DELAWARE'S CORPORATE-LAW SYSTEM: IS CORPORATE AMERICA BUYING AN EXQUISITE JEWEL OR A DIAMOND IN THE ROUGH? A RESPONSE TO KAHAN & KAMAR'S *PRICE DISCRIMINATION IN THE MARKET FOR CORPORATE LAW*

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In this response to Professors Marcel Kahan and Ehud Kamar's article titled Price Discrimination in the Market for Corporate Law, *Vice Chancellor Strine addresses Professors Kahan and Kamar's contention that Delaware's system of corporate law inefficiently subjects corporations to excessive uncertainty and litigation costs.*

Vice Chancellor Strine makes four fundamental points. First, he notes that while Professors Kahan and Kamar criticize Delaware's current approach as indeterminate, they fail to embrace or flesh out a comprehensive alternative. Second, he points out a contradiction in Kahan and Kamar's argument: under their view, the practical operation of Delaware's corporate law is both a benefit to and a drain on social welfare. Third, he suggests that there are two factors—divided constituent input and human fallibility—that better explain the apparent indeterminacy in Delaware corporate law. Finally, Vice Chancellor Strine questions whether Delaware law is overly uncertain or inefficient. He concludes that much of the uncertainty of Delaware's corporate law unavoidably flows from that law's flexibility, which allows economically useful managerial freedom subject to limited judicial intervention to ensure good-faith compliance with fiduciary duties.

INTRODUCTION

When I first read a copy of *Price Discrimination in the Market for Corporate Law*,[1] I was worried. Until then I had thought that the states were exempt from the Robinson-Patman Act and its prohibition on price discrimination.[2] Were Professors Kahan and Kamar suggesting

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1 Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205 (2001).

2 Robinson-Patman Price Discrimination Act, 15 U.S.C. § 13(a) (1994) ("It shall be unlawful for any person engaged in commerce . . . to discriminate in price between differ-

that they should not be? But after a re-read, I understood that Delaware was not being accused of illegal monopolistic behavior, only of monopolistic behavior.

Specifically, the authors have two points. First, they argue that Delaware rationally prices its product by charging those corporations who most value and benefit from Delaware incorporation the highest price, while providing more affordable access to nonpublic corporations.[3] The authors further contend that this form of price discrimination is efficient and enhances social welfare because it does not create a barrier to entry for corporations that would benefit from Delaware incorporation.[4] Second, the authors claim that Delaware also engages in price discrimination by operating an overly litigation-intensive and indeterminate system of corporate law, which results in Delaware obtaining rents in the form of litigation-generated benefits for its own economy.[5] In their view, this indeterminate system of law subjects corporate America to excessive uncertainty and litigation costs, and is thus inefficient.[6]

This Response will focus exclusively on the latter contention—that Delaware's corporation law is excessively uncertain and judge-made and thus inefficient. In particular, I consider, from the perspective of one who has been involved in Delaware's legislative and judicial process of corporate lawmaking, whether Delaware's self-confessed desire to remain the preeminent forum for the resolution of major corporate disputes causes it to take an unclear approach to corporate law that encourages needless litigation.[7]

In addressing these issues, I will make four major points. First, I note that implicit in the arguments raised by Professors Kahan and Kamar is their belief that Delaware law could be improved if it moves away from its current flexible and enabling paradigm (the "Delaware Model") toward a more inflexible and statute-based approach (the "Mandatory Statutory Model"). While Professors Kahan and Kamar fail to embrace any fully realized alternative to the current Delaware

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ent purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly . . . or to injure, destroy, or prevent competition . . . .").

3 *See* Kahan & Kamar, *supra* note 1, at 1223, 1225-28.

4 *Id.* at 1250.

5 *See id.* at 1232, 1246-48.

6 *See id.* at 1250-51.

7 Immediately before becoming Vice Chancellor, I had the privilege of serving as Counsel and Policy Director for nearly six years to The Honorable Thomas R. Carper, Delaware's then-Governor and now United States Senator. In that capacity, I saw firsthand the executive and legislative branches of Delaware's government attend to issues relevant to the state's corporation law. As a litigator at a major Delaware corporate law firm before that, I also observed the diligence of Delaware's bench and bar regarding corporate law issues. In my admittedly biased view, the collective trusteeship that oversees Delaware's corporate-law system is highly motivated and committed to its continual improvement.

Model, they appear to favor changes that would replace director options with statutory requirements.[8] As an initial matter, therefore, I direct the reader's attention to the fact that both the Delaware Model and the Mandatory Statutory Model have benefits and costs, and observe that one should be cautious to tear down a house that has served its residents well in order to construct a new one based on a yet-to-be-produced blueprint.

Second, I point out that Professors Kahan and Kamar seem to contradict themselves as to the overall effect Delaware's corporation law has on social welfare. On the one hand, social welfare is increased because Delaware tax policies permit corporations to gain access to Delaware's beneficial corporate law and courts.[9] On the other hand, Delaware takes back some of its corporation law benefits, because the Delaware Model is too indeterminate and litigation intensive.[10] Thus, according to Professors Kahan and Kamar, the practical operation of Delaware's corporate law simultaneously constitutes Delaware's contribution to and drain on social welfare.

Third, I suggest that there are at least two other factors—divided constituent input and human fallibility—that may better explain why Delaware's law appears indeterminate than the authors' explanation, which tacitly attributes that indeterminacy to Delaware's conscious or subconscious desire to extract litigation rents.[11]

Finally, I question whether it is accurate to characterize Delaware's corporate law as too uncertain and inefficient. Instead, I advance the proposition that much of Delaware corporate law's indeterminacy and litigation intensiveness is an unavoidable consequence of the flexibility of the Delaware Model, which leaves room for economically useful innovation and creativity. That is, reducing the indeterminacy of Delaware corporate law by moving closer to the Mandatory Statutory Model might also impair its central emphasis on corporate empowerment and private ordering, to the detriment of social welfare.

I
A Prefatory Note on the Paradigm Choice That Professors Kahan and Kamar Avoid Making

As I begin, it is critical to note that Professors Kahan and Kamar have left me with a quite narrow target to shoot at. Although they contend that Delaware's corporate law is overly indeterminate, the authors do not firmly embrace any concrete alternative, and certainly

8 *See* Kahan & Kamar, *supra* note 1, at 1240-41.

9 *See id.* at 1250.

10 *See id.* at 1232-40.

11 *See id.* at 1245-48.

not one that is fully fleshed out as a comprehensive law of corporations.

As I proceed, therefore, I assume (simplistically) that there are two paradigmatic models for corporation law.[12] One is reflected in the "Delaware Model," which is largely enabling and provides a wide realm for private ordering. Though the Delaware Model is premised on a statute, that statute provides corporate boards with a substantial amount of leeway to govern their corporations as they see fit. Aside from the corporate electoral process mandated by the Delaware statute, the ultimate protection provided to investors by Delaware law is the guarantee that its courts will hold directors responsible for living up to their fundamental fiduciary duties of care and loyalty.

The other paradigmatic approach is also grounded in a statute, but a statute of a very different sort. The type of corporation statute required by this alternative "Mandatory Statutory Model" is quite detailed and prescriptive. Because the type of corporate statute required by that Model would limit choices and require certain procedures, it would be clearer but also less flexible and nimble. Put somewhat differently, because the statute would dictate how things should happen, there would be less room for judicial interpretation, but also less space for director choice.

My sense is that Professors Kahan and Kamar, at bottom, believe that the Delaware Model is, on balance, the better one. Yet they are disturbed by Delaware's failure to live up to its full potential and frustrated by Delaware's failure to adopt clarifying measures that they believe are unquestionably advisable.

Because Professors Kahan and Kamar fail to articulate a comprehensive vision of the ideal corporate-law system, they render their argument more difficult to refute, but at the same time, less persuasive. I do not quibble with the proposition that Delaware law can be improved in important but marginal ways. To the extent that Professors Kahan and Kamar only contend that Delaware law suffers from the fact that no human-created system is pristine, I am happy to agree with them.

But because Professors Kahan and Kamar imply that Delaware is a long way from optimality, I fairly infer that they support some aggressive changes to Delaware corporation law—changes that lean toward the Mandatory Statutory Model. This inference is supported by the changes Professors Kahan and Kamar tentatively suggest should be

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12 I fully acknowledge that one can shape a system of corporate law that reflects elements of both approaches, and that Delaware law itself embodies elements of each. Even so, I believe that keeping the two basic models in mind is useful in analyzing the arguments made by Professors Kahan and Kamar.

adopted by Delaware, most of which involve the substitution of a supple regime for governing transactions with more rigid statutory rules.

