

FOREWORD: THE DELAWARE COURT OF CHANCERY: CHANGE, CONTINUITY —AND COMPETITION

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I. INTRODUCTION

For Delaware, it is the best of times and the worst of times. The institutional prestige of the Delaware Court of Chancery has never been higher. Under the leadership of Chancellors Allen, Chandler and Strine,¹ the court has converted many (and possibly most) of the academics, who once tended to be skeptical of Delaware.² Academics and practitioners alike have been impressed by both the depth and thoughtfulness of the court of chancery's decisions and the hardworking style of its vice chancellors (who regularly seem able to turn out lengthy decisions in days that would take many federal circuit courts months and even years to

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¹ Chancellor William T. Allen was appointed in 1985, and as Justice Jack Jacobs points out in his contribution to this Symposium, it was a turning point in the Court's long history. See Jack B. Jacobs, *A Brief History of the Delaware Court of Chancery*, 2012 COLUM. BUS. L. REV. 406, 409 (2012). As Justice Jacobs correctly observes, the Supreme Court's decision in *Santa Fe Industries, Inc. v Green*, 430 U.S. 462 (1977), gave the Court of Chancery "the control of modern corporate law," but it was the skill and eloquence of Chancellor Allen that produced a body of takeover law that was subtle, balanced, and lasting.

² See William Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (concluding that Delaware had led a "race to the bottom").

complete).³ Corporate management and their counsel appear equally satisfied, as the rules for various classes of transactions (takeovers and leveraged buyouts in particular) have been clarified. Plaintiffs' attorneys may grumble that they seldom win in Delaware,⁴ but they do settle cases there, and settlements, not fully litigated victories, produce the revenues that fuel the plaintiff's bar. In short, for most of these constituencies, these are the best of times.

But, beginning sometime after 2000, a cloud appeared over the happy skies of Delaware, and that cloud has now grown into a storm.⁵ The new crisis has two elements, which interlock in a way that makes the problem relatively intractable to judicial resolution:

First, cases are fleeing Delaware. For example, where once over two thirds of M&A litigation involving Delaware target companies was brought in the Delaware Court of Chancery,⁶ this percentage dropped to thirty-four percent between 2002 and 2010.⁷ The Court of Chancery's declining share of litigation involving Delaware-incorporated corporations has an obvious meaning for the Delaware Bar: they are losing business! More to the point, because the Bar is a leading local industry in Delaware, this impact cannot be

³ This pace is partly the product of the specialized jurisdiction of the Court of Chancery, whose docket is dominated by M&A cases in which relief must normally be decided on a time-constrained basis before the shareholder meeting.

⁴ Plaintiff victories, however, do occur. *See, e.g., In re S. Peru Copper Corp. S'holder Litig.*, 30 A.3d 60 (Del. Ch. 2011) (awarding \$1.9 billion in stock against controlling shareholder as damages for an unfair "going private" transaction).

⁵ It is difficult to identify the precise date on which this cloud turned into a storm, but a perception of a crisis can be dated back to 2007. *See* Ted Mirvis, *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, 7 M&A J., 17, 18 (2007).

⁶ *See* Brian Cheffins, John Armour & Bernard Black, *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 427, 433 (2012).

⁷ *Id.*

ignored for long by Delaware's judiciary.⁸ Interest groups sooner or later influence politically accountable bodies, including even courts.

Second, the overall rate of stockholder litigation in state courts is increasing sharply, particularly in the M&A field.⁹ Where once the percentage of Delaware target corporations that were sued in M&A litigation was just under fifty percent for all such Delaware transactions,¹⁰ the percentage of M&A transactions now attracting litigation has soared to ninety percent or above in some recent years (both for Delaware and non-Delaware corporations.)¹¹ Yet given that the volume of federal securities litigation appears to be steadily declining,¹² this across-the-board growth in state court litigation is in sharp contrast to, and cannot be explained in terms of, any broad social theory of increased litigiousness in American society. Something more specific and limited is happening.

The relationship between these two elements is critical to the understanding of the dilemma now facing Delaware. In

⁸ See Jonathan H. Macey & Geoffrey Miller, *Toward An Interest Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987). For the more specific claim that the Delaware judiciary has a strong incentive to support the Delaware bar and to seek to retain jurisdiction over major cases, see Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 127–32 (2009).

⁹ Cheffins, Armour & Black, *supra* note 6, at 436–39.

¹⁰ *Id.* at 437 (noting rate to be forty-eight percent).

