Toll Bros. Inc., 723 A.2d 1180 (Del. Ch. 1998); Quickturn Design Sys., Inc., v. Shapiro, 721 A.2d 1281, 1289-92 (Del. 1998)).

448 Marcel Kahan & Edward Rock, Embattled CEOs, 88 TEX. L. REV. 987, 1007 (2010).

449 DEL. CODE ANN., tit. 8, §§ 141(d), 211 (2006); Bebchuk, Coates & Subramanian, supra note 361, at 893.


451 Id. at 1353 & n.110.

452 DEL. CODE ANN., tit. 8, § 242(b)(1) (2006); Bebchuk, Coates & Subramanian, supra note 361, at 894 (defining an "effective" standard board).
Even an effective staggered board will in isolation, however, be only a weak takeover defense. A bidder who uses a tender offer to acquire a majority shareholding in a target with an "effective" staggered board can be confident of ultimately gaining full board control by directorial elections. Moreover, in practice a successful bidder likely would not have to take two board elections to prevail. Given that the incumbent directors would struggle to accomplish anything against the will of the controlling shareholder and given the dubious legitimacy of a board lacking the backing of that shareholder those directors likely would resign. This would clear the way for the controlling shareholder to take full control of the target company.

Where the effective staggered board comes into its own as a takeover defense is when it operates in combination with the poison pill. As a practical matter, hostile bidders never "break through" a poison pill by pressing onwards after suffering the dilution associated with triggering the pill to buy enough shares to acquire a majority stake. Correspondingly, for a corporation with an effective staggered board/poison pill combination it is highly unlikely that a putative bidder will be able to gain sufficient voting clout to guarantee winning consecutive directorial elections. Indeed, it appears that there has yet to be a hostile acquisition where a bidder seeking to gain control of a target with a staggered board has persevered and waged two successful proxy contests to gain directorial control and then removed a poison pill. Moore v. Wallace Computer, a 1995 federal court decision involving a Delaware company, illustrated the post-Paramount effectiveness of the poison pill/staggered board combination. The court
ruled, relying on *Paramount* and the *Unitrin* decision\(^{461}\), that incumbent directors serving on a staggered board could keep a poison pill in place that was blocking a hostile bid even though the bidder had won the one-third of the board seats available in a proxy contest.\(^{462}\)

While the combination of a poison pill and an effective staggered board created a substantial obstacle to hostile takeovers in the wake of *Paramount*, this does not mean that Delaware jurisprudence was the primary reason that the Deal Decade ended, thereby fostering the operation of internal corporate governance mechanisms. The poison pill/effective staggered board combination that *Paramount* fortified was only going to be decisive in a subset of corporations, namely Delaware companies with effective staggered boards. It might be thought a pill would have to be in place as well, but by virtue of *Paramount* and similar cases, the directors of a Delaware corporation had wide discretion to adopt one whenever that might be convenient.\(^{463}\)

As of the mid 1990s approximately three out of five U.S. public companies had staggered boards,\(^{464}\) a majority of which were "effective."\(^{465}\) Assuming that the proportion was the same for Delaware companies, which again comprised in the 1980s about half of all public companies,\(^{466}\) this means Delaware companies with the potent anti-takeover defensive scheme in place fortified by *Paramount* constituted a minority within the entire population of publicly traded companies. It follows that in order for the market for corporate control to be side-tracked in the way it was at the beginning of the 1990s, factors other than Delaware case law must have come into play, with the tightening of credit markets being the most obvious contender.\(^{467}\) Correspondingly, while the *Paramount* decision may indeed have helped to prompt the switch of emphasis in favor of internal corporate governance


\(^{462}\) *Moore Corp. Ltd.*, 907 F. Supp. at 1557-58.

\(^{463}\) See Coates, *supra* note 455, at 286-87 ("[With respect to bidders, unless there is something unusual about the target, the target will have the ability to—and almost certainly will—adopt a pill as soon as you start your bid."); Klausner, *supra* note 450, at 1351 (explaining why the actual adoption of a pill was a "nonevent").