Permeating my dubious reaction to the authors' thesis that a move towards the Mandatory Statutory Model would improve social welfare is a sensitivity to the relationship between increased certainty and decreased flexibility. The Delaware Model and the Mandatory Statutory Model each have their own benefits and their own costs. Professors Kahan and Kamar appear to believe that a variety of easily adopted changes could turn Delaware law into the optimal blend of these two paradigmatic choices, and that Delaware's failure to take these easy steps results from its self-interest in excessive uncertainty. While the grounds for my demurral follow in more detail, suffusing my analysis is the natural skepticism that arises because the authors chip away at the edifice of Delaware law without advancing a new blueprint of their own and carefully explaining its drawbacks.

II
Delaware Corporation Law: Do Professors Kahan and Kamar Posit that Major American Corporations Can't Live with It, Can't Live Without It?

The reasoning of Professors Kahan and Kamar has a central contradiction that serves to reinforce some of my concerns about their conclusion that Delaware's corporation law price discriminates in a manner injurious to social welfare. Professors Kahan and Kamar argue that Delaware's corporate franchise tax price discriminates in an economically efficient manner.[13] Because Delaware prices its franchise tax to impose the highest costs on those corporations most likely to derive genuine benefits from Delaware incorporation, corporations can domicile in Delaware under a tax-pricing structure that tailors costs roughly to the benefit each corporation will derive from domiciling in Delaware.[14] What this means, in essence, is that the corporations that pay the highest franchise taxes are large, publicly traded firms.[15]

On the other hand, Professors Kahan and Kamar also conclude that Delaware's corporation law price discriminates in a manner that likely has a negative effect on social welfare. By virtue of its indeterminate quality, the Delaware Model results in a greater amount of transactional uncertainty and litigation than is optimal.[16] Because large,

13 Kahan & Kamar, *supra* note 1, at 1250-52.

14 *See id.* at 1225-29.

15 *Id.* at 1225-28.

16 *See id.* at 1252.

publicly traded firms are much more likely to be subjected to litigation, the costs of this indeterminacy fall primarily on them.[17]

The contradiction inherent in these two arguments emerges from the fact that Professors Kahan and Kamar essentially admit that the benefits that large, publicly traded corporations derive from Delaware incorporation are intertwined with the costs that those firms allegedly suffer by reason of the indeterminacy of Delaware corporate law.[18] The benefits that Professors Kahan and Kamar claim motivate large, publicly traded corporations to pay sizeable franchise taxes are all related to Delaware's supposedly excessively uncertain corporation law. Thus, they say that large, publicly traded corporations are willing to pay more for the following benefits of Delaware incorporation: (1) the ability to have lawsuits resolved by Delaware's expert judiciary;[19] (2) access to Delaware's highly developed case law and the ease of obtaining legal advice about that law;[20] (3) the value that investors, traders, and other market participants place on an enterprise's status as a Delaware corporation operating under a familiar and trusted corporation law;[21] and (4) Delaware's commitment to updating its corporation law to ensure that it meets the needs of its constituents.[22] Indeed, Professors Kahan and Kamar acknowledge that large corporations frequently redomicile into Delaware in advance of undertaking major acquisitions.[23] That is, these large corporations seek out Delaware's indeterminate and litigation-intensive corporation law at exactly the time in their corporate existences when the potential for litigation is at its zenith.

Paradoxically, these same large, publicly traded corporations also suffer the greatest costs from the fact that Delaware's system of corporation law, while superior to anyone else's, is not perfect. These corporations endure the maddening experience of buying into Delaware to obtain the benefits of its corporation law, only to face costs resulting from the indeterminate and litigation-intensive nature of that same law. Indeed, Professors Kahan and Kamar contend that if the burdens of that indeterminacy and litigation intensiveness did not fall primarily on those large public firms that derive the most value from those aspects of Delaware corporation law that (one supposes) do not suffer from these defects, Delaware would have a stronger incentive to improve its corporation law.[24]

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17 *See id.* at 1242-45.
18 *See id.* at 1245.
19 *Id.* at 1212.
20 *Id.*
21 *Id.* at 1213.
22 *Id.* at 1214.
23 *Id.* at 1228 n.101.
24 *Id.* at 1245-46.

The overall conclusion of Professors Kahan and Kamar can be distilled as follows: the Delaware corporate-law system is so superior to any of its current alternatives that large, publicly traded corporations will suffer its marginal defects without much protest. In other words, Professors Kahan and Kamar embrace a "can't live with it, can't live without it" view of Delaware corporate law. Their conclusion that Delaware's franchise tax price discriminates in a socially useful manner is premised on the fact that Delaware's franchise tax is designed not to discourage corporations that benefit from incorporating in Delaware from doing so.[25] To say it pithily, Delaware's taxing practices price discriminate in a socially useful way because those practices do not obstruct access to our corporation law and our courts.[26]

Recognizing that Delaware corporate law is not optimal, Professors Kahan and Kamar argue that some of the social gains produced by Delaware's franchise tax pricing policies are taken back by the costs imposed on corporations and shareholders by Delaware's litigation-intensive and overly indeterminate corporate law.[27] Although quite cautious about the extent of this drain on economic efficiency,[28] they seem convinced that Delaware's system of corporate law could be markedly improved by replacing the current flexible, standards-based Delaware Model with their clearer and more rigid Mandatory Statutory Model.[29]

But, as I proceed, I suggest to the reader that a deeper consideration of the data Professors Kahan and Kamar rely upon points to another possibility. That possibility is that large, publicly traded corporations rationally choose Delaware law because its preference for flexibility rather than rigidity allows corporate boards to structure corporate transactions in a manner best tailored to the particular circumstances their corporations face. While the Delaware Model might subject firms to litigation, these firms readily accept that risk as a cost of greater flexibility, especially because they know that the litigation they face will have the following two characteristics: (1) it will likely be administered by a Delaware judiciary well schooled in corporate law and with a track record of producing rational results, and (2) it will be governed by a body of statutory and decisional corporation law which articulates many norms that, if followed at the time of the transaction being litigated, can limit the possibility of an adverse judgment. These public corporations may well recognize that litigable uncertain-

25 *See id.* at 1252-53.

26 *See id.*

27 *See id.* at 1250-52.

28 *See id.* at 1234-36.

29 *See id.* at 1240-41.

ties are difficult to eradicate totally from a corporation law system whose flexibility provides great freedom for private ordering.

Indeed, it is not at all clear that the nirvana which Professors Kahan and Kamar aspire to—a corporation-law system that has all the virtues of the Delaware Model with none of its costs—can exist. Any serious effort to eradicate the marginal uncertainty of Delaware corporate law by moving closer to the Mandatory Statutory Model may well diminish social welfare by stifling innovation and reducing transactional flexibility.

III
Do Other Factors Better Explain the Alleged Indeterminacy of Delaware Law?

Professors Kahan and Kamar proceed with commendable discretion in addressing why they view Delaware law as overly indeterminate. They do not boldly suggest that Delaware corporate-law elites consciously shape[30] a corporation law that yields a constant stream of corporate litigation in the Delaware courts, thereby promoting legal employment, filling hotel rooms, and (modestly) raising tax revenues.[31] Instead, their argument focuses on effect, not cause. That is, they gently point out that the economic benefits Delaware derives from a healthy flow of corporate litigation, combined with the need for interpretive opinions of our corporation law, limit Delaware's "incentives" to reduce the indeterminacy of its law.[32] Remarkably, Professors Kahan and Kamar even suggest that Delaware has a motive to muddy up its corporate law because this murkiness makes it difficult for other states to copy it.[33]

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30 *Id.* at 1232.

31 *See id.* at 1245-47 (detailing the benefits of corporate litigation for Delaware).

32 *Id.* at 1245-48.

33 *Id.* at 1247 n.170. Although it is beyond the scope of this response, I pause to note that this particular argument is somewhat unusual. By making its law a muddle, Kahan and Kamar say, Delaware makes it difficult for other states to copy it. *Id.* But if the underlying value in Delaware law is not its murky case law but something else that Kahan and Kamar do not define, one would think that other states have an opportunity to trumpet legal structures (if such structures exist) that provide greater clarity than Delaware and that limit the opportunity and need for litigation. Is our corporation law a wine that cannot be decanted of its impurities? Isn't it the case that new products are often marketed as having all the virtues of an existing product, but without the bugs?