¹¹ *Id.*

¹² The average number of securities class action filings between 1997 and 2004 was 231 per year. See DR. JORDAN MILEV, ROBERT PATTON, SVETLANA STARYKH & DR. JOHN MONTGOMERY, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2011 YEAR-END REVIEW 2 (2011), available at http://www.nera.com/67_7557.htm. The Private Securities Litigation Reform Act was enacted in late 1995, and in 1996 the number of cases fell to 133, but then slowly increased to 512 in 2001. Since that time there has been a steady decline in “standard” securities class actions, down to 128 in 2010 and 138 in 2011. *Id.* But special categories of cases (such as “options backdating cases”) have arisen to fill much of the gap. In particular, NERA follows “M&A objection lawsuits,” which have become “the single largest category of non-standard cases tracked by NERA.” *Id.* at 1. There were sixty-eight such cases in 2010 and sixty-one in 2011. *Id.*

general, litigiousness can be curbed. The Private Securities Litigation Reform Act (the "PSLRA") did chill securities class actions,¹³ and the number of such actions has recently fallen again, possibly as the result of a variety of legal developments.¹⁴ Thus, if it wanted to, Delaware could easily curb M&A litigation in Delaware by a variety of means, such as by mandating presumptive sanctions or reducing fee awards in unpromising cases that settle. Some Delaware decisions appear to have moved in this direction.¹⁵ But reducing fee awards increases the incentive for relatively mobile plaintiffs' attorneys to sue outside of Delaware. Some believe that the trend to suing in the state courts outside of Delaware is at least in part a product of the relative parsimony of the Delaware Court of Chancery in its fee award jurisprudence.¹⁶ Thus the dilemma becomes apparent: take action to cure one problem, and you exacerbate the other! Discouraging litigation in Delaware (even non-meritorious litigation) only increases the migration of cases out of Delaware.

¹³ See *id.*

¹⁴ Several recent U.S. Supreme Court decisions, and tighter class certification standards, may explain some of the decline in securities class actions. See, e.g., *Morrison v. Nat'l Austl. Bank*, 130 S. Ct. 2869 (2010) (limiting suits against foreign defendants); *Stoneridge Inc. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008) (limiting suits against third-party advisers). These decisions have eliminated whole classes of cases and defendants who previously were sued regularly. Tighter class certification standards are also a factor. See *Miles v. Merrill Lynch*, 471 F.3d 24 (2d Cir. 2006).

¹⁵ See, e.g., *In re Revlon, Inc. S'holder Litig.*, 990 A.2d 940, 945-46 (Del. Ch. 2010) (replacing lead counsel and describing a pattern in M&A litigation under which "No One Litigates Anything," but all seek to settle early); *In re Cox Commc'ns, Inc.*, 879 A.2d 604, 608 (Del. Ch. 2005) (describing pattern of "hastily-filed, first-day complaints that serve no purpose other than for a particular law firm and its clients to get into the metal round of the speed filing (also formerly known as the lead counsel selection) Olympics"). Obviously, the rhetoric here is not flattering.

¹⁶ This appears to be the view both of Professors Cheffins, Armour & Black, see Cheffins, Armour & Black, *supra* note 6, at 492, and of William Savitt. See William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570 (2012).

Discussion at the Columbia Law School Symposium: The Delaware Court of Chancery: Change and Continuity, both on and off the record, focused more intensely on this topic than on any other. Plaintiffs' attorneys grumbled about the rhetoric of some decisions, and the case for and against higher fee awards was vigorously debated. , A large fee awarded in a much publicized Delaware case subsequent to the Columbia Symposium has been read by some as a signal that Delaware will award higher fees to attract litigation back to Delaware.¹⁷ If such a policy were ever adopted, however, it would offend many Delaware-incorporated firms that would see it as an undesirable subsidy for litigation.

From an academic perspective, should we care about Delaware's dilemma? Several reasons suggest we should. In this Symposium, in a provocative article, William Savitt argues that the Court of Chancery functions much like a regulatory agency.¹⁸ Through the use of dicta, its decisions in one case set standards for a range of future cases—much as does guidance in an SEC release. Still, that role could be eclipsed if the migration out of Delaware increases. Today, he argues, the Court of Chancery “takes seriously its obligation to safeguard the interests of the class”¹⁹ and is “no rubber stamp.”²⁰ But what will happen in the future if by rejecting a weak, or potentially collusive, settlement, the Court encourages plaintiffs to file elsewhere in order to

¹⁷ Chancellor Strine awarded \$285 million in attorney fees to two plaintiffs' law firms. *In re S. Peru Copper Corp. S'holder Litig.*, 30 A.3d 60 (Del. Ch. 2011). The press and some blogs have read this as evidence that Delaware is seeking to lure the plaintiff's bar back to Delaware. See Gina Chon & Joe Palazzolo, *An Early Christmas for These Lawyers*, WALL ST. J., Dec. 28, 2011, at C1; see also Steven Davidoff, *Year End Surprises in Deal Law*, N.Y. TIMES DEALBOOK, (Dec. 21, 2011, 1:45pm), <http://dealbook.nytimes.com/2011/12/21/year-end-surprises-in-deal-law>.

