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# Regulatory Competition, Choice of Forum and Delaware's Stake in Corporate Law

Faith Stevelman

*New York Law School*, [faith.stevelman@nyls.edu](mailto:faith.stevelman@nyls.edu)

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

BY FAITH STEVELMAN\*

## ABSTRACT

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

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\*Professor of Law and Director, Center on Business Law & Policy, New York Law School. Special thanks are owed to Professor Steven Davidoff, and to NYLS Professors Molly Beutz, James Grimmelman, David Johnson, Edward Purcell, and Donald Zeigler, as well as participants in the NYLS Faculty Colloquium where an earlier draft was presented. This article is dedicated to my parents, Barbara and Harold Stevelman, who listened to its early beginnings in a Chinese restaurant in Yorktown, New York; and to Thelma Stuart, for her loving kindness across three generations.

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## I. INTRODUCTION

In matters of state corporate law, Delaware has won—that is the consensus among scholars, commentators, and practicing corporate lawyers. A majority of the largest public companies elect to incorporate in Delaware. Annual fees from selling corporate charters can generate as much as \$600 million or more<sup>1</sup>—about one-fifth of the state's total annual tax revenue.

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

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

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

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

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

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

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

<sup>2</sup>U.S. CONST. art. I, § 8, cl. 3.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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<sup>10</sup>924 A.2d 951 (Del. Ch. 2007).

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



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

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

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

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

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

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

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

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

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

## II. DELAWARE'S STAKE IN CORPORATE LAW

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

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

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

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

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

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

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

<sup>16</sup>Veasey & Di Guglielmo, *supra* note 14, at 1403.

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

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

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

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<sup>17</sup>Daines, *supra* note 15, at 1562.

<sup>18</sup>Bebchuk & Hamdani, *supra* note 1, at 578 & tbl.5.

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

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

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

<sup>22</sup>*Id.* at 1754.

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

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

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

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

<sup>24</sup>Delaware charges slightly higher franchise fees than do other states; but for large firms, the relative cost difference is *de minimis*. For information on Delaware franchise fee rates, see STATE OF DEL. DEPT OF FIN., 2007 FISCAL NOTEBOOK 97 (2008), [http://finance.delaware.gov/publications/fiscal\\_notebook\\_07/Section07/corp\\_franchise.pdf](http://finance.delaware.gov/publications/fiscal_notebook_07/Section07/corp_franchise.pdf). The franchise fee structure is set forth in the Delaware corporate code. See DEL. CODE ANN. tit. 8, §§ 391(a)(1)-(2), 503(a) (2001). Also, if one believes that Delaware law insufficiently restricts managerial agency costs, then managers who select Delaware are also able to "pass on" the higher cost of incorporation to the firm.

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

### B. *Fees and Prestige for the Delaware Bar*

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

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

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

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<sup>25</sup>DEL. LAWYERS' R. OF PROF'L CONDUCT § 5.5 (2008).

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

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

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

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

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

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

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<sup>28</sup>Hamermesh, *supra* note 21, at 1755.

<sup>29</sup>*Id.*

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

<sup>31</sup>*See id.* at 498-505.

<sup>32</sup>*Id.* at 503-04.

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

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

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

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

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

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<sup>34</sup>Veasey & Di Guglielmo, *supra* note 14, at 1408.

<sup>35</sup>*Id.*

<sup>36</sup>*Id.*

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

<sup>51</sup>924 A.2d 951 (Del. Ch. 2007).

### A. *History of the Internal Affairs Doctrine*

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

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

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

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

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

*Id.*

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

<sup>54</sup>*Id.* at 46.

<sup>55</sup>17 U.S. (4 Wheat.) 518 (1819). Technically, the case addressed a charter for a charitable corporation, Dartmouth College, but the charitable versus business corporation distinction was not considered significant.

<sup>56</sup>*Id.* at 554.

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

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

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

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

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<sup>58</sup>*Id.* at 696-704.

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

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

<sup>61</sup>*See* Tung, *supra* note 53, at 47.

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

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

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

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

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

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

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

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

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

### B. *Judicial Deference to the Chartering State*

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

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

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

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

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

<sup>70</sup>288 U.S. 123 (1933). See also *infra* Part V.E.1 (discussing *Rogers'* precedent and impact on the IAD).

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

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

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

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

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

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

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<sup>73</sup>330 U.S. 518 (1947).

<sup>74</sup>*Id.* at 528.

<sup>75</sup>*Id.* at 527.

<sup>76</sup>*Id.* at 527-28.

<sup>77</sup>*Koster*, 330 U.S. at 527-28.



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

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

### C. Choice of Corporate Law

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

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

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

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

<sup>80</sup>See RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§ 301-310 (1971).

litigated.<sup>81</sup> Second, the Restatement sets forth an expansive definition of corporate internal affairs<sup>82</sup> (consistent with that described above in Part II.A).<sup>83</sup>

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

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

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<sup>81</sup>*Id.* § 302 cmt. g.

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

*Id.*

<sup>83</sup>*See supra* Part II.A.

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

<sup>85</sup>MODEL BUS. CORP. ACT § 15.05(c) (1984).

<sup>86</sup>*Id.*

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

#### D. *The Regulatory Competition Defense for the IAD*

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

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

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

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

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

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

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

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

<sup>89</sup>*Id.*

<sup>90</sup>*Id.* at 697.

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

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

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

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

### E. *Constitutional Claims for the IAD*

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

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

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

<sup>94</sup>*Id.* at 597-98.

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

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

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

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

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

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

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

<sup>99</sup>871 A.2d 1108 (Del. 2005).

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

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

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

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

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

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

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

<sup>102</sup>VantagePoint I, 873 A.2d at 319.

<sup>103</sup>*Id.*

<sup>104</sup>*Id.* at 320.

<sup>105</sup>*Id.*

<sup>106</sup>VantagePoint I, 873 A.2d at 323.

<sup>107</sup>*Id.* at 325.

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

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

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<sup>108</sup>531 A.2d 206 (Del. 1987).

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

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

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

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



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

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

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

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

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

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

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

#### IV. FEDERAL THREATS TO DELAWARE'S PREMINENCE IN CORPORATE LAW

##### A. *Eradication Through Express Preemption*

Explicit federal preemption is the most salient, though not the most pressing threat to Delaware corporate law. There is no question that preemption is legally possible. Under the Commerce Clause, Congress has authority to regulate almost any aspect of interstate corporate affairs,<sup>115</sup> and legal scholars have at times enthusiastically supported the enactment of federal minimum corporate law standards.<sup>116</sup> Nevertheless, federal disinclination to preempt state corporate law dates back to the enactment of the Securities Act of 1933<sup>117</sup> and the Securities Exchange Act of 1934.<sup>118</sup> Rather than preempting state law, Congress has provided for a system of dual (federal and state) regulation of corporate governance. In enacting federal proxy laws, for example, Congress avoided legislating the subject matter that shareholders could vote on—leaving that to the states' corporate laws.<sup>119</sup> Even in 1968, in enacting the Williams Act and establishing federal tender offer laws, Congress focused primarily on promoting disclosure. It left entirely to state regulation the scope and nature of boards' freedom to resist unwanted bids.

The federal courts have also sought to avoid preempting state corporate law. This is evident in the U.S. Supreme Court's interpretations of section 10(b) and Rule 10b-5.<sup>120</sup> For example, in the landmark case of *Santa Fe Industries, Inc. v. Green*,<sup>121</sup> the Court declined to extend the federal antifraud prohibition to allegedly unfair acts and transactions which did not involve misrepresentation.<sup>122</sup>

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

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

<sup>116</sup>Cary, *supra* note 20, at 701-02.

<sup>117</sup>15 U.S.C. § 77a (2006).

<sup>118</sup>*Id.* § 78a.

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

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

<sup>121</sup>430 U.S. 462 (1977).

<sup>122</sup>*Id.* at 479.

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

## B. *Eclipse or Marginalization*

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

### 1. Federal Laws and SEC Regulations

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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<sup>136</sup>485 U.S. 224 (1988).

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

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

<sup>139</sup>See, e.g., Press Release, U.S. Dep't of Justice, Former Enron Chief Financial Officer Andrew Fastow Pleads Guilty to Conspiracy to Commit Securities and Wire Fraud, Agrees to Cooperate with Enron Investigation (Jan. 14, 2004), available at [http://www.usdoj.gov/opa/pr/2004/January/04\\_crm\\_019.htm](http://www.usdoj.gov/opa/pr/2004/January/04_crm_019.htm).

<sup>140</sup>See, e.g., Press Release, U.S. Dep't of Justice, Former McAfee General Counsel Indicted for Stock Options Backdating (Feb. 27, 2007), available at [http://www.usdoj.gov/usao/can/press/2007/2007\\_02\\_27\\_roberts.indictment.press.html](http://www.usdoj.gov/usao/can/press/2007/2007_02_27_roberts.indictment.press.html) (describing indictment of former general counsel of McAfee, Inc. in connection with stock options backdating in 2000 and 2002).

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

<sup>142</sup>See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101, 116 Stat. 745, 750 (2002) (establishing a "Public Company Accounting Oversight Board"); see also Press Release, U.S. Dep't of Justice, KPMG to Pay \$456 Million for Criminal Violations in Relation to Largest-Ever Tax Shelter Fraud Case (Aug. 29, 2005), available at [http://www.usdoj.gov/opa/pr/2005/August/05\\_ag\\_433.html](http://www.usdoj.gov/opa/pr/2005/August/05_ag_433.html) (discussing KPMG's involvement in a tax fraud that provided for over \$2.5 billion in evaded taxes).

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

(both through rulemaking<sup>144</sup> and enforcement actions<sup>145</sup>), and the federal courts have established a broad array of corporate governance-related rules and standards—ones which are at least as authoritative and efficacious as those in state corporate law.<sup>146</sup>

## 2. Listing Standards from the Exchanges and the NASD

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

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

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

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

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

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

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

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

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

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

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

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

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

requirements promulgated by the NASD and the exchanges<sup>153</sup> are superseding Delaware's criteria for defining director independence and ensuring their service consistent with shareholders' best interests.<sup>154</sup>

### 3. Shareholder Activist Initiatives

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

### A. *Incentives to File Suit Outside of Delaware*

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

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

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

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

<sup>162</sup>924 A.2d 951, 961 (Del. Ch. 2007) ("Random results may be good for plaintiffs' lawyers who can use the uncertainty factor that comes with disparate forums to negotiate settlements of cases that might otherwise be dismissed as unmeritorious.").

<sup>163</sup>879 A.2d 604, 640-42 (Del. Ch. 2005). See also Stevelman, *supra* note 43, at 857-59 (discussing the cash-out merger in *Cox* and the Delaware Court of Chancery's decision). Both *Cox* and *Topps* are discussed at greater length below.

<sup>164</sup>See *Topps*, 924 A.2d at 961 n.39.

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

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

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

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

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

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<sup>167</sup>Pub. L. No. 105-353, 112 Stat. 3227 (1998).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## B. *Alternative Tribunals, Alternative Procedural Rules*

### 1. In General

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

### 2. Juries

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

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

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

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

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

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

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

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

<sup>178</sup>879 A.2d 604 (Del. Ch. 2005).

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

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

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

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

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<sup>180</sup>*Id.* at 642-48.

<sup>181</sup>*Id.* at 605-06.

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

<sup>183</sup>*Cox*, 879 A.2d at 640-42.

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

<sup>185</sup>*Id.* at 640-41.

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

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

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

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

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<sup>186</sup>*Id.* at 641-42.

<sup>187</sup>*Cox*, 879 A.2d at 642.

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



courts are surely well aware of this as they decide corporate cases. Hence litigants' choices regarding forum, in combination with the limits of the IAD, results in a more balanced Delaware corporate law doctrine.