A very recent example of marketing efforts along these lines states:

> Many practitioners choose Delaware on instinct, based on nonquantifiable concepts such as the existence of a wider body of case law interpreting corporation law and a judiciary that is perceived to be more sophisticated in corporation law matters. Others choose Delaware due to inertia, based on prior experience in Delaware or investment banker advice that everybody does it.
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> The Texas Legislature over the past fifteen years has sought to address the Delaware bias by improving the corporation laws of the State and estab-

In advancing these arguments, Professors Kahan and Kamar again emphasize the "bitter with the sweet" quality of the choice to incorporate in Delaware. Because large public corporations on the whole derive extensive benefits from Delaware, they are unlikely to flee.[34] Yet, because those corporations are most likely to suffer from the indeterminacy of Delaware law, the imperfections of that law fall principally on them.[35] For that reason, Professors Kahan and Kamar contend, Delaware is not subjected to as much pressure to improve its law as might be the case if its law's costs did not fall on the primary beneficiaries.[36]

Although they may be too polite to say it bluntly, Professors Kahan and Kamar basically assert that Delaware is a bit of a fat and happy monopolist. Confident in its preeminence, Delaware is content to reap the extra benefits thrown off by the litigation generated by the unclear aspects of its corporation law, knowing that its most important customers have nowhere better to go.

This Delawarean does not find this argument convincing, for reasons that I will now explain. I begin by conceding at the outset that in many ways Delaware corporation law is less than optimally clear.[37] I

> lishing clear statutory answers to questions that have historically been addressed in Delaware by case law. Although Delaware has attempted to follow suit in certain areas by providing corporations with greater flexibility in structuring business combinations and establishing their capital structures, many areas continue to be left to the Delaware courts. The Delaware courts have in turn tended to establish legal principles that often create more questions than they resolve. Often this leaves counsel unable to give clear advice as to how transactions may be structured and allows Delaware judges to second guess the business judgment of Texas-based corporations. Accordingly, it is now time for practitioners to shed their historical notions of Delaware as the most desirable jurisdiction for incorporation and to seriously consider the differences between Texas and Delaware law on corporation law issues. The results of such an inquiry may be surprising.

Byron F. Egan & Curtis W. Huff, *Choice of State of Incorporation—Texas Versus Delaware: Is It Now Time to Rethink Traditional Notions?*, 54 SMU L. REV. 249, 250 (2001).

34 Kahan & Kamar, *supra* note 1, at 1245.

35 *See id.* at 1242.

36 *Id.* at 1246.

37 Recently, I have dealt with numerous examples of Delaware corporate law's suboptimal clarity. One such area involves the question of when appraisal is a plaintiff's exclusive remedy after *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099 (Del. 1985). *See, e.g.*, Nagy v. Bistricer, 770 A.2d 43, 50-56 (Del. Ch. 2000); Turner v. Bernstein, 768 A.2d 24, 26-27 (Del. Ch. 2000); Andra v. Blount, 772 A.2d 183, 191-96 (Del. Ch. 2000). Another such area involves the sometimes elusive distinction between derivative and individual claims. *See, e.g.*, Golaine v. Edwards, No. 15404, 1999 Del. Ch. LEXIS 237, at *10-*26 (Del. Ch. Dec. 21, 1999); *In re* Gaylord Container Corp. S'holders Litig., 747 A.2d 71, 75-83 (Del. Ch. 1999). Yet another difficult spot involves when to apply the compelling-justification standard of *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. 1988). *See, e.g.*, Chesapeake Corp. v. Shore, 771 A.2d 293, 317-24 (Del. Ch. 2000). Finally, there is the problematic relationship between the *Unocal* standard of review, *see* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-56 (Del. 1985), and the business judgment and entire fairness stan-

admit also that there are aspects of Delaware law that the judiciary itself has the unquestioned authority to clarify.

One area Professors Kahan and Kamar properly cite by way of example is shareholder ratification.[38] In several opinions, the Court of Chancery has urged the Supreme Court to provide more certain guidance about the effect to be given a fully informed majority vote of disinterested stockholders.[39] In less-than-subtle ways, the Court of Chancery has implied that Delaware's current case law provides little or no incentive for a corporation to condition a transaction on the approval of a majority of the disinterested minority.[40] Such approval (at least in the case of a squeeze-out merger) has no greater likelihood of reducing the risk of director liability than would the formation of a special committee of independent directors to negotiate the transaction.[41]

It makes sense, at least to me, that the business judgment rule should protect a transaction expressly conditioned on approval of the disinterested minority stockholders and based on adequate disclosures. But does everyone agree? My sense is that the answer is no. For example, Robert Clark advances the following view of the efficacy of stockholder votes in ensuring the integrity of self-interested transactions:

> To summarize about the shareholder approval procedure as a way of policing basic self-dealing transactions: It would be perverse for the legal system to have many such matters taken to the shareholders; folly to expect the shareholders to pass upon them in a careful, well informed way; and wrong to hold them to the consequences of their failing to do so.[42]

Some commentators have also criticized as indeterminate Delaware law's approach to defenses against hostile takeovers.[43] Can one

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dards of review. *See, e.g., In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 473-77 (Del. Ch. 2000).

38 *See* Kahan & Kamar, *supra* note 1, at 1237 n.133.

39 *See* Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 902 & n.88 (Del. Ch. 1999); Solomon v. Armstrong, 747 A.2d 1098, 1113-14 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000) (unpublished table decision); *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1204-05 (Del. Ch. 1995).

40 *See Huizenga*, 751 A.2d at 900-01.

41 *See id.* at 900-01, 901 n.81 (noting cases which hold that neither device removes the entire fairness standard's application to a squeeze-out merger, but merely shifts the burden of proof to the plaintiff).

42 ROBERT CHARLES CLARK, CORPORATE LAW § 5.4, at 182 (1986).

43 *See, e.g.*, Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1191 (1999); Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 859 n.4 (1993); Charles M. Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J. 54, 71-81.

really reconcile *Paramount Communications, Inc. v. Time Inc.*[44] and *Paramount Communications Inc. v. QVC Network Inc.*?[45] Is it sensible to view a stock-for-stock merger as having a less significant influence on stockholder economic rights than an outright sale? Is a target board legally entitled to "just say no" and keep a poison pill in place regardless of the circumstances?

I will not play pretend and advance the proposition that Delaware's takeover law is perfectly clear. On the other hand, I am also unaware of any alternative approach that would generate a consensus among American corporate-law practitioners and commentators.

For example, the law would have been far more clear had Delaware courts simply prohibited boards of directors from using rights plans or other defenses to interfere with a tender offer to buy the company. That clarity would, however, have denied corporate boards the ability to protect their stockholders from structurally coercive tender offers[46] and to negotiate for better offers.[47]

But having authorized boards to use extraordinary defensive devices such as poison pills, Delaware courts could hardly sit back and let directors employ those options without scrutiny. The potential for abuse would have been intolerable, and the value-enhancing benefits of properly used defenses would have been outweighed by the risks created by giving directors free rein to reject genuinely worthy offers.

Policing potential director abuse in this area raised many questions. When and for how long could directors keep poison pills and other defensive measures in place?[48] Were some defensive measures too extreme?[49] To what extent did the fact that stockholders could or could not vote out the board enter into the court's evaluation of defensive measures?[50] Was a board required to forsake a long-term strat-

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44 571 A.2d 1140 (Del. 1990).

45 637 A.2d 34 (Del. 1994).

46 *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953-59 (Del. 1985).

47 *See* Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 120-21 (1986).

48 *See, e.g.*, Moore Corp. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545 (D. Del. 1995) (applying Delaware law and upholding target board's refusal to redeem poison pill in the face of increasingly valuable all-cash offers by hostile bidder); City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988) (granting affirmative relief requiring board of directors to redeem poison pill because mild threat from noncoercive cash offer did not justify effectively foreclosing shareholders from accepting offer), *called into doubt by* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).

49 *See, e.g.*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998) (invalidating a slow-hand poison pill on grounds that it impermissibly "deprive[d] any newly elected board of both its statutory authority to manage the corporation . . . and its concomitant fiduciary duty pursuant to that statutory mandate").