¹⁸ See Savitt, *supra* note 16. Savitt recognizes that it is not necessary for Delaware courts to hear every case (or even most) to play a lawmaking role, so long as other courts respect, apply, and abide by Delaware law. But competitive pressure may change the law if Delaware must please plaintiff law firms to retain litigation.

¹⁹ *Id.* at 582.

²⁰ *Id.*

obtain approval of a questionable settlement from a more tolerant or more generous (or less sophisticated) court in another jurisdiction?

The causes underlying this exodus out of Delaware are debatable and were much debated at this Symposium. Professor Black and his co-authors argue in their important contribution to this Symposium that the migration from Delaware is the product of a new level of competitiveness within the plaintiffs' bar, caused at least in part by the breakup of Milberg, Weiss, long the *de facto* dominant firm in the field.²¹ They could be right, and certainly they provide the fullest recent account of developments within the plaintiff's bar. Nonetheless, there may be other, simpler explanations for the growing rate of stockholder litigation in state courts, and Occam's Razor should oblige us to prefer the simpler theory.

From that perspective, the key fact for the plaintiffs' bar is that M&A litigation in state court appears fairly riskless. M&A cases seem usually to settle. This may be attributed to any of several related reasons. First, target management (and the bidder as well) are under time pressure to close a deal and may be risk averse. Second, the costs of settling M&A litigation are very modest in terms of the transaction's size. As a result, defendants may see this cost as simply a "rounding error" in terms of the overall transaction costs, small even in comparison to the fees to the investment bankers or the corporate lawyers. Thus, corporate issuers may pay a modest sum to ensure that the closing schedules for their transactions are not disrupted. Hence, if it is perceived that the defendant will always settle, it becomes likely that the plaintiffs will almost always sue (and also normally settle fairly cheaply).

But why has the rate of state court M&A litigation recently soared? The Cheffins-Armour-Black hypothesis explains that there are more such suits today because competition within the plaintiff's bar causes every possible suit to be brought by someone. But this explanation seems

²¹ See Cheffins, Armour & Black, *supra* note 6.

incomplete without some further consideration of why defendants do not resist settlement. Here, the growing size of M&A transactions over recent years may make the costs of settlement seem increasingly modest and so reduce the defendants' urge to resist.

Let's make some not unrealistic factual assumptions. If a settlement can be achieved based only on increased disclosure and the payment of attorneys' fees, it will likely amount to less than one percent of a large (e.g., \$1 billion or more) transaction's total cost. If there is even a one percent chance that the transaction might be delayed or enjoined by the litigation, that payment will likely seem easily cost-justified to the target management (which is not using its own money in settling). Here, the migration out of Delaware may increase the uncertainty that leads risk-averse defendants to settle in M&A cases. Although litigation outcomes can be predicted with relative accuracy when litigation is brought in Delaware, this is less true in other jurisdictions where the judges may have had little experience with M&A litigation. Thus, one advantage to plaintiffs in litigating before a state court outside of Delaware is that defendants cannot as easily predict the outcome.²² The bottom line is that uncertainty is desired by plaintiffs because it encourages settlement, particularly when defendants have much at risk.

Alternatively, a more troubling and less benign explanation for multi-forum litigation is that if defendants expect to be sued in multiple jurisdictions (as, realistically, they must expect today), they may find it more useful to settle than to win a litigated victory. This is because a settlement can be designed to collaterally estop actions over which the state court does not even have subject matter jurisdiction. From the defendant's perspective, the release given incident to the settlement can be structured so as to

²² Moreover, having never before seen a billion-dollar lawsuit or litigation involving major public corporations that is attracting press attention, the out-of-state judge may be fascinated with the case (as the author has observed in some actual cases) and may be in no hurry to resolve it.

have the widest possible preclusive impact on other actions.²³ At worst, this can lead to what I have elsewhere called the “reverse auction,” in which the defendants seek to settle with the weakest plaintiffs because they will predictably settle for the lowest amount.²⁴ The frequency of such “reverse auctions” in this context is an uncertain empirical question that need not be pursued further in this introduction. But it suggests that deeper public policy issues lie beneath the surface here; increased competition may only be part of the story.