### C. *Delaware's Traditional Approaches to Resolving Forum Disputes*

A twin doctrinal framework governs equitable claims contesting forum in Delaware. Under the heading of *forum non conveniens*, a well-established jurisprudence governs motions to stay claims first filed in Delaware. For claims which are second filed in Delaware, in the alternative, the relevant framework is the so-called *McWane* doctrine, which favors the grant of a stay. In both instances, motions contesting forum are judged against pragmatic considerations, including the court's access to proof and witness testimony, and other practical considerations bearing on the court's ability to resolve the dispute fairly and expediently in the parties' interest. To be clear: in these equitable claims the defendant is not contesting the court's formal jurisdiction to hear the claim. That the court has the requisite personal and subject matter jurisdiction to proceed is not in question in these cases.

#### 1. First-Filed Actions—*Forum Non Conveniens* Doctrine

The most important principle in Delaware's *forum non conveniens* jurisprudence is that plaintiffs' forum choices are given great weight.<sup>189</sup> To prevail in a motion to stay or dismiss a first-filed claim based on *forum non conveniens*, a defendant must demonstrate that it would suffer

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<sup>189</sup>"Delaware courts consistently uphold a plaintiff's choice of forum except in rare cases . . . ." *Berger v. Intelident Solutions, Inc.*, 906 A.2d 134, 135 (Del. 2006). In *Berger*, the Delaware Supreme Court refused to grant dismissal, notwithstanding the fact that the court is aware of what "often happens in corporate litigation, [that] all of the documents and all of the likely witnesses in th[e] dispute are located outside of Delaware. In this case, the relevant evidence [was] all in Florida." *Id.* at 136. See also *Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Ref., L.P.*, 777 A.2d 774, 777-78 (Del. 2001) ("The standards that govern a motion to dismiss on grounds of *forum non conveniens* are well-established under Delaware law. A plaintiff seeking to litigate in Delaware is afforded the presumption that its choice of forum is proper and a defendant who attempts to obtain dismissal based on grounds of *forum non conveniens* bears a heavy burden.") (citations omitted); *Ison v. E.I. duPont de Nemours & Co.*, 729 A.2d 832, 835 (Del. 1999) (stating that in order for a defendant to have an action dismissed on *forum non conveniens* grounds it must show "that this is one of those rare cases where the drastic relief of dismissal is warranted based on a strong showing that the burden of litigating in this forum is so severe as to result in manifest hardship to the defendant").

"overwhelming hardship" if the court were to proceed.<sup>190</sup> Hence it is only in truly exceptional circumstances that the Delaware courts have granted a stay on *forum non conveniens* grounds. (Delaware's "classic" *forum non conveniens* jurisprudence is only applied to first-filed claims.) Again, it is the contesting party—the defendant requesting the stay—who has the burden of demonstrating it would suffer overwhelming hardship if the court were to proceed.<sup>191</sup> Though linguistic infelicity suggests the court should balance the equities in adjudicating *forum non conveniens* motions, this is not how the doctrine has developed.<sup>192</sup> Judicial balancing is expressly proscribed in Delaware's *forum non conveniens* jurisprudence.<sup>193</sup>

The Delaware Supreme Court has recognized the following factors as relevant to a court's decision making in *forum non conveniens* motions. Collectively, they are referred to as the *Cryo-Maid* factors:<sup>194</sup>

(1) the relative ease of access to proof; (2) the availability of compulsory process for witnesses; (3) the possibility of the view of the premises; (4) whether the controversy is dependent upon the application of Delaware law which the courts of . . . [Delaware] more properly should decide than those of another jurisdiction; (5) the pendency or nonpendency of a similar action or actions in another jurisdiction; and (6) all other practical problems that would make the trial of the case easy, expeditious and inexpensive.<sup>195</sup>

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<sup>190</sup>*Berger*, 906 A.2d at 135 (advising that "[t]he trial court recited the applicable legal standard and acknowledged that dismissal should be granted only in rare cases where a defendant would be subjected to overwhelming hardship").

<sup>191</sup>*Id.*

<sup>192</sup>*See, e.g.*, *Chrysler First Bus. Credit Corp. v. 1500 Locust Ltd. P'ship*, 669 A.2d 104, 107 (Del. 1994) (en banc) (reiterating that "a defendant must establish that one or more of the *Cryo-Maid* factors actually causes such significant hardship or inconvenience").

<sup>193</sup>*Aveta, Inc. v. Colon*, 942 A.2d 603, 607 n.7 (Del. Ch. 2008). In *Aveta*, a 2008 Court of Chancery decision, the court stated that "Delaware does not conceive of the *forum non conveniens* doctrine as a mere 'balancing of convenience test.'" *Id.* at 608.

<sup>194</sup>In *Ison*, the Delaware Supreme Court affirmed the consistency and stability of Delaware's *forum non conveniens* doctrine. As described therein, the court's "analysis has been guided since at least 1964 by what has come to be known as the *Cryo-Maid* factors." *Ison*, 729 A.2d at 837.

<sup>195</sup>*Id.* at 837-38 (quoting *Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1198-99 (Del. 1997)). *See also* *General Foods Corp. v. Cryo-Maid, Inc.*, 198 A.2d 681, 684 (Del. 1964) (establishing the factors to consider when addressing a *forum non conveniens* issue). As is evident from the text, many of these factors are mostly irrelevant to corporate law cases, including M&A litigation and other fiduciary disputes in corporate law. For example, there is almost never any need to view a physical premises. Documents can easily be transported nationally without undue inconvenience or expense and, in any event, there is no reason to assume the documents would be located in

These factors are consistently employed by the Delaware courts in adjudicating *forum non conveniens* motions.<sup>196</sup> Based on these factors, defendants' *forum non conveniens* motions are almost universally denied in Delaware.<sup>197</sup> Indeed, the Delaware court's general disposition to go forward and hear the claim before it applies even where later-filed, substantially similar proceedings are ongoing elsewhere.

The great respect afforded plaintiffs' choice of forum by the Delaware courts is expressed in *Mar-Land Industrial Contractors, Inc. v. Caribbean Petroleum Refining, L.P.*,<sup>198</sup> decided by the Delaware Supreme Court in 2001. In *Mar-Land* the court declared, "Our jurisprudence makes clear that, on a motion to dismiss for *forum non conveniens*, whether an alternative forum would be more convenient for the litigation, or perhaps a better location, is irrelevant."<sup>199</sup> Similarly, in 2006, in *Berger v. Intelident Solutions, Inc.*,<sup>200</sup> the supreme court stated that "Delaware courts consistently uphold a plaintiff's choice of forum except in rare cases . . . ."<sup>201</sup>

Importantly, as earlier noted, *Berger* demonstrates that the Delaware Supreme Court has been no less inclined to keep forum merely because another state's corporate law governs the dispute. In *Berger*, the Delaware Supreme Court denied the defendant's requested stay notwithstanding that it concluded the case presented novel issues of Florida corporate law.<sup>202</sup>

The Delaware Supreme Court's expansive approach to keeping forum over disputes governed by other states' corporate law presents a dilemma for the Court of Chancery vis-à-vis its recent rulings in parallel proceedings.<sup>203</sup>

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Delaware. Access to witness testimony has also been mostly irrelevant to choices among forums in corporate law cases, i.e., for the most part it is has had no practical significance in the courts' determinations in favor of one jurisdiction or another. Because these concrete, logistical factors are mostly irrelevant to the forum determinations at issue in these cases, they have not received significant treatment herein.

<sup>196</sup>See, e.g., *Berger*, 906 A.2d at 135; *Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Ref., L.P.*, 777 A.2d 774, 778 (Del. 2001); *Ison*, 729 A.2d at 837-38.

<sup>197</sup>See *Aveta, Inc.*, 942 A.2d at 608 (laying a legal foundation consistent with prior supreme court precedent, the court advised that the critical issue in deciding the issue of *forum non conveniens* is whether the defendant can show that any or all of the relevant considerations rise to the level of the defendant's suffering "significant, actual hardship" if the claim proceeds).

<sup>198</sup>777 A.2d 774 (Del. 2001).

<sup>199</sup>*Id.* at 779.

<sup>200</sup>906 A.2d 134 (Del. 2006).

<sup>201</sup>*Id.* at 135 (quoting *Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1198 (Del. 1997)).

<sup>202</sup>*Id.* at 137.

<sup>203</sup>See, e.g., *County of York Employees Ret. Plan v. Merrill Lynch & Co.*, No. 4066-VCN, 2008 WL 4824053, at \*2-5 (Del. Ch. Oct. 28, 2008); *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 958-61 (Del. Ch. 2007); *Ryan v. Gifford*, 918 A.2d 341, 348-51 (Del. Ch. 2007). *But see In re Bear Stearns Cos., S'holder Litig.*, No. 3643-VCP, 2008 WL 959992, at \*5-8 (Del. Ch. Apr. 9, 2008), *reprinted* in 33 DEL. J. CORP. L. 515, 522-28 (2008) (deferring to New York even though Delaware fiduciary law governed).

It undercuts the legitimacy of the Court of Chancery's claim that other courts should defer to Delaware when Delaware corporate law governs the dispute. Consistent with the most elementary principles of comity, Delaware cannot adopt a stance of "what's yours is mine and what's mine is mine" as the hallmark of its forum jurisprudence.

## 2. Second-Filed Actions—The *McWane* Presumption Favoring a Stay

Again, the counterpart of Delaware keeping forum in first-filed claims is the *McWane* doctrine or presumption.<sup>204</sup> *McWane* and its progeny establish a presumption favoring the stay of later-filed claims where earlier-filed, substantially similar proceedings are ongoing before a qualified tribunal.<sup>205</sup>

Under *McWane*, the *Cryo-Maid* factors are again crucial. As applied to later-filed claims, however, balancing is allowed and the presumption is in favor of staying the lawsuit.<sup>206</sup> The presumption in favor of granting the stay rests on principles of fairness and efficiency. The objective is to resolve the dispute in a timely and cost efficient manner, consistent with the litigants' best interests.

But there are also broader, institutional interests at stake in the *McWane* presumption. The *McWane* presumption promotes the perceived legitimacy of the judicial system by preventing unseemly judicial "turf wars." It also avoids the unseemliness of potentially conflicting judgments. These concerns are usually discussed under the (admittedly vague) rubric of "comity." The reliance on strict filing chronology to resolve equitable forum disputes—which is codified both in *forum non conveniens* jurisprudence and the *McWane* presumption—has provided a clear, objective standard. In this regard it has promoted the interests of the litigants in particular disputes and the interests of the judicial system.

Nevertheless, neither *forum non conveniens* nor *McWane* jurisprudence is a perfect fit for resolving forum disputes where there are substantially identical shareholder lawsuits ongoing in different forums.

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<sup>204</sup>*McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970).

<sup>205</sup>*Id.*

<sup>206</sup>*See id.* (affirming the rule that "litigation should be confined to the forum in which it is first commenced, and a defendant should not be permitted to defeat the plaintiff's choice of forum in a pending suit by commencing litigation involving the same cause of action in another jurisdiction of its own choosing").

*McWane* itself did not address this setting.<sup>207</sup> Nor has the Delaware Supreme Court had occasion to rule in this context. In this slight jurisprudential gap, the Court of Chancery is improvising, developing a new body of doctrine that partially expands upon, and partially deviates from, the so called *Cryo-Maid* factors. These new standards are examined immediately below.

#### D. *The Court of Chancery's Post-McWane Jurisprudence*

A point of clarification is in order here. Where there are multiple ongoing shareholder claims in different forums but Delaware has the first-filed claim, Delaware applies its *forum non conveniens* jurisprudence, which as earlier described almost inalterably leads to its keeping the case.

The new wrinkle is where substantially identical shareholder actions are pending in different forums, and Delaware has the later-filed claim. The new standards the Court of Chancery is devising to address this precise procedural setting are discussed hereinafter.