50 *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995) (reversing Chancery Court's grant of preliminary injunction and remanding for determination of whether repurchase program, as an addition to a poison pill previously in place, was a

egy simply because an unsolicited bidder presented an immediate premium-generating offer?[51]

Fortunately for me, to raise—rather than answer—these questions is enough to make my point. That is, I think it is worth exploring whether Delaware law is indeterminate and thus litigation intensive in areas where there is no consensus among its constituency. Consider, for example, the questions just raised. Who would venture to say, with confidence, that there is a sufficient consensus among the various constituents to whom Delaware is responsive to develop precise legislation addressing exactly what, when, and how defensive measures can be used?

During the 1980s, Delaware did pass a so-called antitakeover statute.[52] That effort, however, was modest. It merely constrained the ability of a hostile bidder to acquire a substantial voting block and thereafter exert pressure to acquire the rest of the company.[53] There was no political consensus that a more aggressive antitakeover statute was advisable.

This perspective suggests that the indeterminacy of Delaware's corporation law may not result from Delaware's subconscious desire to extract more lucrative litigation "rents." Instead, it results from Delaware's acknowledged responsiveness to its corporate constituency and the corresponding reality that its law will tend to reflect any lack of accord within that constituency. My own firsthand observation of the policy elites central to Delaware corporate lawmaking—most importantly, the members of the Delaware State Bar Association's Corporate Law Council—is that they are acutely sensitive to constituency input. These decision makers can and do persuade the Governor and the General Assembly to amend the corporate law rapidly when there is a demonstrable consensus in the corporate community that such changes are advisable.

But—and the "but" is important—this process breaks down when Delaware's corporate constituency is divided on the subject matter at hand. It is, by now, commonplace to say that Delaware responds reflexively to corporate managers,[54] but such trite statements are, in my

"draconian" defense measure based on viability of proxy fight after completion of repurchase program).

51 *See, e.g.*, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).

52 66 Del. Laws ch. 204, § 1 (1988) (codified as amended at DEL. CODE ANN. tit. 8, § 203 (2000)).

53 *See* DEL. CODE ANN. tit. 8, § 203 (2000). The statute does so by, among other things, preventing a hostile bidder from buying more than 14.9% of the voting stock of a company if it wishes to acquire that company in the ensuing three years. *Id.* § 203(a), (c)(5).

54 *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 670 (1974) (arguing that Delaware "courts have undertaken to . . . create a 'favorable climate' for management").

view, naïve and do not tell the whole story. That tired notion ignores the belief of most Delaware corporate law decision makers that Delaware's primacy depends on balance.[55] If Delaware law does not continue to afford sufficient protection for the actual providers of capital—the investors—it will eventually lose its dominance.

To illustrate this point, lawyers from several states are presently marketing the fact that their state corporation laws allow "bulletproof" antitakeover defensive measures, whereas Delaware's does not.[56] Why has Delaware not responded in kind? Putting aside the normative thought that it might be inadvisable to allow managers virtually unchecked power to keep owners from selling their stock, I would suggest that Delaware has not responded because self-interested Delawareans believe that a more balanced approach is essential to maintain their competitive advantage. Delaware's corporate bar is not unmindful that investors in initial public offerings (IPOs) would be disinclined to invest in entities that cannot be sold down the line.[57] The fact that Delaware law limits a corporate board's ability to insulate itself completely from a change in control is attractive to those investors and provides corporations seeking capital an incentive to domicile in Delaware.[58]

Professors Kahan and Kamar correctly imply that Delaware law will likely be inefficiently indeterminate only at the margin.[59] Even they point out that Delaware has much to lose by creating a corporate law so indeterminate and litigation intensive as to drive out its corpo-

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55 *Cf.* E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 BUS. LAW. 681, 694-95 (1998) (emphasizing that Delaware's traditional approach is a balanced one).

56 *See, e.g.*, Bart J. Colli & Debra S. Groisser, *A Reason to Incorporate in New Jersey*, 159 N.J. L.J. 608, 612 (2000) ("New Jersey may offer significant advantages [over Delaware] to corporations seeking anti-takeover protection . . . .").

57 Delaware appears to be the state of choice for firms going "public." *See, e.g.*, John C. Coates IV, Explaining Variation in Takeover Defenses: Failure in the Corporate Law Market 31, 43 (June 26, 2000) (unpublished manuscript, on file with author); ROBERT DAINES, DOES DELAWARE LAW IMPROVE FIRM VALUE? 48 tbl.4 (N.Y. Univ. Ctr. for Law & Bus., Working Paper No. CLB-99-011, 1999; and Columbia Law Sch. Ctr. for Studies in Law & Econ., Working Paper No. 159, 1999), *available at* http://papers.ssrn.com/paper.taf?abstract_id=195109 (last visited July 26, 2001). In suggesting that investors are comfortable with the balance Delaware law affords, I do not mean to assert that most of the companies that go public in Delaware do so with no defenses in their certificates. *See* Coates, *supra*, at 44, 47 (noting that only forty-three percent of studied firms who went public in Delaware had defensive measures that made it more difficult to acquire a firm than if the default provisions of Delaware law applied, but that companies incorporated in Delaware had more defensive measures than the average of the whole sample). Rather, I simply note that Delaware has a more investor-friendly approach to takeovers than many states that authorize insurmountable defenses.

58 There is some empirical evidence that suggests that Delaware's balanced approach is reflected in higher market valuations for Delaware firms than comparable firms incorporated elsewhere. *See* DAINES, *supra* note 57, at 4.

59 *See* Kahan & Kamar, *supra* note 1, at 1282.

rate constituency.[60] *Smith v. Van Gorkom*[61] is a prime example. It did not take Delaware long to figure out that it would pay dearly if it insisted on subjecting directors who made good-faith, but negligent, business decisions to damages liability.[62] To avoid that, Delaware quickly came up with a mechanism—title 8, section 102(b)(7) of the Delaware Code—to all but eradicate the effect of *Van Gorkom*.[63] Indeed, but for the adoption of section 102(b)(7), my sense is that the Delaware Supreme Court's decision in *Cede & Co. v. Technicolor, Inc.*[64] ("*Cede II*")—that directors who breach their duty of care must prove that they did not cause damage[65]—would also have been dealt with through legislative action. In areas where a consensus emerges that there is a need for greater clarity or certainty, Delaware's Corporate Law Council will generally draft and obtain swift passage of legislative amendments.[66] When there is no consensus, however, they will not.

Our courts are also responsive to "constituent pressures," which often take the form of learned commentary on our corporation law. The judiciary's articulation and subsequent abandonment of the "bus-

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60 *Id.* at 1235.

61 488 A.2d 858 (Del. 1985).

62 *See id.* at 877-78, 880, 893 (holding board of directors liable for approval of cash-out merger when, *inter alia*, board members failed to inform themselves as to the value of the corporation and accepted a price based on calculations designed solely to determine the feasibility of a leveraged buy-out, even though the board received a highly favorable price and negotiated for the ability to seek out superior bids).

63 DEL. CODE ANN. tit. 8, § 102(b)(7) (2000) (allowing corporations to waive director liability for monetary damages for breaches of the duty of care). The enactment of section 102(b)(7) is but one example that contradicts the assertion of Kahan and Kamar that the Delaware Corporate Law Council "will be inclined not to endorse proposals to make Delaware law less litigation-intensive even if doing so would benefit Delaware corporations." Kahan & Kamar, *supra* note 1, at 1232 n.117. For two more recent examples, see *infra* note 66.

64 634 A.2d 345 (Del. 1993).

65 *Id.* at 370-71. *Cede II* has this effect by requiring a negligent director to show that the outcome resulting from his negligent behavior was "entirely fair" to the plaintiffs. *Id.*

66 For example, this year the Corporate Law Council proposed and secured adoption of an amendment to title 8, section 122 of the Delaware Code to give corporate boards more flexibility to define business opportunities that are not within the scope of the corporation's strategic plan. 72 Del. Laws ch. 343, § 3 (2000) (codified at DEL. CODE ANN. tit. 8, § 122(17) (2001)) (giving each Delaware corporation the power to "[r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in . . . specified business opportunities . . . that are presented to the corporation or one or more of its officers, directors, or stockholders"). This amendment will enable corporations to better avoid corporate-opportunity claims against their directors and officers, as exposure to such claims has been a concern among directors of firms in the high-technology sector. *Cf.* Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1916 (1998) (identifying the corporate-opportunity doctrine as an example of indeterminacy in Delaware law).