II. THE EXODUS FROM DELAWARE: HOW WILL IT PLAY OUT?

Delaware has a problem, but not yet a crisis. Declining market share would be a crisis if it were inducing firms to incorporate elsewhere. There is no evidence that this is happening, and no logical reason that it should, as corporate issuers normally want the availability of a Delaware forum.

²³ To give but one illustration, if a case in Delaware is dismissed on pleading grounds or because of a failure to make demand on the board (in a derivative action), this outcome may not be seen by a court in a different jurisdiction as a substantive holding that bars that court from reaching the merits because of *res judicata* or collateral estoppel. In contrast, a settlement can bar other actions, even those in federal court based on the federal securities laws. See *Matushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996) (settlement in state court must be given full faith and credit, even though state court lacked subject matter jurisdiction over federal securities claims that were released by the settlement). Hence it may be more practical to settle than to fight in a world characterized by multi-forum litigation. Also, it may be easier to secure a release of federal claims in state court when they cannot be litigated there.

²⁴ The author coined this term in the context of mass torts actions. It now may characterize some forms of corporate litigation as well. See John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370, 392 (2000); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1370–73 (1995). Several courts have picked up this term. See *In re Cmty. Bank of N. Va. & Guar. Nat'l Bank of Tallahassee Second Mortg. Loan Litig.*, 418 F.3d 277, 308 (3d Cir. 2005); *Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 282 (7th Cir. 2003) (Posner, J.).

The problem is that the venue for litigation is traditionally chosen by the plaintiffs.

This problem is not unique and has historical precedents. Case flow has in the past rapidly shifted from one jurisdiction to another. For example, it is widely believed that the flow of derivative actions moved from New York to Delaware when New York, in the 1940s, enacted a security-for-expenses statute that required plaintiffs to post a bond to cover defendants' reasonable expenses if their action was unsuccessful.²⁵ Delaware never enacted a similar statute, in all likelihood because one of its leading local industries corporate legal services—profited from the influx of cases. This example shows a fundamental difference between the two states: in New York, derivative actions were perceived as “strike suits” brought against local corporations by extortionate attorneys who needed to be discouraged; in Delaware, the same actions were regarded as a valuable business opportunity, which the state was happy to attract (and even compete for).

A more recent example of case migration involves the response of the securities class action bar to the passage of the PSLRA in 1995. Almost immediately, plaintiff firms began to file class actions in state court, often suing under the state's “Blue Sky” statute, in order to escape the heightened pleading standards of the PSLRA.²⁶ Their rapid adaptation was sufficiently effective that the same coalition of business groups that had forced the passage of the PSLRA over President Clinton's veto were forced to return to Congress and secure the enactment of the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”), which largely precluded most securities-related fraud class actions in state court.²⁷

²⁵ Justice Jacobs makes this same point in his contribution to this Symposium. See Jacobs, *supra* note 1, at 406.

²⁶ For a judicial recognition of this pattern, see *Segal v. Fifth Third Bank*, 581 F.3d 305, 308 (6th Cir. 2009).

²⁷ SLUSA chiefly revised Section 16 of the Securities Act of 1933 to preempt securities class actions in state court. See 15 U.S.C. § 77p(b) (2012). Ironically, Delaware had sufficient legislative clout to prevent

Is the SLUSA precedent relevant here? Could Congress conceivably act to restrict multi-forum litigation in order to give a preference to the jurisdiction of incorporation? This seems unlikely. First, Delaware is unlikely to seek federal assistance (given its efforts to secure the “Delaware carve-out” from SLUSA). Second, even though M&A litigation is a virtual certainty today in major transactions, the scale of the problem is much smaller than in the case of securities class actions. Fewer companies are affected.²⁸ Third, it is open to argument whether Delaware corporations truly want M&A suits outside of Delaware precluded, as multiple forums may enhance their ability to settle favorably with one of the weaker teams of plaintiffs suing them.

Little consensus exists at present on what reforms are optimal. Traditional liberals who are skeptical of Delaware tend to fear any outcome that gives Delaware a greater role because it will increase Delaware’s hegemony over the other states. Thus, they may favor letting plaintiffs go to the jurisdiction of their choice in order to erode Delaware’s law-making ability. Realists, however, will doubt the wisdom of deferring to the plaintiff’s choice of forum, because the plaintiff’s own motives may be more suspect. Some plaintiffs’ attorneys may avoid Delaware because they perceive they are not respected there. Some may believe that they have a home court advantage in their own jurisdiction. Some may want a jury trial, which is generally not available in Delaware. Others may simply prefer to file an action anywhere and wait for defendants to approach them with a settlement offer.