\(^{464}\) "Bebchuk, Coates & Subramanian, *supra* note 361, at 895 (discussing a sample of 2,421 large public companies drawn from 1993 to 1998 volumes of IRRC Corporate Takeover Defenses databooks). Most of the companies with staggered boards in place by this time introduced their staggered board regime prior to 1990, with a majority of these being implemented after 1984. *Id.* at 941.

\(^{465}\) "Bebchuk & Cohen, *supra* note 430, at 413 ("A minority of staggered boards [were] not fully effective.").

\(^{466}\) See *supra* note 431 and related discussion.

\(^{467}\) See MCCAULEY, RUUD & IACONO, *supra* note 63, at 73 (evaluating the impact of the *Paramount* case on the market for corporate control and concluding "the practical effect of the *Time* decision is questionable").
mechanisms at the beginning of the 1990s, it was by no means a controlling or decisive factor. As Chancellor Allen and Chief Justice Strine said in 2005 when assessing the practical impact of Delaware case law concerning the poison pill "[j]udicial decisions, after all, are important, but in the end only weakly control fundamental economic forces."

VI. SHAREHOLDER ACTIVISM

Decisions of Delaware courts may indeed have contributed to the transformation boards underwent as corporate governance grew in prominence and helped to foster the development of internal governance mechanisms by discouraging hostile takeover bids. In other respects, however, Delaware's impact on corporate governance was marginal. For example, aside from the boost Paramount may have provided by prompting institutional shareholders to shift their attention away from takeovers, neither Delaware legislation nor case law had a marked impact on shareholder activism.

Shareholder activism has come a long way in recent decades. In 1983, law professor Donald Schwartz argued that "promotion of shareholder welfare" would beneficially "impose restraints on all manner of abuse of by managers," but conceded that "most sophisticated observers" assumed "that shareholder participation is not capable of working well because of its impracticability and because of the rational indifference of shareholders to participation in corporate affairs." Thirty years later, the Financial Times, focusing on activism campaigns hedge funds had been launching, proclaimed that "[c]orporate America and activist investors have had a war; the activists have won." Correspondingly, as a Wall Street Journal columnist observed in 2014, activist investor priorities "hardened into the default boardroom agenda."

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468 William T. Allen & Leo E. Strine, Jr., When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law, 60 BUS. LAW. 1383, 1392 (2005).
469 See supra notes 409-11 and related discussion.
471 Cheffins, supra note 74, at 400 (quoting Carl Icahn, Web Mogul, FIN. TIMES, Oct. 26, 2013, 24)).
Changing ownership patterns do much to explain the shareholder activism surge. Throughout much of the twentieth century individual "retail" investors owned most of the shares in publicly traded U.S. companies. Due to pronounced collective action problems and a lack of relevant expertise, they were ill suited to step forward and keep executives of public companies in check. A dramatic shift in favor of institutional shareholding created more congenial conditions for activism and indeed in the 1990s public pension funds pressed for changes concerning takeover defenses, boardroom composition and executive pay. However, due to reluctance on the part of mutual funds and private pension funds to pursue a corporate governance agenda actively, the impact of institutional shareholders was not as dramatic as optimistic observers anticipated. Over the past decade, though, backing received from mainstream institutional shareholders has substantially bolstered the leverage of activist hedge funds.

Legal change at the federal level contributed to the surge in shareholder activism. The reforms the SEC introduced in 1992 in response to the lobbying effort Calpers commenced in 1989 to facilitate interaction between shareholders reduced the range of situations where there had to be compliance with requirements securities regulation imposed on parties seeking change through the use of proxy voting. Though activism by mainstream institutional shareholders failed to fulfill optimists' expectations the subset of institutional investors inclined to step forward began to take advantage almost immediately of the 1992 rule changes. The 1992 reforms also provided activist hedge funds with discretion to communicate with other shareholders that would serve them in good stead when they began pursuing their agenda in earnest in the early and mid 2000s.