Another example is the relatively recent amendment to title 8, section 251(c) of the Delaware Code enabling a board of directors to bind itself to put a transaction to a shareholder vote even if it changes its mind about the advisability of that transaction before the vote. 72 Del. Laws ch. 123, § 6 (1999) (codified at DEL. CODE ANN. tit. 8, § 251(g) (2000)).

iness purpose" requirement in parent-subsidiary mergers provides a good example.[67] Some of the disclosure decisions after *In re Tri-Star Pictures, Inc., Litigation*[68] may also be read this way,[69] as may *Paramount Communications, Inc. v. Time Inc.*[70]

The reality is that Delaware courts and corporate practitioners receive a steady stream of feedback in many forms nationwide. Some of this feedback involves implicit threats from corporate practitioners that corporations will redomicile elsewhere unless Delaware makes improvements.[71] Delaware corporate law decision makers do not blithely ignore such commentary; to the contrary, they take it very seriously. Indeed, in my view, Delawareans perceive their state's ability to extract rents through excessive litigation as extremely limited. Thus, Professors Kahan and Kamar should hesitate before ascribing Delaware law's indeterminacy to subconscious rent-seeking motives.

The foregoing analysis should encourage corporate-law scholars to test whether the indeterminacy in Delaware corporate law occurs in areas where there is no consensus among learned corporate commentators and other relevant constituencies.[72] If that hypothesis is correct, it is predictable that in those circumstances, Delaware will muddle through on a case-by-case basis, using judicial review as a safeguard against abuse, but with the mindset of validating well-motivated director action. The Delaware Model, while perhaps not optimal, does allow for a more unfettered evolution of corporate practice than would the hasty adoption of legislative standards about which substantial disagreement persists. Uncertainty has its costs, but so does ill-

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67 Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977), *overruled by* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983).

68 634 A.2d 319, 333-34 (Del. 1993) (holding that proof of damages was not required in a case involving breach of the fiduciary duty of disclosure).

69 *See, e.g.*, Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 142 (Del. 1997) (limiting *Tri-Star* to only require courts to award "nominal damages" absent proof of damages flowing from breach of duty of disclosure).

70 571 A.2d 1140 (Del. 1990); *see id.* at 1150-51 (refusing to apply the enhanced-scrutiny analysis of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), to a case in which a target board's actions "*might* be viewed as effectively putting [the target] up for sale"); *see also* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1072-75 (1997) (construing *Time* as a validation of the "just say no" defense, and a response to criticisms of an earlier case).

71 *See* Laurie P. Cohen, *Lipton Tells Clients that Delaware May Not Be a Place to Incorporate*, WALL ST. J., Nov. 11, 1988, at B7.

72 *Cf.* William T. Allen, *Ambiguity in Corporation Law*, 22 DEL. J. CORP. L. 894, 899 (1997) ("[M]ore often than not, the most interesting conflicts in corporation law are engendered not by 'bad gnys' seeking with guile to protect or advance private interests. The difficult and interesting questions arise from differing, but plausible, conceptions of what constitutes right action in the circumstances.").

advised certainty, especially when that certainty comes about through a universally applicable legislative edict.[73]

I also briefly note, in this regard, that Professors Kahan and Kamar give short shrift to another powerful explanatory factor: Delaware corporate law is written by humans who are fallible and torn by conflicting values that can lead to somewhat inconsistent public policies. Human-run institutions sometimes engage in tacit rivalries with other institutions in areas of shared responsibility, rivalries that sometimes generate paradoxical[74] or confusing[75] results. These noneconomic factors must also be taken into account before one can confidently attribute the indeterminacy of Delaware law to the state's economic motivations.

IV
Is Delaware's Approach to Corporate Law Inefficient?

I turn now to the larger claim that Delaware corporate law is suboptimal and that there is a better way. I start by posing a rhetorical question: Do Delaware's constituents want Delaware corporate law to be optimally nonlitigious? As Kahan and Kamar point out:

> The costs of a litigation-intensive system fall primarily on Delaware corporations that participate in the kind of activities that tend to give rise to legal disputes. To the extent that these companies are involved in litigation, they directly bear the costs of a more litigation-intensive corporate law. . . .
>
> Companies that are involved in litigation or undertake transactions that may result in litigation are the ones assigning the highest value to incorporating in Delaware. These companies gain most from the fact that Delaware law, though litigation intensive, offers a

73 In another article, Professor Kamar has noted as an example of our judiciary's reluctance to formulate bright-line rules the Supreme Court's frequently quoted statement in *Barkan v. Amsted Industries, Inc.*, 567 A.2d 1279 (Del. 1989), that "there is no single blueprint that a board must follow to fulfill its [*Revlon*] duties," *id.* at 1286. Kamar, *supra* note 66, at 1915 & n.18. Would it have been more efficient for the Delaware General Assembly or the Delaware Supreme Court to have written such a blueprint rather than accord substantial deference to corporate boards who seek the highest value through means they find appropriate for their situation and industry sector? The question has, at the very least, an uncertain answer.

74 *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 358, 361, 369-71 (Del. 1993) ("Cede II"). In that case involving the duty of care, the Delaware Supreme Court turned Chancellor Allen's *assumption for purposes of analysis* that the defendant board had violated the duty of care, *see* Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *55-*57 (Del. Ch. June 21, 1991), *aff'd in part and rev'd in part sub nom.* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993), into a *finding of fact* to that effect, *Cede II*, 634 A.2d at 358-59. Furthermore, the Delaware Supreme Court held that a breach of the duty of care requires directors to prove that they did not cause damage, *see id.* at 371, despite the fact that Delaware had adopted a gross-negligence standard to ensure that directors were not inhibited by liability risk.

75 *See Time*, 571 A.2d at 1150 (affirming the Chancellor, but on a different ground).

> higher quality judiciary, a better developed case law, and more readily available legal advice than any other state law.[76]

Kahan and Kamar add the following in a footnote:

> In a litigation-oriented system (as opposed to a system based on regulation or private ordering), involvement in litigation reflects firms' use of the law. The level of litigation is determined by the extent to which the law generally fosters litigation and by the propensity of individual firms to be involved in lawsuits. If Delaware law was less litigation intensive, but still litigation oriented, the same firms would demonstrate a higher incidence of involvement in lawsuits than others as today, but the general level of litigation would be lower.[77]

Do these large public firms believe Delaware corporate law is too uncertain? There is reason to think not.

Consider the area of disclosure. In virtually every transaction involving stockholder approval, shareholder plaintiffs may bring claims asserting that proxy disclosures are legally deficient. In 1998, corporate America persuaded Congress to restrict the ability of shareholder plaintiffs to bring disclosure class actions in the federal courts and to preempt most state regulation of corporate disclosures in such lawsuits.[78] That legislation has an exemption known as the "Delaware carve-out," which preserves the ability of stockholders to bring a suit alleging that directors have breached their fiduciary duties by providing inadequate disclosures to stockholders in connection with a stockholder vote.[79] The Delaware carve-out was passed with the support of corporate America, even though a so-called "duty of disclosure" claim under Delaware law does not require the plaintiff to make any showing of reliance.[80]

Why would corporate America and the then-Speaker of the House, Newt Gingrich, have allowed this carve-out? One (albeit immodest) suggestion is that corporate America would prefer to defend disclosure claims in the Delaware courts rather than in the federal courts. One reason for this preference might be that Delaware courts will often resolve disclosure claims before a stockholder vote, thereby enabling the defendants to cure any disclosure problem promptly. Another might be that Delaware courts have developed a level of experience with such claims that affords greater predictability. Still an-

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76 Kahan & Kamar, *supra* note 1, at 1242-43 (footnotes omitted).

77 *Id.* at 1243 n.155.

78 *See* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227.

79 15 U.S.C. § 78bb(f)(3)(A)(ii)(II) (Supp. IV 1998).

80 Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998).

other might be that a lawsuit in Delaware can efficiently address most, if not all, of the claims arising out of a transaction.[81]

This service might be seen as efficient if it were not for the possibility that a Mandatory Statutory Model of corporate law might obviate the need for most of this litigation in the first place.[82] Therefore, one area for further inquiry is whether such an approach is really feasible given our political culture. That is, is the choice confronted by corporate America (and stockholders) *whether* to litigate or *under what law* to litigate?