Congress from also preempting Delaware-style fiduciary breach cases, which were specifically exempted from SLUSA’s coverage. This “Delaware carve-out” was contained in Section 16(d)(1) of the Securities Act. *See* 15 U.S.C. § 77(p)(d). *See also* *Atkinson v. Morgan Asset Mgmt.*, 658 F.3d 549 (6th Cir. 2011) (discussing the scope of the “Delaware carve-out”). Essentially, the carve-out preserves “M&A objection” cases (in NERA’s terminology) that would otherwise be preempted by SLUSA. These cases have recently increased. *See supra* note 12 and accompanying text.

²⁸ The number of “M&A objection” cases in 2010 and 2011 was sixty-eight and sixty-one, respectively. *See supra* note 12.

From a public policy perspective, competition among states for M&A “fiduciary breach” litigation may present the clearest case in which competition does produce a “race to the bottom.” Close students of M&A litigation have recognized that such litigation often has a “phantom” character.²⁹ Plaintiffs rush to file, then fight intensely over the appointment of lead counsel, but thereafter take little discovery, conduct no depositions, and make few motions. Arguably, they “file early, then free ride.”³⁰ This fits a more general pattern than I have elsewhere described: entrepreneurial litigation is high volume litigation conducted on a portfolio-wide basis in which plaintiffs’ attorneys tend to economize on case-specific investment.³¹ This is logical because plaintiffs’ attorneys cannot safely predict which cases will settle. Increased competition may only reinforce this tendency to avoid substantial case-specific investment, because the rival teams will realize that if they invest significantly in an action, they may only cause the defendant to settle the case more cheaply with others who had invested less. The less one invests in the action, the more cheaply one can settle it profitably.

Perhaps the most striking evidence that interstate competition may be producing perverse results comes not from the Cheffins, Armour & Black paper, but from a more recent study by NERA researchers.³² It finds the same increasing tendency for multiple actions to be filed in

²⁹ For a description of this pattern in which “No One Litigates Anything,” see *In re Revlon, Inc. S’holder Litig.*, 990 A.2d 940, 945–46 (Del. Ch. 2010).

³⁰ See Elliot J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797 (2004).

³¹ See John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 687–90, 711–12 (1986).

³² See DOUGLAS J. CLARK & MARCIA KRAMER MEYER, ANATOMY OF A MERGER LITIGATION, NERA Economic Consulting (April 2012), available at http://www.nera.com/nera-files/PUB_Anatomy_Merger_Litigation_0312.pdf.

multiple jurisdictions, but also that “[t]he vast majority of merger cases settle for disclosure as opposed to monetary consideration, such as an increase in the deal price.”³³ Specifically, it finds that in only ten percent of the M&A settlements that it surveyed did class members receive any monetary consideration.³⁴

To sum up, the impact of the new fragmentation within the plaintiff’s bar is uncertain, but the rise of multi-forum litigation may coincide with an increased number of illusory settlements that benefit only the plaintiffs’ attorneys. If so, what remedy could curb this possibility? One logical answer, which has already been recommended by an important court of chancery decision,³⁵ would be for Delaware corporations to insert forum selection clauses into their corporate charters. These provisions would specify that the Delaware Court of Chancery was the exclusive forum for the resolution of intra-entity disputes.³⁶

Several commentators have agreed that such a provision should be enforceable (at least in the case of a “plain vanilla” provision approved by the shareholders).³⁷ Closer questions

³³ *Id.* at 9.

³⁴ *Id.* at 10. This figure was based on a sample of 162 settled litigation deals.

³⁵ See *In re Revlon, Inc. S’holder Litig.*, 990 A.2d 940, 960–61 (Del. Ch. 2010) (describing the proposed clause).

³⁶ Exactly what is meant by “intra-entity disputes” involves subtler questions of definition. Generally, these forum selection clauses would not apply to Rule 10b-5 and other federal securities fraud claims (because state law cannot supersede federal law), but would preclude the filing of a derivative action or a “fiduciary breach” class action outside of Delaware. For an example of such a “fiduciary breach” class action, see *Weinberger v. UOP, Inc.* 457 A.2d 701 (Del. 1983). Gray areas do, however, arise because Rule 10b-5 actions can be asserted derivatively. See *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977) (minority shareholders may assert claims derivatively for the unfair issuance of shares by their company to a controlling parent company). A prudently drafted forum selection clause might wisely stop short of attempting to transfer such a claim to Delaware, in part because state courts lack subject matter jurisdiction to hear cases arising under the Securities Exchange Act of 1934.