There were no equivalent developments in Delaware. A 2009 amendment to the DGCL which authorized the adoption of bylaws facilitating the use of a corporation's proxy machinery in board elections by dissident shareholders could assist activist investors. However, the change was not transformative, given that the hedge fund activism surge

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473 Cheffins, supra note 57, at xix; see also Gordon, supra note 26, at 1492.
474 See supra notes 20, 69, 399-417 and accompanying text.
475 Cheffins, supra note 9, at 54.
476 Cheffins, supra note 74, at 400.
478 BLAIR, supra note 287, at 72.
479 Cheffins & Armour, supra note 477, at 90-91.
480 See supra note 107 and accompanying text.
U.S. public companies experienced was well underway when the law was changed.

Rulings of Delaware courts also generally had little direct impact on shareholder activism trends. Chancellor Allen's 1988 decision in Blasius Industries Inc. v. Atlas Corporation stands out as a possible exception. The case, both with respect to the outcome and the rhetoric Chancellor Allen deployed, affirmed the significance of shareholder voting at a time when this governance mechanism was thought to have only a minor role in disciplining management. The case arose when Atlas Corp.'s board sought to increase its size and appoint two of its own nominees to fill the new vacancies. Chancellor Allen struck down the move, indicating that the Atlas board had failed to provide the compelling justification that was required when steps were taken that impeded the effective exercise of the shareholder vote. Chancellor Allen, in making this ruling, underscored "the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance." The decision was hailed subsequently as "a milestone in defining board responsibility to the shareholders' right to vote."

While Chancellor's Allen vindication of shareholder voting rights in Blasius was consistent with the promotion of shareholder activism, it was not part of a more general trend. Instead, the shareholder activism agenda was rarely adjudicated upon in Delaware as it gathered momentum. Chief Justice Veasey made the point in a 1997 law review article, saying "[t]here is a long checklist of issues regularly raised by institutional investors. Many of these issues may never become issues in litigation." Among the examples he cited were the splitting the roles of CEO and chairman of the board, ensuring the presence of a lead independent director on the board, and fostering the use of incentivized remuneration for outside directors. Shareholder activism trends correspondingly illustrate how the judiciary's lack of control of the issues

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482 564 A.2d 651 (Del. Ch. 1988).
484 Blasius, 564 A.2d at 652.
485 Id. at 662.
486 Id.
addressed in its cases can compromise the courts' impact on corporate governance.\textsuperscript{490}

The Disney litigation provided a rare example of a situation where institutional shareholders sought to pursue their activist agenda in Delaware courts and indicated that the Delaware judiciary was not particularly sympathetic to such endeavours. In 2000, the CII filed an Amicus Curiae brief with the Delaware Supreme Court in an appeal made in relation to a pre-trial motion in the Disney litigation.\textsuperscript{491} The CII, having emphasized in the brief its significant interest in corporate governance issues and having stressed that independent directors were a cornerstone of Delaware's system of corporate governance, urged the Delaware Supreme Court to adopt a workable definition of "independent director" that took into account corporate governance realities.\textsuperscript{492} Despite referring to the CII as an "eminently prestigious corporate governance organization,"\textsuperscript{493} the Delaware Supreme Court declined to rule on CII's request on the basis that doing so was unnecessary to resolve the case.\textsuperscript{494} The Court also took the opportunity to emphasize that board composition was an issue for shareholders, not courts, to address:

The inquiry here is not whether we would disdain the composition, behavior and decisions of Disney's Old Board or New Board as alleged in the Complaint if we were Disney's stockholders. In the absence of a legislative mandate, that determination is not for the courts. That decision is for the stockholders . . . .\textsuperscript{495}

This stance—not surprising given the institutional limitations under which judges operate\textsuperscript{496}—helped to ensure Delaware courts played at best a tangential role with shareholder activism as it grew in prominence in U.S. public companies from the 1980s onwards.