To the extent that it is somewhat indeterminate and dependent on ex post judicial judgments, Delaware corporate law is not unique. Is not the same true of American tort and products liability law?[83] Antitrust law?[84] Federal case law under the Due Process Clause?[85] How about the HMO debate in the 2000 presidential campaign in which now-President George W. Bush, of all people, took credit for legislation creating a right to sue?[86] Is there any reason to believe that other states or the federal government could competently implement a corporate law less dependent on judicial decision making?[87] Put simply, Delaware corporation law is only one part of a larger American politi-

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81 A cynic, of course, might claim that this preference is because Delaware is pro-defendant and enables corporate defendants to obtain a broad release of liability for all federal and state liability in exchange for modest costs largely involving the payment of attorneys' fees to plaintiffs' lawyers. I am not so cynical, but I do believe that Delaware courts provide a forum where corporations can resolve claims predictably and promptly.

82 *See* Kahan & Kamar, *supra* note 1, at 1240-41. In this regard, one can also ask whether the experience under the federal securities laws would tend to prove or disprove the proposition that a detailed statutory and regulatory scheme will reduce litigation (including administrative adjudicative practice).

83 *Cf.* James A. Henderson, Jr. & Aaron D. Twerski, *Stargazing: The Future of American Products Liability Law*, 66 N.Y.U. L. Rev. 1332, 1342 (1991) (predicting that future products liability law will have a "sharper focus").

84 *See* Daniel J. Gifford, *The Jurisprudence of Antitrust*, 48 SMU L. Rev. 1677, 1682-83 (1995).

85 *See* Richard H. Fallon, Jr., *Some Confusions About Due Process, Judicial Review, and Constitutional Remedies*, 93 Colum. L. Rev. 309, 309 (1993).

86 *See* Richard S. Dunham, *Bush the Reformer? Why He's Not Just Blowing Smoke*, Bus. Wk., Mar. 13, 2000, at 49, 2000 WL 7825138.

87 The assertion that Delaware courts are more likely than other American courts to emphasize that their holdings are limited to the case at hand, *see* Kahan & Kamar, *supra* note 1, at 1239, is questionable. Statements to that effect can be found all over American caselaw, *e.g.*, Bush v. Gore, 531 U.S. 98, 109 (2000) ("Our consideration is limited to the present circumstances . . . ."), and reflect the judiciary's special role in our republican form of democracy.

Indeed, limited holdings have long been considered an integral part of common-law decision making. *See, e.g.*, Oliver Wendell Holmes, Jr., *Codes, and the Arrangement of the Law* (1870), *reprinted in The Early Writings of O.W. Holmes, Jr.*, 44 Harv. L. Rev. 725, 725 (1931) ("It is the merit of the common law that it decides the case first and determines the principle afterwards. . . . [L]awyers . . . frequently see well enough how they ought to decide on a given state of facts without being very clear as to the *ratio decidendi*."); Anthony G. Amsterdam, *Perspectives on the Fourth Amendment*, 58 Minn. L. Rev. 349, 351-52 (1974) (discussing the role of the United States Supreme Court). Professor Amsterdam writes:

cal culture that has traditionally relied upon litigation as a way to check abuses of authority and to provide recompense to those injured by otherwise lawful activity that is carelessly or recklessly conducted. Those who criticize Delaware corporate law as inefficient must confront the difficult challenge of articulating a better system. The Delaware Model, as Professors Kahan and Kamar note, provides corporate managers with the flexibility to do practically any lawful act, subject to judicial review focused on whether the managers were properly motivated and not irrational.[88]

It is far from obvious that adoption of something more akin to the Mandatory Statutory Model would be more efficient. That approach would involve more mandated processes and thus costs of its own, resulting in questionable efficiency effects. By subjecting managers to clearer, but more rigid, rules, the Mandatory Statutory Model might also stifle innovation. Complex human behavior rarely lends itself to bright-line rules. Even stop lights have a grey area—the grey area just happens to be yellow.

Professors Kahan and Kamar confidently point to bright-line rules that they claim "could provide more predictability than . . . the present system" without compromising flexibility,[89] but they do not

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> [T]he welter of life is constantly churning up situations in which the application of clear and consistent theories would produce unacceptable results. The results are unacceptable not because of mere personal or emotional aversion to them, but because the case has stirred some profound countervailing principle. . . . [The principle] speaks imperatively to the case and wrests it from the grip of all the theory that has been before.
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> . . . Clarity and consistency are desirable, certainly, to the extent that they can be achieved. But the temptation to achieve them by ignoring the complex and the unpredictable quality of real problems is fortunately less beguiling to Justices perennially faced with responsibility for solving those problems than to the Justices' academic critics.

Id.; *see also* Thurman Arnold, *Professor Hart's Theology*, 73 HARV. L. REV. 1298, 1312 (1960) (claiming that former Justice Frankfurter of the United States Supreme Court repeatedly asserted that "courts should avoid deciding any question not directly and unavoidably in issue").

Flexibility, as opposed to rigid rules, also plays a central role in due process jurisprudence. *See, e.g.*, Kentucky v. Whorton, 441 U.S. 786, 789-90 (1979) (per curiam) (holding that the Kentucky Supreme Court's inquiry "should have been directed to . . . whether the failure to give . . . instruction[s] *in the present case* deprived the respondent of due process of law *in light of the totality of the circumstances*," and not whether due process requires such instruction in every case (emphases added)); Mitchell v. W.T. Grant Co., 416 U.S. 600, 610 (1974) ("'The very nature of due process negates any concept of inflexible procedures universally applicable to every imaginable situation.'" (quoting Cafeteria & Rest. Workers Union, Local 473 v. McElroy, 367 U.S. 886, 895 (1961))).

As importantly, Professors Kahan and Kamar ignore other commentators who have stressed the important and useful role that the Delaware courts have played in giving guidance to corporations through dictum. *See, e.g.*, Ronald J. Gilson, *The Fine Art of Judging: William T. Allen*, 22 DEL. J. CORP. L. 914, 916 (1997) (referring to Chancellor Allen's practice of "delivering lectures on how transactions should be conducted" via dicta).

88 *See* Kahan & Kamar, *supra* note 1, at 1240.

89 *Id.* at 1240-41.

support that claim. For example, they rightly point to the entire fairness standard as rather elastic,[90] yet they fail to articulate a complete vision of what they would substitute. Would they ban all interested-director transactions? Such a rule would be clear, to be sure, but might also preclude socially beneficial transactions. Even they apparently do not believe that to be a wise option.

In lieu of this approach, Professors Kahan and Kamar suggest that all interested-director transactions be put to a stockholder vote[91]—a liability-insulating technique that is now optional for Delaware directors.[92] While I agree with them that Delaware law gives too little (albeit still important) weight to stockholder ratification votes, Professors Kahan and Kamar have failed to persuade me that it is more efficient to mandate that directors use specific procedural safeguards in *all* interested transactions.[93]

Under current Delaware law, directors are empowered to make their own assessment of the advisability of using such safeguards on a transaction-by-transaction basis.[94] Directors know that subjecting an interested-director transaction to the review and approval of a special committee of independent directors, or of the disinterested stockholders, will profoundly affect their litigation risk.[95]

Only when directors choose not to use one of these procedural safeguards do they bear the burden of proving that the transaction was fair.[96] The proposition that directors who engage in a conflict transaction should bear this burden seems to me uncontroversial. And although the burden to demonstrate fairness may seem imprecise as a matter of theory, as a matter of practice it is fairly straightforward: the board must show that the transaction was consummated on as favorable terms as could have been achieved in an arm's-length deal.[97] Although the relevance of process to this inquiry is sometimes murky,

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90 *Id.* at 1236-37.

91 Although Professors Kahan and Kamar will not stamp their full approval on this suggestion, their failure to embrace it unequivocally and their refusal to fully articulate an alternative model of corporate law are indicative of the difficulty of improving on the Delaware Model. *See id.* at 1241 & n.148.

92 DEL. CODE ANN. title 8, § 144(a)(2) (1991).

93 If Professors Kahan and Kamar do not embrace the bright-line mandatory approach but simply enhanced "safe barbors," Kahan & Kamar, *supra* note 1, at 1241, they are implicitly admitting the marginal nature of their concerns. Any close reader of Delaware law can recognize that our courts already give a heavy weight to informed stockholder votes. *See, e.g.*, Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 895-97 (Del. Ch. 1999); Solomon v. Armstrong, 747 A.2d 1098, 1113 (Del. Ch. 1999); *In re* Gen. Motors Class H S'holders Litig., 734 A.2d 611, 616 (Del. Ch. 1999).