In determining whether to go forward with a later-filed claim where parallel proceedings are pending, the Court of Chancery is improvising. Some of the criteria it is employing are drawn from the *Cryo-Maid* factors. Others are new, and of the Court of Chancery's own devise. The emerging framework is remarkably flexible: more subjective than objective, and hence highly malleable to accommodate the court's preference. In almost all the recent, salient cases (M&A and fiduciary loyalty breach cases involving Delaware public companies), the court has deployed its new standards to keep forum and proceed with the litigation. The sole and fascinating exception is the litigation contesting the sale of Bear Stearns to J.P. Morgan, where Delaware arguably had more to lose from deciding the case, than it did from allowing New York to go forward (as described in Part V.F).<sup>208</sup>

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<sup>207</sup>The *McWane* presumption reflects the Delaware courts' respect for plaintiffs' choice of forum and the desire to prevent defendants from countermanning plaintiffs' forum choice by filing subsequent related (responsive) claims in their (the defendants') preferred forum. See, e.g., *Biondi v. Scrusby*, 820 A.2d 1148, 1159 n. 21 (Del. Ch. 2003) (stating that in regard to first-filed claims, *McWane* "was concerned with preventing defendants from defeating 'the plaintiff's choice of forum in a pending suit by commencing litigation involving the same cause of action in another jurisdiction of its own choosing'") (quoting *McWane*, 263 A.2d at 283).

<sup>208</sup>The litigation contesting the sale of Bear Stearns to J.P. Morgan is the exception in this regard. In that case the Court of Chancery stayed its jurisdiction in deference to the New York Supreme Court (where the litigation had been first filed and was ongoing, as discussed in the text). See *In re Bear Stearns Cos., S'holder Litig.*, No. 3643-VCP, 2008 WL 959992, at \*1 (Del. Ch. Apr. 9, 2008), reprinted in 33 DEL. J. CORP. L. 515, 516 (2008).

## 1. Less Deference to Strict Filing Chronology

The Court of Chancery is increasingly rejecting filing chronology as the standard for resolving whether to go forward or stay the claim before it in parallel proceedings. Filing chronology has been the doctrinal lynchpin under both *forum non conveniens* analysis (where it has overwhelmingly favored the court going forward with first-filed actions), and under *McWane* (where a presumption in favor of a stay applies to later-filed claims).<sup>209</sup> Disregarding filing chronology in forum motions involving parallel proceedings opens the door to the courts' exercise of far more subjective criteria, of course. And the rejection of filing chronology is a key move in Delaware's effort to keep forum in high-profile Delaware corporate lawsuits, especially because in high-stakes M&A and self-dealing cases substantially equivalent shareholder claims are commonly filed in different forums in rapid succession. In light of the common proximity in filing time, the Court of Chancery has opined that privileging filing chronology would be unduly formalistic and rigid in these cases. Indeed, it has stated that preferring the first-filed claim encourages a "race to the courthouse" and unprofessional lawyering by plaintiffs' counsel.

In this mode, the Court of Chancery has disregarded elapses of hours, days, and in one case even three weeks—holding that the claims were effectively *contemporaneously* filed. For example, in the *Bear Stearns* litigation, the Delaware claim was filed three days after the New York claim.<sup>210</sup> In the *Topps* litigation, the Delaware claim was filed one day after the New York claim.<sup>211</sup> In *In re IBP, Inc. Shareholders Litigation*,<sup>212</sup> IBP filed in Delaware five hours after Tyson filed in Arkansas.<sup>213</sup> And, in *Ryan v. Gifford*,<sup>214</sup> the Delaware fiduciary breach claim was filed three weeks after federal and state law claims were filed in California.<sup>215</sup> In each of these instances the Court of Chancery opined that the claims were in effect contemporaneously filed, and rejected filing chronology as an appropriate heuristic for resolving the dispute over forum. Furthermore, although

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<sup>209</sup>To clarify, again, Delaware is rejecting filing chronology in situations where it has the second- or later-filed claim. It is also not more amenable to letting go of first-filed claims, consistent with its *forum non conveniens* jurisprudence.

<sup>210</sup>*Bear Stearns*, 2008 WL 959992, at \*3, reprinted in 33 DEL. J. CORP. L. at 520.

<sup>211</sup>*In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 957 (Del. Ch. 2007) ("The first New York Action was filed a day before the first Delaware Action.").

<sup>212</sup>No. 18,373, 2001 WL 406292 (Del. Ch. Apr. 18, 2001).

<sup>213</sup>*Id.* at \*1.

<sup>214</sup>918 A.2d 341 (Del. Ch. 2007).

<sup>215</sup>*Id.* at 347.

Delaware had the later-filed claim in each of these instances, it refused to stay its jurisdiction in every case except *Bear Stearns*.

Certainly, there is room to argue that where claims are filed in close proximity employing filing chronology to resolve forum disputes seems inflexible or even arbitrary. But from another perspective, this inflexibility or rigidity promotes the positive goals of predictability and objectivity. Predictability benefits litigants; objectivity benefits the legal system.

Relying on filing chronology to resolve forum disputes in parallel proceedings allowed plaintiffs and defendants to be reasonably sure of where the litigation would proceed. Once a reasonably sound and comprehensive claim had been filed against a transaction, the plaintiffs and defendants could begin to prepare their cases accordingly. Relying on filing chronology to resolve forum also minimized motions practice in corporate litigation (thereby reducing unnecessary, costly litigation). The certainty arising from relying on strict filing chronology also limited the expense for plaintiffs who, as a result, would not have to initiate multiple proceedings challenging the same transaction. Hence, the rejection of filing chronology to decide forum seems inefficient. It therefore looks especially bad for Delaware because Delaware's jurisprudence has championed the importance of clear, predictable rules of decision.

Employing filing chronology as the standard to resolve forum also lent greater objectivity to forum disputes. It prevented the courts from relying on potentially self-serving criteria to resolve where the litigation would proceed. As an objective test, it also minimized the potential for unseemly judicial turf wars and the possibility of conflicting judgments. In these respects, relying on strict filing chronology promoted confidence in the judicial system's integrity.

Delaware's present disinclination to respect filing chronology in forum disputes in parallel proceedings thus raises cause for concern. As other courts become more aware of Delaware's new, more aggressive approach to resolving (and keeping) forum in parallel proceedings, there are likely to be more "standoffs" between Delaware and other jurisdictions. Delaware risks being perceived as a bully in keeping forum over later-filed claims. Hence, rejecting filing chronology as part of a strategy to keep high-profile Delaware corporate lawsuits in Delaware is risky—both for the state and its corporate law.

## 2. Favoring the Better-Drafted Complaint

The Court of Chancery is increasingly refusing to stay where it concludes that the complaint before it is better drafted.<sup>216</sup> The court has warned against a rule favoring first-filed complaints on grounds that a rule preferring the earlier-filed complaint, as a general matter, encourages hasty drafting, sloppy lawyering, and bad outcomes for Delaware corporate shareholders.<sup>217</sup>

For example, in refusing to grant the stay requested in *Biondi v. Scrushy*, Vice Chancellor Strine opined that the earlier-filed Alabama complaint was substandard compared to the one later filed in Delaware.<sup>218</sup> In the vice chancellor's words: "The public policy interest favoring the submission of thoughtful, well-researched complaints—rather than ones regurgitating the morning's financial press—would be disserved by granting a stay . . . ." <sup>219</sup> *Biondi* is representative of the Court of Chancery's new emphasis on the quality of the pleadings as a criterion for resolving forum disputes in parallel proceedings.

To be sure, this approach has some validity. If the Court of Chancery was confident that the earlier-filed complaint would be dismissed as legally insufficient, it would ill serve the plaintiffs' interest to stay the Delaware proceedings (assuming an adequately drafted complaint had been filed in Delaware). There is, however, a real danger that the Court of Chancery will put too fine a point on the matter. Most importantly, it has not endorsed a standard of "legal insufficiency" in deciding to go forward despite there being an earlier-filed complaint pending elsewhere. Nor is it clear that Delaware would ascertain whether the plaintiffs in the alternative forum had been given leave to amend their complaint or were in the course of so doing.<sup>220</sup>

<sup>216</sup>See, e.g., *Biondi v. Scrushy*, 820 A.2d 1148, 1153-54 (Del. Ch. 2003) (finding the Alabama complaint seriously substandard).

<sup>217</sup>In *Ryan*, Chancellor Chandler pressed the point, stating expressly that the Court of Chancery "has recognized that the adequacy of the complaint is a more important factor than time of filing in a *McWane* analysis . . . ." *Ryan*, 918 A.2d at 349.

<sup>218</sup>Vice Chancellor Strine explained:

[T]he Delaware Complaint dealt comprehensively with a series of trades and transactions by HealthSouth directors that the plaintiffs allege were consummated when the directors knew of the adverse effect the Group Rate Policy would have on HealthSouth, but the market did not. As important, the Delaware Complaint pled demand excusal with particularity.

*Biondi*, 820 A.2d at 1160.

<sup>219</sup>*Id.* at 1162.

<sup>220</sup>In *Biondi*, Vice Chancellor Strine concluded that even the amended complaint in the



Of course, pleadings matter tremendously. The adequacy or inadequacy of the complaint in shareholder lawsuits is an increasingly contentious matter at both the state and federal level.<sup>221</sup> There is far more attention being paid to the adequacy of the pleadings at the motions phase of corporate law derivative and class actions.<sup>222</sup> In state law derivative suits, complaints must contain particularized statements demonstrating demand futility—which is to say, in effect, a reason to doubt the board's capacity to objectively consider the merits of the lawsuit.<sup>223</sup> And in state law class actions, including disputes in M&A transactions, the complaint must present sufficient basis for the court to certify the class.<sup>224</sup> So the adequacy of pleadings is extremely important in both these essential corporate lawsuits.

However, as the Delaware judges are surely aware, adequacy and "quality" are not equivalents. It does not serve Delaware's interest to go forward in parallel proceedings (where the earlier-filed complaint is still pending) merely because the later-filed complaint before it is "better drafted." Doing so risks making the Delaware courts appear, once again, self-aggrandizing and, in this circumstance, petty and pedantic.

### 3. Less Deference to Plaintiffs' Choices in Derivative and Class Actions

In several of its recent forum rulings in parallel proceedings, the Court of Chancery cited the representative nature of the litigation as a rationale for keeping forum (notwithstanding that it had the later-filed complaint). It extended this rationale of less deference to plaintiffs' forum choices in both derivative and class actions.<sup>225</sup>

Why would the court afford lesser deference to plaintiffs' forum choices in derivative actions? In a derivative action, of course, the company is technically the injured party. The shareholders have suffered a loss

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Alabama "Tucker Action" was deficient. *Id.* at 1153-54.

<sup>221</sup>See, e.g., *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (clarifying the heightened pleading standards endorsed in the Private Securities Litigation Reform Act of 1995).

<sup>222</sup>For discussion of Delaware's jurisprudence on pleading standards in derivative and class actions, see *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38-39 (Del. 1996).

<sup>223</sup>See, e.g., *McCall v. Scott*, 239 F.3d 808, 816-17 (6th Cir. 2001) (citing *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)) (discussing the pleading requirements for demonstrating demand futility).

<sup>224</sup>For a case illustrating Delaware's approach to class certification, see *Barbieri v. Swing-N-Slide Corp.*, No. 14,239, 1996 WL 255907, at \*2-6 (Del. Ch. May 7, 1996), reprinted in 21 DEL. J. CORP. L. 1073, 1077-83 (1996).

<sup>225</sup>*In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 957 (Del. Ch. 2007) (quoting *Biondi*, 820 A.2d at 1159) (finding "the application of *McWane* to class and representative actions . . . 'troublesome,' because 'the potential divergence in the best interests of the plaintiffs' attorneys and the plaintiffs they are purporting to represent'").

derivatively through their interest as equity holders. At the level of formal law, the plaintiffs operate as "mere surrogates" asserting the corporation's claim in a derivative action. It is this formalism of shareholders as "mere surrogates," presumably, that is the Court of Chancery's rationale for affording their forum choice lesser deference in parallel proceedings.