³⁷ For fuller discussions, see Faith Stevelman, *Regulatory Competition, Choice of Forum and Delaware’s Stake in Corporate Law*, 34

arise when the forum selection clause is either adopted by a board-passed bylaw that is not ratified by shareholders or is made to apply retroactively to pre-existing litigation. One recent federal decision has rejected such an attempt,³⁸ but even that case recognized that the arguments for the enforceability of a forum selection clause would be far stronger if a majority of the shareholders had approved it.³⁹

Nonetheless, uncertainty lingers. Companies that have adopted a forum selection charter amendment or bylaw have recently been sued by shareholders seeking to invalidate them.⁴⁰ Plaintiffs in these cases appear to be relying on a statement in *Galaviz v. Berg*, the recent federal decision invalidating Oracle Corporation's board-passed forum selection bylaw, that venue is a matter of federal common law,⁴¹ thus calling into question whether any forum selection clause could ever be enforced. Although the *Galaviz* decision now hangs over this field like Banquo's ghost, its conclusion

DEL. J. CORP. L. 57, 133–35 (2009) (evaluating arguments for and against enforceability); Sara Lewis, *Transfer the “Anywhere But Chancery” Problem Into the “Nowhere But Chancery” Solution*, 14 STAN. J.L. BUS. & FIN. 199 (2008) (answering the question whether non-Delaware courts would enforce a forum selection clause contained in the bylaws or charter of a Delaware corporation in the affirmative).

³⁸ See *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1171 (N.D. Cal. 2011).

³⁹ *Id.* at 1175.

⁴⁰ For example, Chevron Corporation adopted a forum selection bylaw and most recently modified it on March 12, 2012, which bylaw provides that the Delaware Court of Chancery is the “sole and exclusive forum” for derivative actions and certain other litigation alleging breaches of fiduciary duties by its officers and directors. See Chevron Corp., Report of Unscheduled Material Events or Corporate Event (Form 8-K) (Mar. 29, 2012). A lawsuit challenging this bylaw is currently pending in the United States District Court for the Northern District of California. See *Bushansky v. Armacoast*, No. 4:12-cv-01597 (N.D. Cal. Mar. 29, 2012). For another example, see *Verified Complaint, Boilermakers Local 154 Retirement Fund v. Curtiss-Wright Corp.*, No. 7219 (Del. Ch. Feb. 6, 2012).

⁴¹ *Galaviz*, 763 F. Supp. 2d at 1175 (“Even assuming, however, that the directors had the power to adopt a bylaw of this nature in the abstract, the enforceability of a purported venue requirement is a matter of federal common law.”).

that forum selection is governed by federal common law seems overbroad on a variety of grounds.⁴²

Nonetheless, the clearest answer to the *Galaviz* court's doubts about the enforceability of a forum selection clause would be for Delaware to enact a statutory amendment expressly authorizing forum selection clauses. The impact of such an amendment would be to trigger the U.S. Supreme Court's holding in *Cohen v. Beneficial Industrial Loan Corp.*⁴³ that the substantive corporate governance policies of a state must be respected in federal court, even though they are expressed in procedural terms. *Cohen* involved a New Jersey security-for-expenses statute that required plaintiffs to post such a bond in a derivative suit. Plaintiffs sought to claim that federal procedural rules (which did not require such a bond) applied in federal court, but lost because the Court recognized that important state policies on corporate governance needed to be respected. Since that time, the

⁴² *Galaviz* does not adequately distinguish *M/S Bremen v. Zapata's Off-Shore Co.*, 407 U.S. 1 (1972), which upheld a forum selection under federal common law. Nor does it address the Court's decision in *Steward Organization Inc. v. Ricoh Corp.*, 487 U.S. 22 (1988), in which several justices favored granting great deference to such a clause.

⁴³ 337 U.S. 541, 555–56 (1949). A brief word is necessary here about the possible impact of *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*, 130 S. Ct. 1431 (2010). In this recent case, which involved a conflict between Rule 23 and a New York state statute limiting class actions to recover a “penalty,” the plurality ruled in favor of Rule 23 and refused to enforce the New York state statute. However, the concurring opinion of Justice Stevens and the four dissenting justices agreed that courts needed to balance state substantive policies with federal procedural rules. Here, such balancing is particularly appropriate, given the state-derived nature of corporate law. In any event, no direct conflict with a federal procedural rule is involved in the case of a forum selection clause, and federal common law should normally seek to respect important state policies. See *Steward Organization, Inc.*, 487 U.S. 22. Finally, one can read federal statutes authorizing suits to be filed in federal court based on diversity jurisdiction as consistent with giving effect to forum selection clauses by allowing the action to be filed in federal court, but then enforcing the forum selection clause. Under this reading, the action could be filed, but the federal court would refer those state claims covered by the clause to the Delaware court and would stay the action pending such resolution.