94 *See Solomon*, 747 A.2d at 1113 (observing that shareholder ratification "can be employed as a powerful tool").

95 *See id.*

96 *See id.* at 1112-13, 1113 n.38.

97 *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983).

a limitation of the inquiry to "fair" value in the appraisal sense would be bad public policy.[98]

I view the entire fairness standard as a workable one that reflects the Delaware Model's fundamental emphasis on flexibility.[99] Delaware law gives boards the option to structure conflict transactions in a manner that limits litigation risk, but it does not require directors to follow those procedures.[100] If, instead, boards decide to engage in conflict transactions without procedural safeguards, Delaware law simply requires them to prove that they acted fairly.[101] Professors Kahan and Kamar would replace the costs that flow from decisions individual boards make themselves on a transaction-by-transaction basis with the considerable costs that would flow from their own preference for a stockholder vote in every interested-director transaction.[102] But they do not attempt to assess whether their Mandatory Statutory Model would be more beneficial in the aggregate than the Delaware Model. Questions abound about their proposal. For example, will there be an exception for transactions involving less than, say, a million dollars because of the inefficiency of holding a vote in such circumstances? If so, what standard of review will apply to such transactions?

Importantly, Professors Kahan and Kamar do not point to any significant number of irrational results reached by Delaware courts in

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98 A simple example suffices to show why it is necessary to examine process. Assume a board sold a corporate asset at a fair price to an insider when a third-party had offered to pay an even higher price. If the only focus of the fairness inquiry was on fair value in the appraisal sense, an important element of fiduciary accountability would obviously be lost. Why? Because the stockholders were entitled to have the corporate asset sold at the highest available price, not just at a fair price.

Thus, the process prong is best seen as one which ensures that self-interested fiduciaries get the best deal reasonably available for the corporation. Although arguably the definition of fair price in the entire fairness context already takes this into account, *see* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("Cede II") (fair price is the "highest value" that was "reasonably available under the circumstances"), the larger point is that justice necessarily requires that the court examine the process to determine whether the directors obtained a truly fair price.

99 I agree with Professors Kahan and Kamar that this rule could be improved. Aside from giving greater liability-insulating effect to disinterested stockholder votes, there are other concerns about the standard, particularly the recent tendency to entangle the standard with issues (e.g., lack of due care) that do not relate to the justifications for the standard's existence. *See, e.g., Cede II*, 634 A.2d at 350-51 (reversing trial court's approach requiring the shareholder plaintiff to "prove injury resulting from a *found* board breach of duty of care [in order] to rebut the business judgement presumption" and remanding with instructions to apply the entire fairness standard of review); Lyman Johnson, *The Modest Business Judgment Rule*, 55 Bus. Law. 625, 628-33 (2000) (criticizing the use of the entire fairness standard to analyze breaches of the duty of care); Bud Roth, *Entire Fairness Review for a "Pure" Breach of the Duty of Care: Sensible Approach or* Technicolor *Flop?*, 3 Del. L. Rev. 145, 145-46 (2000) (supporting a showing of causation and harm as an additional requirement to entire fairness review in the breach-of-duty-of-care context).

100 *See supra* notes 94-96 and accompanying text.

101 *Weinberger*, 457 A.2d at 710.

102 *See* Kahan & Kamar, *supra* note 1, at 1240-41.

evaluating interested-director transactions.[103] Because Delaware courts have not historically imposed unjustifiably painful judgments on corporate defendants, corporations might well be reluctant to trade in the current common-law regime, which affords them choices in these matters, for an inflexible statutory one. Professors Kahan and Kamar also fail to acknowledge the limitations of their preferred alternative in terms of its ability to foreclose all litigation. Unless they would give ratification effect to uninformed stockholder votes, for example, their choice of a mandated plebiscite in all interested transactions might simply shift the focus of the litigation to the adequacy of the directors' disclosures.

Kahan and Kamar's recommendation for addressing tender offers presents many of the same trade-offs as their proposal for dealing with interested-director transactions. As a litigation-limiting reform, they recommend that every fully-financed, all-shares tender offer be presented to the stockholders.[104] Putting to one side the absence of political consensus favoring this idea within Delaware's corporate constituencies,[105] what empirical evidence convincingly demonstrates that this idea will increase shareholder value over the Delaware Model, which emphasizes fiduciary responsibility in managing the board's reaction to mergers and acquisitions proposals? Undoubtedly, philosophical justification exists for this idea, involving as it does the premise that stockholders own the enterprise and should have the chance to sell it. But again this approach involves replacing a system of director choice monitored by judicial oversight through litigation with an unvarying statutory mandate. Put bluntly, while the Delaware

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103 I acknowledge their citation of *Smith v. Van Gorkom*. *See id.* at 1237 n.133. I also agree that there are incremental improvements that would speed up the pace at which meritless cases are resolved and thus result in a reduction of litigation costs. The Court of Chancery's reaction to the Delaware Supreme Court's opinion in *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999), is indicative of that attitude.

Emerald Partners held that an exculpatory charter provision was "in the nature of an affirmative defense," 726 A.2d at 1223, and arguably cast doubt on whether such provisions could help directors obtain early dismissals of damage claims resting solely on allegations sufficient to state a due care violation, but not a loyalty violation.

In a series of opinions, the Court of Chancery interpreted *Emerald Partners* in a manner that was faithful to the case but that still enabled defendants to obtain dismissal of a complaint by relying on an exculpatory charter provision. *See, e.g.*, McMillan v. Intercargo Corp., 768 A.2d 492, 501-02 (Del. Ch. 2000) (requiring defendants to show that complaint did not state facts that would support a finding that the defendant's actions fell outside the protection of the exculpatory charter provision); *In re* Frederick's of Hollywood, Inc. S'holders Litig., C.A. No. 15944, 2000 Del. Ch. LEXIS 19, at *19-*20 (Del. Ch. Jan. 31, 2000) (Jacobs, V.C.) (same); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 728, 732-34 (Del. Ch. 1999) (same); *In re* Gen. Motors Class H S'holders Litig., 734 A.2d 611, 619 n.7 (Del. Ch. 1999) (same).

104 *See* Kahan & Kamar, *supra* note 1, at 1241 & n.148.

105 This factor greatly limits the prospects for the adoption of this proposal. *See supra* Part III.

Model relies upon governmental involvement, that involvement is limited to a (usually deferential) inquiry into the propriety of choices made in the first instance by the elected representatives of stockholders. Professors Kahan and Kamar would replace that element of director choice (whether or not to allow the presentation of an offer to the stockholders) with an inflexible statutory obligation to do so. That value judgment may or may not be correct, but Kahan and Kamar do not even attempt to demonstrate that their Mandatory Statutory Model would be more efficient.

Although Professors Kahan and Kamar imply that there are corporate-law systems more determinate and efficient than Delaware's,[106] lacking in their exposition is a richer description of where those systems are and how they operate in practice. Have these systems actually been tested in the crucible of a steady stream of transactions? What sort of checks do they provide on the potential for managerial abuse? How do those checks work in practice, with what speed, and at what cost? What values are sacrificed by being more "determinate"? What does the empirical evidence (e.g., the market valuations of their companies compared to comparable Delaware companies) suggest about the relative utility of their approach over the Delaware Model?[107]

I recognize that Professors Kahan and Kamar only tentatively advance their contention that Delaware's corporate law is modestly inefficient.[108] Nonetheless, the absence of a fully articulated example of how their preferred system has operated in a superior manner is telling.[109] Until such an example emerges, one might take a somewhat more optimistic view of the Delaware Model. Namely, one might conclude that Delaware's corporation law is highly dynamic, quick to innovate on the basis of a constituency consensus, but modest and incremental when the "right" answer is in doubt. Delaware corporate law generally permits corporate managers wide flexibility and errs on the side of managerial freedom. At the same time, it reserves to its courts the power to intervene in a careful and case-specific way when it appears, based on demonstrated facts, that managers have placed their self-interest above their duty or have usurped or impaired the authority left to the stockholders as owners. This reserved power of limited judicial intervention is best seen as the necessary cost of ensuring that the broadly empowering—and thus ultimately more effi-

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106 *See* Kahan & Kamar, *supra* note 1, at 1239 n.144, 1242.