This principle of affording lesser deference to plaintiffs' forum choice in derivative actions was first enunciated by the Court of Chancery in its 1998 opinion in *Dura Pharmaceuticals, Inc. v. Scandipharm, Inc.*<sup>226</sup> More recently it was affirmed in *Biondi v. Scrushy*, where Vice Chancellor Strine opined that the "potential divergence in the best interests of the plaintiffs' attorneys and the plaintiffs they are purporting to represent" justifies less deference to plaintiffs' forum choice in derivative actions.<sup>227</sup>

In actuality, the formal status of shareholder plaintiffs as "mere surrogates" in derivative actions seems like a red herring. More plausibly, it reflects the Court of Chancery's open cynicism about plaintiffs-lawyers' conduct in representative actions (as described earlier). For example, in *Topps*, Vice Chancellor Strine observed that plaintiffs' lawyers are seeking to file outside of Delaware in order to leverage greater uncertainty and earn higher fees. In so doing, he opined, they are undermining the best interests of Delaware shareholders in general.<sup>228</sup> Of course, Vice Chancellor Strine is entitled to his opinion about plaintiffs' lawyers. But certainly Delaware should not codify suspicions about the possible selfish motives of plaintiffs' lawyers' into its choice of forum doctrine under the rubric of shareholders being "mere surrogates" for the corporation in derivative actions.<sup>229</sup>

The unobserved difference in the status of shareholder-plaintiffs in derivative actions and class actions is also quite problematic. In *Topps*, the Court of Chancery extended the "lesser deference to plaintiffs' forum choice" rationale from derivative actions to class actions (and rejected the motion to stay the later-filed class claim before it). In reviewing the motion to stay the class action before the court, Vice Chancellor Strine opined that "[i]n the representative action context, *McWane* has far less bite and for good reason.

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<sup>226</sup>713 A.2d 925, 929 n.1 (Del. Ch. 1998).

<sup>227</sup>*Biondi*, 820 A.2d at 1159.

<sup>228</sup>*Topps*, 924 A.2d at 959 ("Random results may be good for plaintiffs' lawyers who can use the uncertainty factor that comes with disparate forums to negotiate settlements of cases that might otherwise be dismissed as unmeritorious. But random litigation results are not good for investors.").

<sup>229</sup>In *Ryan v. Gifford*, the Court of Chancery expansively embraced the principle of "lesser deference in derivative actions," opining that the *McWane* presumption of staying later-filed claims "presents great difficulty in shareholder derivative actions." *Ryan v. Gifford*, 918 A.2d 341, 349 (Del. Ch. 2007).

A first-filing plaintiff has no legitimacy to 'call forum' for all the other stockholders . . . ."<sup>230</sup> In *Topp*s, not only did the court fail to account for the distinctly different status of shareholder-plaintiffs in derivative and class actions, but, troublingly, the court erroneously described them as being "logically identical."<sup>231</sup> In actuality, the "plaintiffs as mere surrogates" rationale is wholly inapplicable to class actions. In class actions, shareholder-plaintiffs assert a direct injury they have incurred as a collective body. If the "mere surrogate" argument were the true basis for affording lesser deference to plaintiffs' forum choice in representative actions, it would certainly not be relevant to class actions.

In actuality, there are reasons to be suspicious of the court's rationale of "lesser deference to plaintiffs' forum choice" as applied to both derivative and class actions. In derivative actions, the plaintiffs will almost always be barred from going forward unless the board itself is incapable of asserting the company's interest (i.e., that "demand is excused"). In such an instance, the "mere surrogate" rationale for lesser deference to the plaintiffs' forum choice is no longer relevant. As for class actions, there is no reason at all to afford class plaintiffs' forum choice lesser deference, unless it is because the shareholder-plaintiffs are acting collectively. But this would be an odd rationale indeed, because in corporate law, collective bodies are the norm. Corporations, boards, and shareholders are all collective bodies, and this is never treated as a reason to afford their decisions less respect. The rationale of giving less respect to plaintiffs' forum choices in representative actions is most likely a placeholder, a cipher. Its function is to provide more discretion to the Court of Chancery to deny motions to stay in parallel corporate proceedings governed by Delaware law. Indeed, once the court has volunteered that less deference is owed to plaintiffs' forum choice in *both* derivative and direct actions, it has essentially acknowledged this.

This is because almost all shareholder actions against public companies are brought either as derivative or direct actions.<sup>232</sup> Claims of breach of loyalty, breach of care, and bad faith are almost always brought as derivative suits. Claims challenging M&A transactions are mostly brought as class actions. The Court of Chancery's move in the direction of affording lesser deference to plaintiffs' choice of forum in representative parallel proceedings is therefore deeply problematic. It represents a sweeping

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<sup>230</sup>*Topp*s, 924 A.2d at 956.

<sup>231</sup>*Id.* at 957.

<sup>232</sup>*Id.* ("The reality is that every merger involving Delaware public companies draws shareholder litigation within days of its announcement. An unseemly filing Olympiad typically ensues . . . .").

expansion of judicial discretion and a sweeping diminution in the respect afforded plaintiffs' forum choice as a general matter.<sup>233</sup> In addition, it contradicts the most basic principle in *forum non conveniens* jurisprudence, including Delaware's own (that is, respect for plaintiffs' choice of forum). Moreover, it appears patently hypocritical because Delaware seems perfectly happy to respect plaintiffs' forum choice in representative actions where Delaware has the first-filed claim. Once again, the new post-*McWane* framework seems short on principle and long on ambition.

This approach to comity may be a good short-term strategy for keeping Delaware corporate lawsuits, but it risks damaging the intellectual coherence and principled integrity upon which Delaware corporate law's long-term preeminence rests.

#### 4. Keeping Cases Presenting Novel Issues of Delaware Law

The final criteria the Court of Chancery has invoked as a basis for keeping forum in parallel proceedings is whether the case presents a novel issue of Delaware law.<sup>234</sup> This rationale has a stronger basis in law than the ones scrutinized above. Consistent with the IAD, where a novel issue of Delaware corporate law is presented, Delaware has a persuasive claim to keep forum and resolve the question.<sup>235</sup>

The problem with the novel issue criteria is not theoretical. It is practical. While the novel issue test sounds clear in the abstract, in practice its application would be almost wholly subjective and arbitrary. If "novel legal issue" means a question of first impression, the test would be clear, but also mostly irrelevant. Genuine legal questions of first impression are extremely rare, perhaps especially in corporate law. The constancy of fiduciary principles (the duty of care, loyalty, and good faith) means that there are hardly ever any genuine legal issues of first impression. Rather, it is the application of these constant fiduciary precepts to changing factual scenarios that makes the cases challenging and important. Indeed, the facts in corporate law cases are never precisely the same. And if the stakes were not high, the parties would have likely settled.

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<sup>233</sup> See *supra* Part V.B.3 and accompanying text.

<sup>234</sup> See, e.g., *In re The Topps Co. S'holders Litig.*, 924 A.2d 951 (Del. Ch. 2007); *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007); *Rapoport v. Litig. Trust of MDIP, Inc.*, No. 1035-N, 2005 WL 3277911 (Del. Ch. Nov. 23, 2005).

<sup>235</sup> This rationale is articulated most forcefully in *Topps*, as described more fully in *infra* Part V.E.

Should "unique" transactional facts that require the court to reinterpret or expand settled legal principles "count" to keep forum under the "novel issue of law" test? If so, then the novel issue standard provides Delaware a basis for keeping forum in almost all parallel proceedings. As this short review illustrates, the application of the "novel issues of law" test for keeping forum is highly indeterminate. Where the Court of Chancery wishes to keep the dispute, it should have little difficulty making the case for there being a novel issue of law. And the contrary is also true.

This indeterminacy is reflected most clearly, perhaps, in the Court of Chancery's interpretation of the novel issue standard in the *Bear Stearns* litigation (where the court granted the requested stay). In that case, the sale transaction was protected by lock ups of unprecedented dimension; the bank was certainly "in the vicinity" of insolvency; and the stakes could not have been higher. Nevertheless, the Court of Chancery concluded that while the facts were novel, the case presented no novel issue of Delaware corporate law (a conclusion that is difficult to accept at face value).<sup>236</sup> The other cases where the novel issue of law test has been applied do not inspire greater confidence.

In *Topps*, the court resolved that, in keeping forum, novel fiduciary loyalty issues were presented by the senior executives having obtained the right to remain in office after the company's sale to a private equity buyer.<sup>237</sup> In *Ryan*, the court held that the allegations of stock options backdating presented novel fiduciary loyalty issues, and the court resolved to keep forum.<sup>238</sup> In *Rapoport v. Litigation Trust of MDIP Inc.*,<sup>239</sup> the court found

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<sup>236</sup>*In re Bear Stearns Cos. S'holder Litig.*, No. 3643-VCP, 2008 WL 959992, at \*6 (Del. Ch. Apr. 9, 2008), reprinted in 33 DEL. J. CORP. L. 515, 524 (2008) ("Despite Plaintiffs' protestations to the contrary, the claims asserted in the Complaint only require the application of well-settled principles of Delaware law to evaluate the deal protections in the merger and the alleged breaches of fiduciary duty."). For commentary also concluding that the litigation presented many open and substantial issues under Delaware corporate law doctrine, see Kahan & Rock, *supra* note 4.

<sup>237</sup>*Topps*, 924 A.2d at 954. As described in *Topps*:

[T]he reality is that the Topps Merger is part of a newly emerging wave of going private transactions involving private equity buyers who intend to retain current management. This wave raises new and subtle issues of director responsibility that have only begun to be considered by our state courts. This factor bears importantly on the question of where this case should be heard. When new issues arise, the state of incorporation has a particularly strong interest in addressing them, and providing guidance.

*Id.*

<sup>238</sup>*Ryan v. Gifford*, 918 A.2d 341, 350 (Del. Ch. 2007) ("The allegations in this case involve backdating option grants and whether such practice violates one or more of Delaware's common law fiduciary duties. This question is one of great import to the law of corporations.").

<sup>239</sup>No. 1035-N, 2005 WL 3277911, at \*2 (Del. Ch. Nov. 23, 2005) ("This action will likely raise at least one novel issue of Delaware corporate law: whether directors and officers' duties

that a novel issue regarding boards' fiduciary duties was presented on account of the company's growing insolvency.<sup>240</sup> In each instance, there are reasons to be skeptical of the Court of Chancery's "novel issues of law" conclusion. With respect to *Topps*, Delaware has well-developed case law regarding boards' duties in overseeing and/or participating in buyouts.<sup>241</sup> In regard to the options backdating alleged in *Ryan*, Delaware has well-developed case law addressing boards' duties in overseeing executive compensation under the duty of care, disclosure,<sup>242</sup> and good faith.<sup>243</sup>

In sum, the "novel issues" rationale is almost entirely malleable—so plastic and indeterminate that it lacks meaning as a legitimate decisional criterion. Court of Chancery risks losing legitimacy when it invokes the "novel issue of law" test as a rationale to keep forum.

If Delaware is going to embrace the "novel issues of law" test as a rationale for keeping forum in parallel proceedings, this creates a conflict vis-à-vis its *forum non conveniens* jurisprudence. As mentioned previously, Delaware has chosen to deny defendants' *forum non conveniens* motions even where keeping the case requires it to resolve novel issues in sister states' corporate laws. This was exemplified in *Berger v. Intelident Solutions, Inc.*, as discussed earlier.<sup>244</sup> The Delaware courts cannot afford to

change materially in the face of 'deepening insolvency.'").

<sup>240</sup>*Id.* In fact, Delaware has a fairly expansive case law on the changing (or unchanging) duties of directors in the face of corporate insolvency. *See, e.g.,* Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 789 (Del. Ch. 1992) ("The existence of the fiduciary duties at the moment of insolvency may cause directors to choose a course of action that best serves the entire corporate enterprise rather than any single group interested in the corporation at a point in time when the shareholders' wishes should not be the directors only concern."); Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. 12,150, 1991 WL 277613, at \*34 (Del. Ch. Dec. 31, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099, 1155 (1992) (discussing "where a corporation is operating in the vicinity of insolvency," the directors owe duties not merely to shareholders but to the entire corporate enterprise, including the corporation's shareholders). For commentary, see Geoffrey B. Morawetz, *Under Pressure: Governance of the Financially Distressed Corporation*, in CORPORATE GOVERNANCE IN GLOBAL CAPITAL MARKETS 275 (Janis Sarra ed., 2003).