Court has repeatedly emphasized that corporations are creatures of state law.⁴⁴ Presumably, if it wanted to, Delaware could simply abolish the derivative action or make its availability dependent on extremely rigorous preconditions.⁴⁵ In this light, a forum selection clause is a far more modest incursion on shareholders rights and is as much a substantive policy as the security-for-example bond in *Cohen*.

At present, corporations seem to be holding back from adopting forum selection clauses, at least by means of a shareholder vote.⁴⁶ Four explanations for their caution seem plausible: (1) legal uncertainty deters some issuers, particularly in view of pending litigation; (2) for other issuers, apathy still reigns, as the prospect of M&A litigation is not sufficiently material to them to justify an advance response; (3) more corporations appear to fear that proxy advisors will resist such a proposed charter amendment and cause institutional investors to vote it down; and (4) some corporations may actually want multi-forum litigation because it reduces the likely settlement they will have to pay in the event of a future M&A transactions in which they are the target.

The case for a statutory amendment authorizing the use of forum selection charter provisions comes into clearer focus if we examine the last occasion on which Delaware did something similar. In 1985, the Delaware Supreme Court decided *Smith v. Van Gorkom*⁴⁷ and held outside directors liable for their breach of the duty of care in an M&A transaction in which their company was sold at a substantial

⁴⁴ These cases begin with *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977).

⁴⁵ Indeed, *Cohen v. Beneficial Industries Loan Corp.* more or less says this, holding that restrictive legislation limiting derivative actions does not violate due process or deny equal protection. See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 550–53 (1949).

⁴⁶ Prominent M&A lawyers advise the author that they are inserting such clauses into IPOs and spinoffs where no shareholder vote is required, but are otherwise awaiting the outcome of pending litigation.

⁴⁷ 488 A.2d 858 (1985).

premium. Although the decision can certainly be defended, Corporate America was shocked. The intensity of the reaction was compounded by a cyclical crisis in "D&O" insurance market that led some insurers to cancel their D&O insurance policies for directors, and some directors resigned from their boards. Feeling that it had to act, Delaware borrowed an idea from the Principles of Corporate Governance Project of the American Law Institute ("ALI"). As part of the ALI's efforts to prepare a "Restatement-like" codification of fiduciary duties and best corporate governance practices, the ALI's Reporters had just recommended that corporate statutory law authorize charter amendments reducing the liability of directors for duty of care violations that were unaccompanied by illegality or self-dealing.⁴⁸ Seeing the merit in this idea but going slightly further than the ALI, Delaware enacted Section 102(b)(7) of the Delaware General Corporation Law, which expressly authorized charter amendments exculpating directors of Delaware companies from monetary liability for duty of care violations.⁴⁹ The idea was an instant success: other states followed Delaware (or, in some case, the earlier ALI proposal), and the vast majority of public corporations adopted similar charter amendments. Institutional investors happily supported the idea, and the amendments went through smoothly and without protest. Today, it would be rare to find a public corporation, wherever incorporated, without such a charter provision.

⁴⁸ This provision is today contained in Section 7.19 ("Limitation on Damages in Case of Certain Breaches of the Duty of Care") of the American Law Institute's *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* (A.L.I. 1992). The author served as Reporter to the American Law Institute for Litigation Remedies in connection with the preparation of the ALI Principles and is personally familiar with the Delaware Bar Committee's reliance on it in adopting Section 102(b)(7). Originally, Section 7.19 was numbered Section 7.17.

⁴⁹ The author has discussed the debate over the ALI provision and Section 102(b)(7) elsewhere. See John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation and the Special Case of Remedies*, 53 *BROOK. L. REV.* 919 (1988).

Suppose Delaware did add a new Section 102(b)(8) to its General Corporation Law to authorize forum selection clauses that were approved by a shareholder vote. Would corporations propose such clauses to their shareholders if Delaware made them explicitly available? Although the authority to adopt such a clause already exists,⁵⁰ Delaware has not officially endorsed such a clause as a matter of public policy. Such an explicit endorsement by a statutory provision expressly authorizing such a clause should trigger the earlier discussed rule in *Cohen v. Beneficial Industrial Loan Corp.*,⁵¹ because such a clause or bylaw would be implementing a substantive policy of Delaware. Also, no company would be the “test case” because many would be adopting it at the same time. Nonetheless, there remains the question of whether proxy advisors—most notably, Institutional Shareholder Services (“ISS”)—would support such a proposal.⁵² The author’s prediction would be that proxy advisors would be more hesitant to oppose a proposal that was supported by the public policy of Delaware.