107 *Cf.* DAINES, *supra* note 57, at 45 tbl.1, 46 tbl.2 (comparing the typical characteristics of Delaware and non-Delaware firms).

108 *See* Kahan & Kamar, *supra* note 1, at 1233-35.

109 The recent increase in European mergers and acquisitions activity provides an opportunity for such descriptive exercises. *See, e.g.*, John Finley, *LVMH's Failed Bid for Gucci*, 2 M & A J. 8 (2000); John Finley, *Telecom Italia and Olivetti*, 2 M & A J. 4 (2000).

cient—Delaware Model does not result in director abuses that would shake the confidence of investors in the integrity of our system of corporate governance and discourage them from investing capital.

Finally, I cannot help but note that the cries of indeterminacy from sophisticated corporate practitioners strike me as somewhat exaggerated.[110] The Delaware courts have articulated many norms to guide practitioners.[111] For example, it is conventional wisdom that a corporate board wishing to reduce its exposure to derivative suits should consist of a majority of independent directors.[112] Similarly, in the area of self-interested transactions, these norms clearly point a corporate board having an interested majority toward using a well-advised special committee of disinterested directors to negotiate the transaction, and toward requiring stockholder approval based on full disclosure if the board wishes to avoid the burden of proving the transaction's entire fairness.[113] Similar norms give boards guidance about the propriety of certain defensive measures contained in merger agreements, such as termination fees and no-shops.[114] These norms allow for ex ante planning by practitioners and boards thereby enabling them to minimize ex post litigation risks.

Accordingly, only when boards seek to "push the envelope" do they become subject to significant risk of liability. For example, the recent litigation involving "no talk" provisions in merger agreements is indicative of corporate practitioners testing how strong deal protection measures can be made in a non-*Revlon* context.[115] Ditto the now

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110 *See* Kahan & Kamar, *supra* note 1, at 1234 n.120, 1237 n.136 (referring to criticism of practitioners).

111 Rock, *supra* note 70, at 1016-17.

112 *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (indicating that a determination of demand futility in a derivative suit requires the Court of Chancery to find that "directors are disinterested and independent" and "the challenged transaction was otherwise the product of a valid exercise of business judgment").

113 *See, e.g.*, Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1115-18 (Del. 1994).

114 *See, e.g.*, McMillan v. Intercargo Corp., 768 A.2d 492, 505-06 (Del. Ch. 2000) (citing cases).

115 *See, e.g.*, Ace Ltd. v. Capital Re Corp., 747 A.2d 95, 104-09 (Del. Ch. 1999) (concerning a no-talk provision that allowed the target board a "fiduciary out" only upon receiving written advice from counsel that such action was "mandated" by their fiduciary duty in a situation where the board's inability to exercise its fiduciary out would bind stockholders holding 33.5% of the stock to vote for the original merger agreement even if a higher bid was available); Phelps Dodge Corp. v. Cyprus Amax Minerals Co., No. 17398, 1999 Del. Ch. LEXIS 202, at *4 (Del. Ch. Sept. 27, 1999) (indicating that strict no-talk provisions interfere with board members' duty to inform themselves when deciding whether or not to negotiate with third-party bidders); *cf., e.g.*, IXC Communications, Inc. v. Cincinnati Bell, Inc., No. 17324, 1999 Del. Ch. LEXIS 210, at *16-*17 (Del. Ch. Oct. 27, 1999) (concerning a no-talk provision which was subsequently retracted).

Although I acknowledge that there are important unresolved doctrinal tensions in Delaware corporate law that are a source of legitimate concern to transactional lawyers, such lawyers (as one should expect) themselves sometimes create or exploit these tensions moribund "slow hand"[116] and "dead hand" poison pills.[117] In this environment, one should not, I think, overestimate the uncertainty created by Delaware law's failure to address such issues in the legislative process.

During the last several years, a significant amount of mergers and acquisitions activity involving Delaware corporations has taken place without a corresponding wave of takeover litigation.[118] This fact makes it at least worth pondering whether Delaware's norm-based approach has instead provided solid and workable guidance to practitioners structuring fundamental transactions. Litigated cases are the ones that are most studied. What is less often studied is the far greater number of transactions consummated without any serious or costly litigation challenge.[119]

I wish, however, to end on a less self-congratulatory note. Everyone who plays a role in shaping Delaware corporate law should carefully consider the thoughtful and well-articulated views of Professors Kahan and Kamar. We risk much by arrogantly assuming that Delaware's dominance results from the fact that our corporate law is the clearest and best administered. Instead, we must constantly examine

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in the course of zealously representing their clients. By way of example, some practitioners have apparently adopted the view that so-called "deal protection measures" such as no-shops, termination fees, and cross-options contained in stock-for-stock merger agreements are not reviewable under the heightened scrutiny of *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), unless the merger is a change of control implicating duties under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). *See, e.g.*, Paul K. Rowe, The Future of the "Friendly Deal" in Delaware 14-15 (July 10, 2000) (unpublished manuscript, on file with author); *cf., e.g.* Pat Vlahakis, *Fiduciary Duties and Fiduciary Outs*, 2 M & A J. 13, 13, 15 (2000) (acknowledging that deal protection measures are subject to the *Unocal* standard, but criticizing recent Delaware Chancery Court decisions for failing to honor the target board's ability under *Time* to refuse to negotiate with hostile third-party bidders).

They base this view in part on the Delaware Supreme Court's decision in *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990). Rowe, *supra*, at 1. To make my point that practitioners sometimes get a bit edgy, I need only note that *Time* itself *held* that the deal protection measures in the original Time-Warner merger agreement were properly reviewed under *Unocal* even though the merger did not implicate *Revlon*. *Time*, 571 A.2d at 1151-55.

116 That is, the "Eric Clapton" pill. The cases sometimes refer to these as a "no hand" or "delayed redemption" provisions. As a music fan, I prefer the term "slow hand."

117 *E.g.*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1283, 1290-92 (Del. 1998) (invalidating slow-hand pill); Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1189-95 (Del. Ch. 1998) (discussing invalidity of dead-hand pill provision).

118 *See* Bernard S. Black, *The First International Merger Wave (and the Fifth and Last U.S. Wave)*, 54 U. MIAMI L. REV. 799, 809 (2000); Joseph H. Flom, *Merger & Acquisitions: The Decade in Review*, 54 U. MIAMI L. REV. 753, 754-62 (2000).

119 Given the large amount of mergers and acquisition activity during the period from 1989 to 1998, *see* Flom, *supra* note 118, at 753-54, the fact that only fourteen to fifteen percent of the largest Delaware corporations were involved in corporate litigation does not seem to me to provide much support for the argument that the uncertainty of Delaware's corporate law promotes litigation. *See* Kahan & Kamar, *supra* note 1, at 1228 tbl.2.

whether that is true, and must identify and correct the ways in which we fall short of the mark.

One way Delaware's judiciary can help in this process is to commit to grappling more openly and honestly with difficult questions of corporate law. Sometimes, Delaware opinions gloss over challenging policy disputes. Sometimes, decisions cut a new path while failing to admit that the court is turning its back on existing precedent that points in a different direction. Candid struggles with the hard issues Delaware faces will expose what issues are ripe for legislative action, and invite valued feedback from Delaware's varied corporate-law constituents.[120] This mindset will enable Delaware to improve its law and perhaps earn the ultimate accolade from law professors steeped in economics: a paper concluding that Delaware law truly is efficient.

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120 *See* Allen, *supra* note 72, at 901-02. As Chancellor Allen states,

> Candor is the first among a list of essential virtues of judicial opinions in a democracy. Candor is not, however, without social risks and costs. It can expose uncertainty in choice and thus it may be thought a risk to judicial legitimacy in a democracy. While the risks are real, their existence is not conclusive. It is more important, in my opinion, that the citizens who willingly subject themselves to the rule of law understand what that process really is; understand when and why choice is unavoidable; understand that choices made have been made openly in an intellectually honest way and that the judicial process, as a whole, is subject to democratic control. If a case decision necessitates a difficult choice, that fact should be exposed and all choices made should be justified with good reasons. It is neither honest, nor I suppose intelligent, to attempt to hide choice when choice is compelled by circumstance. A judicial system that exposes its grounds—its real grounds, which may extend beyond a set of doctrinal expressions—is in the end, the better system of government.

Id.