<sup>241</sup>The recent private equity deals are an extension of the management buyouts of the 1980s, which have been addressed in depth in Delaware's M&A case law. *See, e.g.,* Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Roberts v. Gen. Instrument Corp., No. 11,639, 1990 WL 118356 (Del. Ch. Aug. 13, 1990), *reprinted in* 16 DEL. J. CORP. L. 1540 (1991); *In re* RJR Nabisco, Inc., S'holders Litig., No. 10,389, 1989 WL 7036 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

<sup>242</sup>*See, e.g.,* Malone v. Brincat, 722 A.2d 5, 9-10 (Del. 1998); Jack B. Jacobs, *The Fiduciary Duty of Disclosure after Dabit*, 2 J. BUS. & TECH. L. 391 (2007); Faith Stevelman Kahn, *Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure*, 34 GA. L. REV. 505 (2000).

<sup>243</sup>*See* Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006). For discussion, see generally Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 DEL. J. CORP. L. 719 (2007) (discussing a triad of recent fiduciary duty cases, including *Stone*).

<sup>244</sup>906 A.2d 134, 136-38 (Del. 2006); *see also* Kolber v. Holyoke Shares, Inc., 213 A.2d 444 (Del. 1965). In *Kolber*, the Delaware Supreme Court noted that:

be seen as bullying and disingenuous—acting defensively to keep cases that present novel issues of Delaware law, while acting aggressively to keep cases that present novel issues of other states' corporate laws. The Delaware courts cannot retain their preeminence in corporate law in this fashion. They would lose respect and damage the stature of Delaware corporate law.

### 5. The Indeterminate Effect of Contractual Choice of Forum Provisions

Parties may contract over choice of forum. Indeed they commonly do so in merger agreements and other highly negotiated corporate and commercial contracts.<sup>245</sup> In several of the cases described herein, there were transactional documents which included choice of forum provisions.<sup>246</sup> Remarkably, in the *Topps* and *Bear Stearns* forum disputes, the Court of Chancery's forum decisions directly conflicted with the choice of forum provisions in the transactional documents. In *Topps*, there was a merger agreement which contained a New York choice of law and choice of forum clause.<sup>247</sup> Yet the Court of Chancery refused to grant the defendants' requested stay in favor of the New York Supreme Court—despite the choice of forum clause and despite New York's expressed intention to go forward.<sup>248</sup> In *Bear Stearns*, the transactional documents (a merger and stock exchange agreement) included a Delaware choice of forum provision. But here the Court of Chancery granted the stay in favor of New York.<sup>249</sup> In both instances, the Court of Chancery's forum decision was counter to the forum choice codified in the parties' contracts.

How could this happen? One reason may be the legal ambiguity surrounding the scope of such choice of forum provisions. Though the forum provisions obviously would apply to claims contesting the terms of the

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[t]his leaves the reason that unsettled New York law governs the case. This factor is not sufficient reason, in our opinion, for dismissal under the doctrine of *forum non conveniens*, either alone or in combination with the other factors mentioned. It is not unusual, of course, for Delaware courts to deal with open questions of the law of sister states or of foreign countries.

*Id.* at 446.

<sup>245</sup>For empirical analysis demonstrating that choice of forum provisions are far less common than choice of law provisions in corporate and commercial instruments, and that parties less commonly select Delaware forum than Delaware choice of law, see Eisenberg & Miller, *The Flight to New York*, *supra* note 160.

<sup>246</sup>*See, e.g., In re Bear Stearns Cos., S'holder Litig.*, No. 3643-VCP, 2008 WL 959992 (Del. Ch. Apr. 9, 2008), *reprinted in* 33 DEL. J. CORP. L. 515 (2008); *In re The Topps Co. S'holders Litig.*, 924 A.2d 951 (Del. Ch. 2007).

<sup>247</sup>*Topps*, 924 A.2d at 962.

<sup>248</sup>*Id.* at 964-65.

<sup>249</sup>*Bear Stearns*, 2008 WL 959992, at \*7, *reprinted in* 33 DEL. J. CORP. L. at 526.

transactional documents, the forum provisions might not be construed to extend to fiduciary breach claims contesting the board's or officers' conduct in the transactions. In *Topps* and *Bear Stearns*, the claims before the Court of Chancery focused on fiduciary questions, not contract-based ones. Delaware's ability to countermand (or disregard) forum provisions in M&A documents depends on the continued preeminence of fiduciary issues in these disputes, in comparison to more narrowly contractual claims and disputes. Of course, the Delaware courts will continue to highlight the pertinent fiduciary issues in transactional cases based on Delaware law. This is their core competence and the basis for their prestige. But if transactions involving Delaware public companies are litigated out of state, the contract law dimensions of these cases may obtain greater salience. This may be part of Delaware's calculus in keeping forum in parallel proceedings.

### E. *Topps*—A Case Study in Keeping Forum

In 2007, in its *Topps* decision, the Court of Chancery makes something akin to a universal claim of right to keep forum over Delaware corporate lawsuits in parallel proceedings. *Topps*' claims for Delaware forum cohere around two principles. The first, based on the IAD, is that Delaware incorporation (and thus Delaware choice of law) mandate Delaware forum. The second is that keeping Delaware corporate lawsuits in the Delaware courts is "efficient," in the sense of wealth maximizing, and thus best for investors. These claims are analyzed below.

#### 1. Internal Affairs Unbound: Our Law, Our Forum

Building on the bedrock of the IAD, *Topps* expands the "novel issues" rationale to a near universal claim of right on Delaware's part to keep forum in Delaware corporate lawsuits.<sup>250</sup> This is not the IAD as a choice of law regime, of course. Rather, in *Topps*, the Court of Chancery invokes the older, sovereignty-imbued IAD to propose that other courts should defer to Delaware in cases governed by Delaware corporate law.<sup>251</sup> The basic notion is that choice of forum should match choice of law—that the Delaware courts have a superior right to hear cases governed by Delaware corporate law. Hence, in parallel proceedings involving Delaware corporate law claims, Delaware should "win."

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<sup>250</sup>*Topps*, 924 A.2d at 958.

<sup>251</sup>*Id.* at 953-54.



To support this claim, the court cites two legal precedents: *Rogers v. Guaranty Trust Co. of New York*,<sup>252</sup> a five-to-four decision from the United States Supreme Court decided in 1933; and *Langfelder v. Universal Laboratories, Inc.*,<sup>253</sup> a decision of the New York Court of Appeals from 1944. The problem is that these citations do not add force to the court's forum argument because both cases have been superseded, if not overruled.

The New York case, *Langfelder*, held that foreign courts should defer to the courts of the incorporating state in corporate law cases.<sup>254</sup> It based its holding on the IAD—the idea being that foreign states should avoid meddling in the internal affairs of corporations incorporated elsewhere.<sup>255</sup> *Langfelder's* view of comity in corporate law cases was, however, subsequently rejected by the New York appellate courts. This is evident from the case of *Broida v. Bancroft*,<sup>256</sup> decided in 1984, for example. (Nor, despite the citation in *Topps*, would New York's precedents have any real, binding authority for Delaware in this matter, of course.)

The U.S. Supreme Court precedent cited in *Topps* is similarly unhelpful to its "superior claim to forum" argument. As it bears on comity in corporate law cases, *Rogers* has also been superseded (if not overruled) by the U.S. Supreme Court, as mentioned earlier.<sup>257</sup> In *Koster v. (American) Lumbermens Mutual Casualty Co.*,<sup>258</sup> the Court admonished that *Rogers* did not establish a rule that foreign courts should defer to the courts of the incorporating state—rather, only, that it was within their discretion to so defer in deciding motions in forum disputes.<sup>259</sup> In sum, these precedents do not support *Topps'* claim that foreign courts should defer to Delaware in Delaware corporate lawsuits.

Moving away from precedent, *Topps* next embraces the older sovereignty-based concepts which have attached to the IAD to support the argument that Delaware courts have a superior right to resolve Delaware

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<sup>252</sup>288 U.S. 123 (1933).

<sup>253</sup>56 N.E.2d 550 (N.Y. 1944).

<sup>254</sup>*Id.* at 552.

<sup>255</sup>*Id.*

<sup>256</sup>478 N.Y.S.2d 333 (N.Y. App. Div. 1984) (reversing lower courts dismissal of a shareholders' derivative action against a foreign corporation); *see also* *Tosi v. Pastene & Co.*, 308 N.Y.S.2d 472 (N.Y. App. Div. 1970) (denying a motion to dismiss and allowing a New York court to entertain a proceeding to dissolve a foreign corporation under the common-law standard).

<sup>257</sup>*See supra* notes 73-77 and accompanying text.

<sup>258</sup>330 U.S. 518 (1947).

<sup>259</sup>In *Koster*, (the later and, hence, more authoritative case), the Supreme Court held that "[t]here is no rule of law . . . which requires dismissal of a suitor from the forum on a mere showing that the trial will involve issues which relate to the internal affairs of a foreign corporation." *Id.* at 527.

corporate lawsuits. The opinion reiterates the nostrum that corporations are "creatures of state law" and affirms the principle that singularity in corporate choice of law is of the essence.<sup>260</sup> These arguments were front and center in the *VantagePoint* litigation of course, and their shortcomings were discussed previously in Part III.<sup>261</sup> Invoking the IAD and state sovereignty principles, *Topps* proposes that it is customary or legally "normal" for choice of law to be dispositive of choice of forum (or at least that this should be the rule in forum disputes in parallel proceedings). But at least since the second half of the twentieth century, as described earlier, this has not been the rule. Instead, as the result of expansive rules of personal jurisdiction, federal diversity and supplemental jurisdiction, and federal removal and transfer rules, state corporate law claims are triable and are tried in many different state and federal forums.<sup>262</sup>

Hence, a rule of judicial deference to the incorporating state's courts would be a new rule, or the return to an outmoded, early twentieth-century rule. Collapsing choice of forum into choice of law is definitively not the current rule or practice. *Topps'* claim that Delaware corporate lawsuits belong in Delaware, consistent with the IAD, simply does not fit the present legal reality.

Returning to precedent, as set forth in the *Cryo-Maid* factors endorsed by the Delaware Supreme Court, choice of law is indeed a factor that may be relevant in a forum dispute. For example, whether Delaware law governed would be one of several factors that the Delaware courts might properly consider, under the *Cryo-Maid* factors, in entertaining a motion to stay or dismiss. But as described in *Cryo-Maid*, which state's law governs would ordinarily have no special weight in the resolution of the forum dispute. It might obtain special weight in the court's consideration of whether to stay or dismiss, *but only if there was something exceptional in the law presented by the case*—some exceptional legal question "which the courts of . . . [the state of incorporation] more properly should decide than those of another jurisdiction."<sup>263</sup> Against the background of the *Cryo-Maid* factors, and the

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<sup>260</sup>*In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 953 (Del. Ch. 2007).

<sup>261</sup>See *supra* Part III.E (discussing the *VantagePoint* litigation).

<sup>262</sup>For discussion, see EDWARD A. PURCELL, JR., LITIGATION AND INEQUALITY 224-54 (1992).

<sup>263</sup>*Berger v. Intelident Solutions, Inc.*, 906 A.2d 134, 136 (Del. 2006). As stated in *Berger's* enumeration of the *Cryo-Maid* factors, in considering the six factors which affect equitable forum disputes, the Delaware courts should consider: "(4) whether the controversy is dependent upon the application of Delaware law *which the courts of this State more properly should decide than those of another jurisdiction . . .*" *Id.* (emphasis added). If Delaware law was an inherently compelling determinant of Delaware control over forum, the caveat at the end would be redundant. In point of fact, in its post-*McWane* jurisprudence, the Court of Chancery has often dropped the full text of

New York and U.S. Supreme Court precedents cited by the court, *Topps'* arguments based on the IAD, and its efforts to tie choice of forum to choice of law fall flat.