The final barrier could be that some corporations will want to preserve the possibility of conducting a “reverse auction.” That assumes, however, that corporations perceive the need for such a tactic well before any merger, “going private,” or leveraged buyout transaction surfaces with them

⁵⁰ Delaware General Corporation Law Section 102(b)(1) already authorizes “[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and *any provision creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders . . . if such provisions are not contrary to the laws of this state*” (emphasis added). The legal issue is not whether Delaware law authorizes such a charter provision, but whether it would conflict in some fashion with federal law. See *supra* notes 40–43 and accompanying text.

⁵¹ See *supra* notes 42–44 and accompanying text.

⁵² The author is advised by counsel active in this area that Institutional Shareholder Services, the largest of the proxy advisors, takes a “case by case” approach as to whether it will recommend that shareholders vote in favor of a forum selection clause (whether in bylaws or in a charter provision). Glass Lewis & Co., the next largest proxy advisor, has been more skeptical and does not support them.

as the target corporation. Some corporations may think this far in advance, but their number is probably modest.⁵³

Of course Delaware could go further and actually mandate by statute a Delaware forum for intra-entity disputes, thus eliminating the need for a shareholder vote. Although this would eliminate the need for proxy advisor support, such a move would be uncharacteristic of Delaware. Delaware believes in an “enabling” body of corporate law that maximizes shareholder choice.⁵⁴ Thus, offering (but not requiring) a forum selection clause seems more consistent with their basic approach.

III. CONCLUSION

The impact of competition among the states has probably been the most debated topic in corporate law over the last forty years.⁵⁵ But the migration of cases out of Delaware raises that issue in a new light. Increased competition favors those for whose business the states are competing. “Law and economics” scholars have long favored a competitive market for corporate charters, believing that competition benefits shareholders.⁵⁶ Other equally eminent scholars are unconvinced, believing that such competition largely benefits managers.⁵⁷ Correspondingly when the

⁵³ Those corporations seeking to benefit from a reverse auction may instead prefer a different type of forum selection clause that allows them to decide after the litigation is commenced whether to seek a remand of the action to Delaware. Such a dubious clause would effectively invite plaintiffs in non-Delaware forums to offer (either implicitly or explicitly) to settle cheap.

⁵⁴ This theme is most fully expressed in *Stroud v. Grace*, 606 A.2d 75 (Del. 1992).

⁵⁵ The modern debate over the “race to the bottom” begins with Bill Cary’s 1974 claim that Delaware had lead a “race to the bottom.” See Cary, *supra* note 2. For the earliest statement of this view, see *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 548–65 (1933) (Brandeis, J., dissenting in part).

⁵⁶ See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993).

⁵⁷ For a representative statement of this rival view, see Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk:*

motive is to attract or retain corporate litigation, the likely beneficiaries of increased state competition will be the plaintiffs' bar. This happened in the past when Delaware declined to adopt a securities-for-expense statute. Delaware thereby won litigation, but exposed corporate officials to a marginally greater litigation risk.

Although other states are not yet actively competing for Delaware's litigation business (and indeed are unlikely to try),⁵⁸ plaintiffs' attorneys can seek to exploit the potential for such competition to extract benefits from Delaware in the form of higher fee awards and relaxed standards. Once again, academics will be able to debate whether competition produces a "race to the bottom" or a "race to the top." The irony is that the sides in this debate are now switching. Although the "race to the bottom" was an argument long made by liberals, in this revised context, it becomes more an argument to be made by corporate counsel, who want to restrict such competition over lawsuits.

Delaware may believe in charter competition, but sees problems in a competition for lawsuits. On balance, Delaware would be well advised to enact a policy favoring such clauses by amending Section 102(b) of its General Corporation Law expressly to authorize them. It is the simplest, cleanest answer to many of the problems discussed in this Symposium.

Reconsidering the Competition Over Corporate Charters, 112 YALE L.J. 553 (2002).

⁵⁸ The volume of such litigation is simply too small to have any impact on other states. In reality, this is the same reason that leads many scholars to doubt that other states care much about corporate franchise revenues or are actively competing with Delaware in the market for corporate characters. *See id.*