Recent events indicate that to the extent that Delaware courts' rulings influence the ability of shareholders to intervene in corporate affairs, shareholder activism may be detrimentally affected. For instance, Chief Justice Strine offered a somewhat skeptical appraisal of

\textsuperscript{490}On the courts' lack of control of the agenda constituting a constraint in this context see \textit{supra} notes 178, 189-90 and related discussion.
\textsuperscript{491}Gelb, \textit{supra} note 200, at 534.
\textsuperscript{492}\textit{id.} at 534-35.
\textsuperscript{493}Brehm v. Eisner, 746 A.2d 244, 256 n.30 (Del. 2000).
\textsuperscript{494}\textit{id.} at 258 n.40.
\textsuperscript{495}\textit{id.} at 256.
\textsuperscript{496}See Part III.B.4.
shareholder activism in a 2014 law review article. He stated there was a "need for the now powerful institutional investor community to mature, and to strike a more sensible balance for those they represent" in reference to institutional shareholder opposition to poison pills. He did so in a milieu where a growing number of boards have been seeking to bolster leverage in dealings with activist investors by amending corporate by-laws to introduce a new generation of poison pill that kicks into operation at a lower threshold (typically around 10%) for shareholders who have disclosed in federal securities law filings an intention to be "active." In a 2014 case, the Delaware Court of Chancery upheld the validity of this sort of poison pill in a case involving auction house Sotheby's and activist Daniel Loeb's Third Point. The fact that Sotheby's, despite its courtroom victory, subsequently agreed to endorse Third Point's three nominees as directors indicates poison pills targeting hedge fund activists may not have a substantial impact. Nevertheless, while it is not clear how much of a setback the 2014 Chancery Court ruling was for shareholder activism, it was a setback nevertheless.

VII. EXECUTIVE PAY

Executive pay, as is the case with shareholder activism, is an important area of corporate governance where Delaware had a marginal impact as corporate governance was transformed. Largely due to changes occurring in the late 1980s and throughout the 1990s, executive compensation grew dramatically and became more closely tied to corporate performance, measured primarily in terms of shareholder returns. The CEO pay surge provoked dissatisfaction, which in turn provided the impetus for the SEC to bolster disclosure rules in the early 1990s and for the 2010 Dodd-Frank Act to introduce "say on pay" votes by shareholders as well as require public companies to establish compensation committees staffed by independent directors.

498 Id. at 498.
501 Cheffins, supra note 74, at 426.
502 See supra notes 79-80 and related discussion; see also Gordon, supra note 26, at 1530-31.
503 See supra note 81-82 and related discussion.
in contrast, largely sat out the reconfiguration of executive pay that accompanied the transformation of corporate governance.

Other than authorizing the board of a Delaware corporation to set director compensation the DGCL is silent on executive pay. Regulation of executive pay under Delaware corporate law has correspondingly been left to the courts, but their rulings had little impact on changes to executive pay that accompanied corporate governance's rise to prominence. Chancellor Chandler and Chief Justice Strine acknowledged the point in a 2003 law review article. Having recognized that there had been "huge Argentina-like inflation in executive compensation in more recent decades" they conceded, "Delaware's common law was perhaps slower than ideal in adapting to the new realities, which seem to many to cry out for a deeper and more skeptical judicial inquiry" but explained, "[t]he common law accretes knowledge, but not always at an optimal pace."

Chancellor Chandler had the opportunity in one particularly high-profile context to deploy the common law to impose a check on executive pay, this being the Disney litigation where the plaintiffs challenged the generous ($140 million) severance package Disney paid to executive Michael Ovitz when he left the company. The Delaware Supreme Court, in granting the plaintiffs an opportunity to replead their complaint in part, observed that "there is an outer limit" to the board's discretion to set executive pay "at which point a decision of the directors on executive compensation is so disproportionately large as to be unconscionable and constitute waste." This might have appeared to be a precursor to an interventionist approach to executive pay but Chancellor Chandler said subsequently at trial "the standard for waste is a very high one that is difficult to meet" and held that, even though he had said at an earlier stage in the proceedings that the payment to Ovitz was "extraordinary," the plaintiffs had indeed failed to make their case. The Delaware Supreme Court concurred, indicating that the plaintiffs' "claim [did] not come close to satisfying the high hurdle required to establish waste."