## 2. Delaware Adjudication and Clarity in Delaware Corporate Law

As expressed in *Topps* and elsewhere, the Court of Chancery's most fervent claim for keeping forum in parallel proceedings is that Delaware adjudication will foster optimal clarity and coherence in Delaware corporate law. Because Delaware courts will produce the clearest decisions, according to the Court of Chancery's recent forum rulings, keeping Delaware corporate law in the Delaware courts will benefit investors. As stated in *Topps*, the adjudication of Delaware corporate law by other state or federal courts will, to the contrary, increase doctrinal uncertainty and incoherence, and thus increase economic inefficiency harmful to investors.<sup>264</sup>

This conviction is repeated throughout the *Topps* opinion. As stated therein: "[T]he chartering state has a powerful interest in ensuring the uniform interpretation and enforcement of its corporation law, so as to facilitate economic growth and efficiency."<sup>265</sup> Elsewhere *Topps* states that "a state has a compelling interest in ensuring the consistent interpretation and enforcement of its corporation law."<sup>266</sup> And in another section, *Topps* states that "important coherence-generating benefits created by our judiciary's handling of corporate disputes are endangered if our state's compelling public policy interest in deciding these disputes is not recognized and decisions are instead routinely made by a variety of state and federal judges who only deal episodically with our law."<sup>267</sup> Obviously, these are tremendously passionate calls for keeping Delaware corporate lawsuits in the Delaware courts.

In some measure, they are empirical claims—claims about the causal relationship between choice of law, choice of forum, doctrinal clarity, and economic efficiency. The testing of the empirical dimensions of these claims is beyond the bounds of this article. It is noteworthy, however, that as empirical claims for keeping Delaware corporate law in Delaware's

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factor four and abbreviated it as being merely "whether Delaware law applies to the action." But in so doing the Court of Chancery has altered the *Cryo-Maid* factors as recognized by the Delaware Supreme Court.

<sup>264</sup>*Topps*, 924 A.2d at 953, 958-59.

<sup>265</sup>*Id.* at 953.

<sup>266</sup>*Id.* at 958.

<sup>267</sup>*Id.* at 959.

courtrooms, they are not supported by the Court of Chancery's citation to empirical evidence.

Experience, at least, would seem to contradict the above assertion that efficiency losses and doctrinal chaos will result from the emigration of Delaware corporate law claims. This is because we already live in a system where litigants have, and have had for decades, substantial choices among other state and federal forums in adjudicating Delaware corporate law cases. There are no signs that this freedom of choice has had dire effects on Delaware's doctrine, the broader legal system, or the economy. Indeed, the Court of Chancery's opinions have effectively conceded as much because their starting point is that Delaware corporate law doctrine is presently clear and coherent.

What has most likely changed is not the potential for investors to be harmed by Delaware corporate lawsuits being adjudicated elsewhere. Nor is Delaware's fiduciary doctrine likely to be rendered incoherent by other state or federal courts' interpretations. What has most likely changed is Delaware's perception of the likelihood of it sustaining its successful chartering business and its preeminence in nationally significant corporate law. Apparently the Court of Chancery believes that it can bolster Delaware's future preeminence in corporate law by keeping more Delaware corporate lawsuits in Delaware courts. But the particular arguments that the Court of Chancery is making and the rationales and principles it is invoking for keeping forum in parallel proceedings are not particularly coherent or persuasive. They are more likely to undermine the quality and integrity of Delaware corporate law than promote it.

### 3. Reconsidering Clarity and Efficiency in Delaware Corporate Law

In considering the Court of Chancery's claims about out-of-state adjudication and its potential to render Delaware corporate law less clear and coherent, it is essential to recall that decisions from other jurisdictions are nonbinding on Delaware or other courts' interpretations of Delaware law. As a matter of formal law, only the Delaware courts (and legislature) can define Delaware corporate law. Other states cannot truly damage Delaware corporate law, at least not directly.

So, again, in what sense could the adjudication of Delaware corporate law by other state or federal judges impair that law or Delaware's interests? "Bad" decisions from other states could potentially damage the popular perception of the quality of Delaware law. This could hurt Delaware's chartering business. "Bad" decisions from other courts could reduce chartering firms' confidence that they will get what they think they are

paying for; this could reduce firms' incentives for chartering in Delaware. Widespread variation in other tribunals' adjudication of Delaware corporate law could reduce the indentifiability of Delaware's brand of corporate law, which also might reduce an out-of-state firm's incentive to charter in Delaware. Truly radical "claims flight" could eventually diminish Delaware's corporate case load so that its body of corporate law precedents would be less rich, and its judges less practiced. Claims emigration at this level, however, is highly unlikely. And, finally, there is the feedback effect described earlier. If plaintiffs or defendants commonly anticipate that they will achieve more favorable results by litigating out of state, then Delaware judges may have to adjust their own decision making in order to diminish the incentive for such claims emigration. This article proposes that the system's porousness is ultimately good for Delaware corporate law. But the loss of control would not feel good to Delaware's judges.

At this juncture the loss of clarity issue deserves some further consideration on the merits. The law and economics school of thought has conflated clear corporate law with good, wealth maximizing corporate law. But the connection has been pressed too far. Law can be clear and yet inefficient in its result. The operative notion has been that so long as private laws are clear and relatively stable, and choice among different systems of law is possible, then private parties will select the best, most wealth-maximizing laws. The narrative is quite compelling at this theoretical level. In practice, however, there are limits and impediments that disrupt the tight circuit between clear law and wealth maximization. For example, investing is not a la carte: you cannot separately assemble a company you like, in an industry you like, with the managers you trust, and the corporate laws you prefer, or ideally would prefer. The choices are not infinite, and they are bundled. And information is incomplete. And rationality is bounded—and that only begins the discussion of the behavioral limits affecting investors' pursuit of profit and law's role in promoting it. This means that claims for the connection between clear law and wealth maximization are easily exaggerated. There are intrinsic "glitches" in the clarity/efficiency circuit.

Stripping away this supra-layer of theory, just how clear and coherent is Delaware's fiduciary doctrine anyway? In actuality, certain well respected scholars have argued that Delaware's success in corporate law is attributable in large measure to its law's Gnostic qualities. That for the most part, Delaware's fiduciary doctrine is comprised of normatively saturated, ethical/transactional "sermons" served up with a large dose of caution

regarding the imposition of harsh, concrete sanctions.<sup>268</sup> (The doctrinal phenomenon has sometimes been described in terms of "acoustic separation.") In this vein, Delaware's corporate fiduciary law exists (metaphorically speaking) as jurisprudential flashes of divine lightning whose primary function is to warn of dire consequences for misconduct without starting too many fires. This accepted, characteristic of Delaware's fiduciary doctrine does not fit neatly into the model of clear law yields the most wealth.

Even at a simpler, even narrower doctrinal level, there is less clarity in Delaware's fiduciary case law than one might anticipate. Professors Kahan and Rock have described the present fluidity, if not genuine opacity, in several of Delaware's signature fiduciary doctrines relating to boards' duties in M&A transactions. They have analyzed these several doctrines as they relate to the shareholder claims filed against the sale of Bear Stearns to J.P. Morgan.<sup>269</sup> Kahan and Rock's writing has accurately captured the multiplicity of the relevant fiduciary standards, and the many questions that the case law does not clearly resolve, as applied to this recent important transaction.<sup>270</sup>

There is another reason to doubt Delaware's absolute commitment to clarity in corporate law standards. If clarity was the single goal of Delaware's corporate jurisprudence then, presumably, the Court of Chancery would stick more closely to the Delaware Supreme Court's pronouncements. Instead, the Court of Chancery not uncommonly departs from the letter of the law as enunciated by the Delaware Supreme Court. For example, this is evident in the forum rulings in parallel proceedings under discussion. The Court of Chancery is neither applying the Delaware Supreme Court's *forum non conveniens* jurisprudence (which applies to first-filed claims), nor the *McWane* presumption (favoring the grant of a stay in later-filed claims).

The Court of Chancery may be entirely justified and wise in charting a new course, but in so doing it is not promoting clear corporate law. The

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<sup>268</sup>See Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1919 (1998). See also Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1015-17 (1997) (arguing that Delaware corporate law's vitality lies precisely in its normatively laden, open-ended narratives).

<sup>269</sup>Kahan & Rock, *supra* note 4 (discussing the broad range of fiduciary standards relevant to the sale of Bear Stearns to J.P. Morgan and their indeterminate application).

<sup>270</sup>*Id.* The Delaware judges have themselves complained about the multiplication of standards of review in corporate law. This complaint is addressed to the freezeout doctrine by Vice Chancellor Strine in *Cox. In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 642-47 (Del. Ch. 2005). The same complaint was aired at length by members of the Delaware bench. See William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001).

same bold "creative destruction" is evident in the Court of Chancery's rulings on freezeout transactions. The Court of Chancery has expressed its views on the inadequacy of the supreme court's doctrine both for tender offer-based freezeouts and single step cash out merger freezeouts, and is seeking to apply new standards to both contexts.<sup>271</sup> Once again, this may be wise and the right thing to do for investors, but there is no question that it makes it more difficult to know what Delaware corporate law "is" in these transactions. This is quite a dramatic form of "lack of clarity."

Reading *Topps* carefully, it is not even clear that the Court of Chancery is persuaded that Delaware's fiduciary jurisprudence is so very clear and coherent. In *Topps*, the court argues that really only the five chancellors on the Court of Chancery and the five justices on the Delaware Supreme Court can dependably apply it accurately and consistently.<sup>272</sup> *Topps* expressly proposes that the continued coherence of Delaware corporate law rests in the hands of the small cadre of judges on the Court of Chancery and the Delaware Supreme Court.<sup>273</sup> Institutionally speaking, this is a very risky argument for Delaware to make in defense of its corporate law. In a nation "of laws, not men," the most preeminent brand of U.S. corporate law should not be so complex or opaque or vague that it can only reliably be interpreted by ten jurists. If Delaware is to keep preeminence as the purveyor of national corporate law, it should not be because Delaware judges are, like Gnostic priests, uniquely able to interpret it.

#### F. *More on Motives to Refuse to Stay*

The discussion immediately below focuses on certain incentives which are shaping the Court of Chancery's "post-*McWane*" forum decisions. Several of them have been touched on earlier.

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<sup>271</sup>For discussion of the Court of Chancery's, and in particular Vice Chancellor Strine's, willingness to take license in reinventing Delaware corporate fiduciary doctrine in regard to controllers' going-private transactions, see Stevelman, *supra* note 43. This is not to say that the vice chancellor's interpretations are "incorrect." Rather, the point is that he has been unhesitating in altering the fabric of Delaware corporate law as he sees necessary. This may produce better fiduciary doctrine, but it does not produce more uniform or clearer standards—in light of the gaps which will arise between the Delaware Supreme Court's pronouncements and the more daring members of the Court of Chancery.

<sup>272</sup>"[I]t is natural to expect that we have some advantage in our own domain." *Topps*, 924 A.2d at 964 n.43.

<sup>273</sup>*Id.* at 958-59 (explaining the benefits derived from having ten judges decide important corporate law issues, as opposed to the much larger federal judiciary).

### 1. Publicity, Prestige, and Fees: Delaware's Incentive to Keep High-Profile M&A and Self-Dealing Cases

It is plain that the Court of Chancery is going out of its way to keep forum in high-profile M&A cases and fiduciary loyalty and good faith claims against Delaware incorporated public companies. These cases are the crown jewels, the most value-producing "brands" in Delaware corporate law. Delaware needs the fees generated from keeping large, famous public companies incorporated in Delaware, and the media attention their transactions (and attendant litigation) generate.

In the category of recent forum disputes in public company M&A deals, there is *Merrill Lynch*,<sup>274</sup> *Topps*,<sup>275</sup> and *Tyson*.<sup>276</sup> In the category of alleged fiduciary loyalty and good faith breaches, there is *Ryan v. Gifford* (a stock options backdating case),<sup>277</sup> *Rapoport v. Litigation Trust of MDIP Inc.* (alleging loyalty and good faith breaches against corporate directors and officers),<sup>278</sup> and *Biondi v. Scrushy* (alleging misrepresentation and insider trading claims against directors).<sup>279</sup> In each instance, there were substantially equivalent claims proceeding elsewhere, and the Court of Chancery had the later-filed complaint before it. If the court had adhered to *McWane*, it would have had to grant the requested stays. Instead, in each of these cases, the court rejected the motion to stay—despite parallel litigation having been commenced elsewhere. In this respect, the decisions reflect Delaware's tenacity in keeping forum and the Court of Chancery's daring inventiveness in reaching this result.

The great exception to this pattern is the Court of Chancery's grant of the requested stay in the *Bear Stearns* case, as mentioned earlier.<sup>280</sup> Watching the company's liquidity evaporate with breathtaking rapidity, Bear Stearns's board had agreed to an impromptu, "rescue" sale to J.P. Morgan. The transaction was backed by the Federal Reserve and the Treasury—their

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<sup>274</sup>County of York Employees Ret. Plan v. Merrill Lynch & Co., No. 4066-VCN, 2008 WL 4824053 (Del. Ch. Oct. 28, 2008).

<sup>275</sup>*In re The Topps Co. S'holders Litig.*, 924 A.2d 951 (Del. Ch. 2007).

<sup>276</sup>*In re IBP, Inc. S'holders Litig. v. Tyson Foods, Inc.*, No. 18,373, 2001 WL 406292 (Del. Ch. Apr. 18, 2001).

<sup>277</sup>918 A.2d 341, 361 (Del. Ch. 2007).

<sup>278</sup>No. 1035-N, 2005 WL 5755438, at \*5 (Del. Ch. Nov. 23, 2005) (requiring the court to analyze whether directors' or officers' fiduciary loyalty and good faith duties are altered in the face of deepening insolvency).

<sup>279</sup>820 A.2d 1148, 1166-67 (Del. Ch. 2003).

<sup>280</sup>*In re Bear Stearns Cos., S'holder Litig.*, No. 3643-VCP, 2008 WL 959992, at \*8 (Del. Ch. Apr. 9, 2008), reprinted in 33 DEL. J. CORP. L. 515, 527-28 (2008).



support validated the transaction's widely perceived importance to the markets.

Nevertheless, Bear Stearns's shareholders protested that the price was too low and that the deal had been forced upon them in light of the lock ups granted to J.P. Morgan. Motions for a preliminary injunction to block the sale were commenced in the New York Supreme Court, and then in the Court of Chancery as well. Upon the defendants' motion, and in the face of New York's determination to proceed, Vice Chancellor Parsons granted the requested stay.<sup>281</sup>

Why in *Bear Stearns* did the Court of Chancery agree to stay its jurisdiction, when it had declined to do so in the other notable cases referred to above? In actuality, the move was a deft one on the part of the Court of Chancery. Arguably it avoided a classic "lose-lose" situation.

Granting an injunction against Bear Stearns's sale would have posed real dangers for Delaware. On the merits, however, a strong case could be made that this was exactly what the court would have to do. The price agreed to was quite low; the deal was rushed; and the lock ups were of a genuinely unprecedented scale. Though they had been approved by the board (evidently in good faith), the lock ups had not been approved by the shareholders of course.<sup>282</sup> The value conferred on J.P. Morgan in the transaction raised genuine doubts about whether Bear Stearns's board had fulfilled its fiduciary duties to the company's shareholders in so rapidly agreeing to the sale. In light of Delaware's fiduciary precedents, these factors suggested that the court might have to grant the preliminary injunction. This prospect would have been deeply unnerving for the Court of Chancery—on account of Bear Stearns's dire financial situation, the involvement of the Federal Reserve and the Treasury Department, and the possible negative macroeconomic consequences for the financial system if Bear Stearns were to fail. Tremendously negative publicity, in the worst case, would have been directed against the Delaware court.

Hence, in *Bear Stearns*, the court faced the prospect of either applying the relevant precedents according to their terms, and unsettling a much favored transaction, and perhaps the financial system, or departing from its established doctrinal framework to facilitate the transaction, thereby establishing precedent arguably adverse to Delaware corporate shareholders' best interests. Both possibilities would have been unattractive to the court, as professors Kahan and Rock have also observed.<sup>283</sup> Under these

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<sup>281</sup>*Id.*, reprinted in 33 DEL. J. CORP. L. at 527.

<sup>282</sup>*Id.*

<sup>283</sup>For discussion of the court's alternatives, and also the substance of the background

circumstances, granting the stay and ceding the "hot seat" to the New York Supreme Court seemed to be the most attractive option.

But granting the stay was not costless for Delaware. Delaware cannot maintain its preeminence in corporate law by ducking the issues and hiding in the media's shadows. For this reason, seven months later when faced with a complaint against the proposed sale of Merrill Lynch to Bank of America, the balance of the equities for Delaware tipped in the direction of going forward and refusing the requested stay (i.e., the opposite conclusion from *Bear Stearns*).<sup>284</sup>

Importantly, the facts bearing on the motion to stay in the *Merrill Lynch* proceedings would not have augured a different result from *Bear Stearns*. Delaware, once again, did not have the first-filed claim. There were much earlier-filed derivative claims against Merrill Lynch pending in a New York federal court, and claims against the merger were added to the New York action three days before the complaint was filed in the Court of Chancery. Here, unsettling the transaction by granting an injunction would be risky, controversial, and potentially costly for Delaware's reputation. Merrill Lynch's financial situation may not have appeared quite as dire as *Bear Stearns's* had been, but the Court of Chancery itself observed (in its decision refusing the stay) that the price of Merrill's stock had fallen by thirty-six percent in the week before the merger was announced.<sup>285</sup> There were claims of disclosure deficiencies, unfair price, and even self dealing on the part of the board.<sup>286</sup> It was not at all obvious, therefore, that the Court of Chancery would be able to deny a requested injunction, consistent with its fiduciary precedents, especially given the haste in which the deal had been agreed to and the absence of a market check.<sup>287</sup>

As had been true in *Bear Stearns*, granting the injunction and unsettling the transaction would pose peril for investors, the market, and the "business friendly" reputation of the court. Yet approving the transaction based on its terms would arguably have created bad precedent. Surely the court considered the move it had made in *Bear Stearns*: granting the requested stay and leaving the quandary to be resolved by the New York court. But having ceded the limelight to New York in the *Bear Stearns* proceedings, it may just have seemed too costly to the Court of Chancery to do so again, so soon, in such a notable transaction.

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fiduciary doctrines relevant to the claims against the sale, see Kahan & Rock, *supra* note 4.

<sup>284</sup>See *County of York Employees Ret. Plan v. Merrill Lynch & Co.*, No. 4066-VCN, 2008 WL 4824053 (Del. Ch. Oct. 28, 2008).

<sup>285</sup>*Id.* at \*1.

<sup>286</sup>*Id.*

<sup>287</sup>*Id.*

In fact, the contrast between the outcomes in the *Bear Stearns* and *Merrill Lynch* forum disputes dramatically illustrates the plasticity of the Court of Chancery's new forum jurisprudence for parallel proceedings. Plasticity can be good for a court; it allows it to reach decisions which will be well received. But this same plasticity may seem like a lack of principled coherence, which can damage a court's reputation.

## 2. Keeping Control Over the Brand in Order to Promote Chartering

As stated earlier, if claims emigration reached a critical mass, this could undermine Delaware's control over its corporate jurisprudence. Fending off such a profound loss of control is clearly essential to the state's prospects in corporate law. As scholars have noted, Delaware's preeminence in corporate law depends on maintaining the expertise of its judiciary, the depth of its corporate case law, and the national media attention and prestige these produce. Massive claims emigration could certainly erode Delaware's success in these respects. If Delaware cannot guarantee particular results in the adjudication of cases governed by Delaware corporate law (consistent with its precedents)—results that are generally favorable to the corporate actors who make the chartering decisions—then those actors will have less incentive to charter in Delaware. It is not clear whether *Topps* is correct that promoting jurisdiction over Delaware corporate law cases will promote overall economic efficiency, but it is clear that Delaware must lead the way—must stay at the forefront of adjudicating novel issues in high-profile, high-stakes Delaware corporate law cases—if Delaware is to maintain control over its brand and ensure the flourishing of its chartering business.

That said, this article argues for circumspection in Delaware's exercise of discretionary jurisdiction in later-filed parallel proceedings, and forbearance vis-à-vis other mechanisms for enforcing forum in Delaware. Delaware could lose its preeminence in corporate law by eroding its perceived legitimacy—this could happen if it seemed excessively partisan to managers' interests. It could also happen if its courts were perceived to base decisions in forum disputes on Delaware's best interests, rather than those of the litigants.

## 3. The Delaware Courts' Incentive to Support the Delaware Bar

There is another incentive that may motivate the Court of Chancery to refuse motions to stay in parallel proceedings. This is the mutually beneficial professional relationship between the state, its judiciary, and its

corporate bar—with respect to both defense and plaintiffs counsel. Delaware litigators benefit from forum decisions which concentrate Delaware corporate litigation in the Delaware courts. Most of these lawyers are "repeat players" before the Court of Chancery—so that a cooperative affinity would naturally develop among them. By exercising their authority to keep forum in Delaware, Delaware's judges can encourage the state's litigators to make valuable investments of intellectual capital in the asset that is Delaware corporate law. In promoting this investment by Delaware's corporate litigators, Delaware's judges are also fostering the state's leading reputation in corporate law, promoting the perpetuation of their own expertise, and safeguarding the financial returns which flow to Delaware from its chartering business.

Again, this affirmative, symbiotic professional relationship between Delaware's judges and the state's litigators applies even in respect to Delaware corporate plaintiffs' lawyers. Especially because the Delaware courts are sensitive to federal pressure to "rein in" shareholder litigation, they have an interest in supporting the plaintiffs' lawyers and law firms whom they respect and have some indirect influence over. In ruling to go forward even with later-filed claims in parallel proceedings, the Court of Chancery can foster the career of the plaintiffs' firms whom they trust. This is a further incentive for Delaware to keep forum in parallel proceedings.

## VI. MECHANISMS FOR KEEPING CASES IN DELAWARE AND THEIR RISKS

Delaware's corporate bar is obviously aware of the damage that could result from massive claims emigration. Along with the legislature, these lawyers will undoubtedly consider the legal and intra-corporate mechanisms which could be used to ensure that corporate lawsuits governed by Delaware corporate law remain in Delaware. What measures are available to achieve this result, and what are their comparative advantages?

### *A. Federal Jurisdiction—A Prologue*

A word about federal jurisdiction is in order. Most importantly, any measures to limit shareholder-plaintiffs' otherwise legitimate access to the federal courts would almost certainly prove unconstitutional.

This has profound implications for Delaware corporate law cases. In effect, it means that Delaware cannot succeed in corraling Delaware

corporate lawsuits into its equity courts. If access to the federal courts cannot be waived, then because federal jurisdiction is so commonly available,<sup>288</sup> the system of litigating Delaware corporate lawsuits will remain inherently porous. Indeed, consistent with notions of federalism, it would seem intentionally to have been made so, consistent with the interests of justice. For example, access to the federal courts based on diversity jurisdiction was intended to counteract a perceived bias on the part of the state courts against out of state defendants.<sup>289</sup> In just this fashion, access to forums beyond Delaware's equity courts, as this article contends, exerts a salutary, countervailing force against corporate managers' preferences in Delaware corporate law. In addition, the fact that the federal courts have not "ruined" Delaware corporate law in decades of adjudicating Delaware corporate law cases, undermines many of the Court of Chancery's recent arguments for the necessity of it keeping forum in parallel proceedings.

### B. *Bylaw Provisions*

In theory, shareholders of Delaware corporations could enact bylaw provisions restricting their ability to file corporate lawsuits outside of Delaware. That is, they could restrict Delaware corporate lawsuits to the Court of Chancery (or the Delaware Superior Court, as applicable) and federal courts in Delaware.