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504 See DEL. CODE ANN. tit. 8, § 141(h) (2006).
505 See Chandler & Strine, supra note 253, at 1001.
506 Id.
507 Brehm v. Eisner, 746 A.2d 244, 262 n.56 (Del. 2000).
509 See In re Walt Disney, 907 A.2d at 759; see also id. at 748-49.
510 See In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 75 (Del. 2006).
An inference that could be drawn from the severance package ruling in the Disney litigation was that "the corporate waste doctrine seemed all but abandoned," which implied in turn that Delaware courts had little appetite to address the controversies that had arisen concerning executive pay. This could be too simplistic. In the appeal arising from the Disney trial, the Delaware Supreme Court took the opportunity to stipulate what procedures a compensation committee would follow in a "best case" scenario. This may have been an instance where utterances of Delaware judges had "norm-generating value." Moreover, a 2009 decision by Chancellor Chandler to deny a preliminary motion to dismiss a case alleging that a generous retirement package paid by Citigroup to its departing CEO Charles Prince constituted waste signaled there indeed may be a meaningful judicially defined "outer limit" to a board's discretion to set executive pay. Nevertheless, as was the case with shareholder activism, the fact remains that with respect to executive pay's contribution to the transformation of corporate governance that began in the mid 1970s, Delaware had only a marginal impact.

VIII. CONCLUSION

Over the past four decades the corporate governance landscape in the United States has been transformed. Not only did the term "corporate governance" emerge from obscurity but boards were reconfigured in tandem with growing expectations of their contribution to managerial accountability, shareholder activism grew in prominence, and executive compensation ostensibly tied more closely to share performance increased dramatically. In seeking to account for this reconfiguration of the corporate landscape, Delaware is an obvious place to look. It can be thought of as the home of corporate America, with two-thirds of U.S. public companies being incorporated under Delaware corporate law, with Delaware courts deciding a large proportion of major corporate law cases, and with courts in other states often applying Delaware case law. Indeed, Delaware has been identified as a pivotal player in the corporate governance realm.

513In re Walt Disney, 906 A.2d at 56.
514Fisch, supra note 196, at 749.
515In re Citigroup, Inc. Shareholder Derivative Litig., 964 A.2d 106, 138 (Del. Ch. 2009); see Fisch, supra note 196, at 750 (discussing Citigroup).
516See supra notes 10-14 and related discussion.
What in fact has been Delaware's contribution to the development of corporate governance in the United States over the past four decades? The answer offered by this Article, briefly put, is substantial but not decisive. Delaware had only a marginal impact on important changes relating to executive pay and shareholder activism. On the other hand, in the case of boards of directors a series of well-known cases in the mid 1980s substantially reinforced emerging trends and Delaware jurisprudence contributed to the demise of the Deal Decade, which in turn likely prompted a shift in emphasis away from the market for corporate control to "internal" corporate governance mechanisms.

Given institutional constraints applicable to Delaware lawmakers it is not surprising that the state's impact on the transformation of corporate governance was not profound. Under what Chief Justice Strine has referred to as the "Delaware Model" of corporate law, it was never likely that the DGCL would have a decisive influence. Moreover, while features of courts that can compromise the standard-setting ability of the judiciary were not as pronounced in Delaware as potentially can be the case, they were in play nevertheless. This does not mean, however, that Delaware was a bit player with respect to the transformation of corporate governance. Delaware courts in particular issued a series of judgments that contributed substantially to governance changes affecting U.S. public companies. Correspondingly, any systematic historical account of the corporate governance transformation the United States has experienced over the past four decades would be seriously incomplete if Delaware's significant role was neglected.

517 See supra note 122 and related discussion.
518 On other significant aspects of this transformation, see Cheffins, Corporate Governance, supra note 88; Gerald F. Davis, Managed by the Markets: How Finance Reshaped America 62-63, 81-101 (2009); Mark S. Mizruchi, The Fracturing of the American Corporate Elite 204-18 (2013).