As a general matter, there is no doubt that shareholders have the power to enact bylaw amendments. Under section 109 of the DGCL, bylaw amendments can be effectuated by a vote of holders of a majority of a company's shares.<sup>290</sup> Bylaw amendments can also be effectuated by a vote of the board, if the board has been granted such authority in the company's charter, which is often the case.<sup>291</sup>

Relative to the other alternatives discussed below, shareholder-enacted bylaws restricting forum choice are the least troubling. At least a superficially plausible argument can be made that they are "consensual," as consent is defined in corporate law (i.e., where a vote of the majority of shares is binding on the rest). But the argument based on consent is surely less than compelling. Unanimous shareholder consent is impossible to

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<sup>288</sup>Congress has recently altered the standards for defendants to remove cases to the federal courts based on diversity. See Edward A. Purcell, Jr., *The Class Action Fairness Act in Perspective: The Old and the New in Federal Jurisdictional Reform*, 156 U. PA. L. REV. 1823, 1856 (2008).

<sup>289</sup>*Id.* at 1833-34 & n.39.

<sup>290</sup>DEL. CODE ANN. tit. 8, § 109(a) (2001).

<sup>291</sup>*Id.*

obtain. Hence, some shareholders will inevitably challenge the forum restrictions in litigation outside of Delaware, arguing that their right to litigate in the forum of their choosing has unlawfully been abridged. It is entirely plausible that courts beyond Delaware would be sympathetic to such complaints about the inequitable nature of bylaw forum restrictions. Certainly they have no stake in shoring up Delaware's control over these claims.

An argument that bylaw forum restrictions are unconstitutional, or at least inequitable, would be strengthened by the fact that shareholders have so few rights under the scheme of corporate law. Their right to pursue effective enforcement of the fiduciary duties owed to them, as defined by corporate law, is a fundamental one. Courts would reasonably be reluctant to allow one group of shareholders to impinge on another group's right to vindicate these fiduciary obligations in the forum of their choosing.

The dubiousness of consent would be infinitely compounded if the company had a controlling shareholder—i.e., if the controller's shares had counted towards the forum restriction's adoption. The conflict of interest would be alleviated if there had been "majority of the minority" consent. But as mentioned earlier, Delaware has not been entirely convinced about the legitimacy of such a curing vote where controller self dealing is present.<sup>292</sup>

The same problems would attach, in stronger form, if the forum restricting bylaw had been adopted by the board, without shareholder consent.

### C. Charter Provisions

Under the DGCL, charter amendments require approval of the board and a majority of the shares.<sup>293</sup> Hence, if a majority of the board and a majority of the outstanding shares of a corporation voted in favor, a forum restricting charter provision would be lawful under the DGCL. There is at least one example of such a charter provision in a Delaware public company—that is, NetSuite, Inc.<sup>294</sup>

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<sup>292</sup>For discussion of the limits placed on controllers' self-dealing transactions and the limited effect Delaware has given to approvals which would otherwise cleanse a self dealing taint, see *supra* note 46 and accompanying text.

<sup>293</sup>DEL. CODE ANN. tit. 8, § 242 (2001).

<sup>294</sup>NetSuite, Inc. first sold stock to the public in late 2007. See NETSUITE INC., AMENDED AND RESTATED CERTIFICATE OF INCORPORATION art. VI, § 8, available at [www.netsuite.com/portal/pdf/ns-a-and-r-certificate-of-incorporation.pdf](http://www.netsuite.com/portal/pdf/ns-a-and-r-certificate-of-incorporation.pdf).

Charter provisions are usually more publicly accessible than are bylaw provisions. As such they present a somewhat stronger basis for defendants to claim that shareholders "accepted the risk" of being restricted to the Delaware courts when they purchased their shares. Not all legal rights, however, are waivable, and such nonwaivability would probably be given more weight where the vindication of fiduciary duties is at stake.

Forum restricting charter (or bylaw) provisions would certainly inspire litigation. Some number of vocal shareholders would foreseeably argue that their purported consent to the charter provision was invalid. Companies that proposed a charter forum selection provision without ascertaining whether they could count on the support of proxy advisory consultants like RiskMetrics would be taking a substantial risk of bad publicity.<sup>295</sup> And, once proxy advisory services become involved, the issue could take on salience far in excess of what Delaware lawmakers would have wanted.

Furthermore, claims that such forum restrictions contributed to clarity and efficiency would be undermined by the litigation that the provisions would inspire. Even where they passed muster in a shareholder vote, the provisions would be tested by plaintiffs in litigation beyond Delaware. One state's conclusion about the enforceability of the charter forum restriction would not be binding on another. And minor variations in their language would provoke further litigation, and further inconsistent rulings. It is foreseeable that there would be a profusion of claims against the forum restrictions in as many as fifty states. Delaware shareholder-plaintiffs preferring to litigate beyond Delaware would simply proceed to do so—leaving it to the defendants to attempt to enforce the charter or bylaw forum restriction in Delaware's favor. Nor is there any reason to presume that other state or federal courts would look favorably on the forum restrictions and seek to uphold Delaware's jurisdiction.

Challenges to the enforceability of the charter forum selection clauses would add a new, supra-layer of motions practice to the already extensive motions practice of modern corporate litigation. For all these reasons, charter forum selection provisions, even where they received sufficient approval to be lawful, would not promote legal certainty, the efficient resolution of disputes, or the maximization of shareholder wealth. (The same applies for bylaw provisions restricting forum to Delaware.) Negative corporate publicity arising from litigation over the enforceability of forum

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<sup>295</sup>For discussion of the agency problems relating to proxy advisory services, see Belinfanti, *supra* note 156; Daines et al., *supra* note 156.

restricting charter and bylaw provisions would be costly, distracting, and would almost certainly offset any anticipated efficiency gains.

#### D. *Legislation Restricting Forum Choice*

Delaware legislation that merely "enabled" corporations to adopt forum selection clauses would be effectively meaningless. The effect of such legislation would depend on whether individual Delaware corporations enacted charter or bylaw forum selection provisions, how the individual provisions were drafted, and the reception they received in non-Delaware courts in cases where they were tested, as discussed above.

In the alternative, a mandatory Delaware forum restriction enacted into the DGCL would pose several salient problems. Once again, there would inevitably be shareholder challenges to the law's enforceability. The challenges would be based on, *inter alia*, due process and equitable principles. Such a heavy handed approach would certainly call attention to itself because the DGCL has so few mandatory terms. A forum restricting statute in the DGCL would seem especially out of place because Delaware corporate law prides itself on promoting shareholder choice. And when the constitutional due process questions are put to the federal courts, other issues relevant to Delaware corporate law would likely come to the fore (like the constitutional underpinnings of the IAD). It is not obvious that Delaware would welcome the result. In sum, Delaware is likely to lose more than it would gain from forcing the forum issue through legislation.

#### E. *Judicial Doctrine (Case Law)*

To reiterate, under its existing, authoritative *forum non conveniens* jurisprudence, Delaware almost universally keeps cases first filed in its courts.<sup>296</sup> No further action by the Delaware courts is required to secure this legal practice, or shore up Delaware's discretion to keep first-filed cases.

The achilles heel for Delaware jurisdiction is later-filed claims in parallel proceedings. Until the Delaware Supreme Court rules otherwise, the Court of Chancery can continue to exert its authority expansively to keep forum over these cases. In addition, it is possible for the Court of Chancery to issue an injunction against litigation proceeding elsewhere. For example, in the *Rapoport* case, mentioned above, the directors sought but were denied

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<sup>296</sup>See *supra* Part V.C.1 (discussing Delaware's *forum non conveniens* jurisprudence).



an injunction to arrest parallel proceedings in Ohio.<sup>297</sup> The denial of the injunction was a wise exercise of comity on Delaware's part.

At present, in its post-*McWane* jurisprudence, the Court of Chancery is navigating the doctrinal gap between the established *forum non conveniens* jurisprudence and *McWane's* presumption in favor of a stay. Neither expressly addresses forum disputes in parallel proceedings. Hence, the Court of Chancery has room to maneuver. But departing from strict filing chronology is dicey, and the standards currently being deployed to justify this departure are enormously plastic and susceptible to result-oriented application. Hence, their optics is bad. As the court invokes these new, highly subjective standards, it risks making Delaware look grasping and insecure with respect to its corporate law—self-aggrandizing, possibly, to the disadvantage of the litigants themselves.

In *Topps*, the Court of Chancery came close to making a universal claim of right for Delaware courts to keep forum where there are parallel proceedings in multiple forums governed by Delaware corporate law. But its claims based on the IAD, clarity, and efficiency in Delaware corporate law are unpersuasive, as illuminated above.

A ruling from the Delaware Supreme Court would go far to promote clarity and coherence in Delaware's treatment of forum disputes in parallel proceedings. Adhering to strict filing chronology to resolve these forum disputes is one option. Refusing to defer to an earlier-filed complaint that the court resolves is legally deficient and would be dismissed also makes sense. If interpreted narrowly and conservatively, the presence of a novel issue of Delaware corporate law should also tilt the balance of the equities in Delaware's favor—though this is a favor that Delaware should be prepared to return.

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<sup>297</sup>*Rapoport v. Litig. Trust of MDIP Inc.*, No. 1035-N, 2005 WL 3277911, at \*8 (Del. Ch. Nov. 23, 2005) (refusing to grant requested injunction against proceedings elsewhere). The Court of Chancery, however, noted:

It is well-settled that this Court "is empowered to enjoin a party to an action from removing the subject of the controversy to a foreign jurisdiction by filing a later action or proceeding in a foreign forum." It is equally well-settled, however, that the exercise of such authority "is discretionary in nature and should be exercised cautiously." A sense of comity owed to the courts of other states drives this caution.

*Id.* (quoting *Ivanhoe Partners v. Newmont Mining Corp.*, No. 9281, 1988 WL 34526, at \*3 (Del. Ch. Apr. 7, 1988); 1 DONALD J. WOLFE, JR. & MICHAEL A. PITTINGER, *CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY* § 5-3 (2005)).

VII. CONCLUSION:  
HARDBALL TACTICS FOR KEEPING FORUM  
WOULD BE BAD FOR DELAWARE

This article began by elucidating the monetary and nonmonetary stakes various Delaware actors have in the continued preeminence of the state's corporate law. This law generates substantial tax revenues for Delaware, fees for its corporate bar, and prestige for the judges deciding corporate cases. For these reasons, Delaware's citizens, legislature, corporate litigators, and judges have a powerful interest in fostering Delaware corporate law's national preeminence. In many respects these high-powered stakes will have positive effects. They keep the legislature focused on updating the DGCL and the Delaware judges keenly focused on the quality and swiftness of their corporate legal decisions. Reflecting their exceptional professional commitment, these chancellors and justices frequently speak and publish as part of academic and professional conferences, and in so doing have promoted the quality and the legitimacy of Delaware's corporate law.<sup>298</sup>

Yet there is also danger for Delaware in "selling" its corporate law. As posited in the race for the bottom literature, because managers rather than shareholders select the state of incorporation, there is a danger that Delaware's corporate laws will insufficiently attend to agency costs—that is, pander to managers' self-interest and under protect shareholders' best interests. The ability of the capital markets to discern this bias and limit it is uncertain. Admittedly, there is some threat to Delaware's continued preeminence from the growth of federal corporate law standards, which might eclipse or marginalize Delaware's corporate law. And if there were radical claims flight out of Delaware's courts, this too could upset the status quo—to Delaware corporate law's detriment.

But the greatest threat to Delaware corporate law's preeminence would be for its lawmakers to overreact and attempt to gain complete control over the adjudication of Delaware corporate law cases. Hubris is dangerous. Disregarding principles of comity is dangerous. For Delaware to attempt to wall off an open-ended system of litigation—the porousness of which helps to balance the interests of shareholders and managers—would be dangerous, indeed foolhardy.

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<sup>298</sup>See Hamermesh, *supra* note 21, at 1788-92 app. A (outlining a series of appearances and public remarks made by members of the Delaware judiciary at public forums on corporate law); Kahan & Rock, *supra* note 42, at 1603 n.117 (providing a detailed list of corporate law-related publications by recent members of the Delaware judiciary).

