THE GENIUS OF THE MODERN CHANCERY SYSTEM

William Savitt*

The Delaware Court of Chancery has developed a transactional jurisprudence that blends the oldest traditions of equitable judging with a modern regulatory sensibility. Chancery's innovation is its deployment of common law methods to recreate the policymaking toolbox of a regulatory agency. Through its considered use of dictum, frequent engagement with practitioners and scholars of corporate law, and expert adjudication of a large and representative sample of shareholder lawsuits challenging public company deals, the Court has largely captured the substantive and procedural benefits of notice-and-comment rulemaking in announcing and developing Delaware corporate law.

The thesis of this Essay is that the Delaware Court of Chancery has developed over the past two decades an innovative form of corporate transactional jurisprudence that blends the oldest traditions of equitable judging with a modern regulatory sensibility. The Court's approach has allowed it to supervise the market for corporate control and clarify the competing rights and obligations of corporate

* Member, Wachtell, Lipton, Rosen & Katz. I extend deep thanks to Ryan McLeod, Anitha Reddy, and Sabrina Ursaner for outstanding assistance in the preparation of this Essay and the organization of the November 11, 2011 Symposium at Columbia Law School where the paper was orally delivered. Warm thanks as well to Justice Jack B. Jacobs of the Delaware Supreme Court and Professor John C. Coffee, Jr. of Columbia Law School for their superb collaboration in organizing the Symposium; to all those who generously took the time to participate in the Symposium; to Steven Davidoff for permission to use his preliminary research findings at the Symposium; to Ted Mirvis who reviewed and commented on an earlier draft of the Essay; and to Chris Lacovara, Jack Rossman, and the other editors of the *Columbia Business Law Review* for their terrific editorial assistance.

stakeholders with efficiency uncommon for a common law court.

This Essay is principally descriptive. In Part I, I identify seven aspects of contemporary Delaware deal litigation. Standing alone, none are controversial. But, as I argue in Part II, these uncontroversial attributes of M&A litigation practice add up to something new: a system of mergers and acquisition regulation that resembles old-fashioned equitable judging, but which yields special benefits typically obtained only through the operation of modern regulatory agencies. The result is a remarkable brand of commercial justice—a court that is uniquely able to regulate vast quantities of deal activity, protect the interests of absent stakeholders, test previously-announced rules of law, and announce forward-looking rules consistent with market efficiency and traditional rules of equity.

The analysis focuses on litigation brought by shareholder plaintiffs challenging announced public company deals on the ground that the directors of the target corporation breached their fiduciary duties by approving the transaction or by inadequately disclosing material facts concerning the transaction. I focus on this aspect of Chancery's docket not because these are the only important cases. To the contrary, the Court's traditional equitable function requires it to deal with a broad range of important non-corporate matters and with many significant corporate disputes—especially those that pit one company against another—that are not litigated through the prism of a stockholder challenge. But fiduciary attacks on announced deals are now the primary vehicle through which the Court develops the rules that govern director conduct and that provide transaction planners (and plaintiffs' lawyers) the basis to plan (or attack) the next deal.

I

What follows is a thumbnail sketch of seven characteristics of fiduciary-breach M&A litigation in the Court of Chancery. Most are uncontroversial. All are supported by both data and the anecdotal experience of frequent practitioners. Many reflect significant evolution

within the past generation of practice. Considered collectively, they form the factual foundation for the analysis and conclusions in Part II.

1. More cases. Way more cases.

Over the last 15 years, the incidence of shareholder litigation challenging mergers and acquisitions of U.S. public companies has skyrocketed. In 1999 and 2000, 19% of announced public company transactions with a minimum value of $80 million were challenged in court.[1] Five years later, that percentage doubled—in 2005, 39% of announced transactions with a minimum value of $100 million drew litigation.[2] By 2010, the proportion of public company deals subject to litigation more than doubled again, to 84%.[3] Of such deals announced last year, 94% were challenged in at least one lawsuit.[4]

Thus, in a little more than a decade, deal litigation has shifted from the exception to the norm. Ten to fifteen years ago, it was the unusual transaction that was subject to litigation. Shareholder plaintiffs seldom attacked a third party deal struck at a premium to market. Management buyouts and controlling shareholders transactions—the kinds of deals that carry a greater presumptive possibility of conflict—made up a significant portion of the much smaller merger litigation docket.[5] Not so anymore. Today, nearly

[1] *See* C.N.V. Krishnan, Ronald W. Masulis, Randall S. Thomas & Robert B. Thompson, *Litigation in Mergers and Acquisitions* 53 (Vanderbilt Law and Econ. Research Paper No. 10-37, Nov. 14, 2011) (on file with author).

[2] Matthew D. Cain & Steven M. Davidoff, A Great Game: The Dynamics of State Competition and Litigation 31 tbl.1 (Apr. 1, 2012) (unpublished manuscript), *available at* http://ssrn.com/abstract=1984758.

[3] *Id.*

[4] Matthew D. Cain & Steven M. Davidoff, Takeover Litigation in 2011, at 2 (Feb. 2, 2012) (unpublished manuscript), *available at* http://ssrn.com/abstract=1998482.

[5] Krishnan et al., *supra* note 1, at 2, 50 tbl. 2 (Of 299 deal suits filed nationwide in 1999 and 2000, 106, or 35%, challenged management buy-outs or controlling shareholder squeeze-outs.).

every merger is challenged by shareholder plaintiffs alleging a breach of fiduciary duty, no matter how great the premium, no matter how apparently independent the directors, no matter how proper the board's decision-making process appears in the public record, no matter what the standard of judicial review. Every deal now gets its day in court.

And usually more than one day, in more than one court. Each deal now draws a substantially higher number of litigation challenges than even a decade ago. In 2005, mergers challenged in court drew an average of 2.2 lawsuits; in 2010, the average was 4.7.[6] It is no longer uncommon for a deal to be challenged in a dozen or more lawsuits filed by different plaintiffs represented by varying coalitions of plaintiffs' attorneys.[7]

Equally striking is the increase in the proportion of deals attacked in multiple jurisdictions. Until 2002, nearly all deals with large Delaware-incorporated targets were attacked (if at all) only in the Court of Chancery.[8] By 2011, however, 75% of challenged deals with large Delaware

[6] Cain & Davidoff, *supra* note 2 (data on public company deals of $100 million or more). The data reveals little or no correlation between deal size and litigation filings. In 2010 and 2011, 96% of announced deals with a value of more than $1 billion drew litigation, and each of those deals drew an average of 6.1 lawsuits. But deals with a value of $100 million to $500 million were almost as frequently subject to suit. Of those deals, 85% drew litigation, and each deal drew an average of 4.1 lawsuits. And the deals in that period that attracted the most lawsuits—fifteen or more—ranged in value from $280 million to $29 billion. *See* ROBERT DAINES & CORNERSTONE RESEARCH, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 3 tbls. 2 & 3 (2012).

[7] Of deals valued at $100 million or more announced in 2010 and 2011, 11 were attacked by at least 15 individual lawsuits. *See* DAINES & CORNERSTONE RESEARCH, *supra* note 6, at 3 tbl. 3.

[8] *See* John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing Its Cases?* 19 (Eur. Corporate Governance Inst., Law Working Paper No. 151/2010, Feb. 2012) (unpublished manuscript), *available at* http://ssrn.com/abstract=1578404.

targets were subjected to suit in Delaware and in at least one other forum.[9]

The import of these trends is striking: The incidence of fiduciary merger litigation has nearly doubled in the past five years, and increased some 700% in a decade. In absolute numbers, the Court of Chancery is reviewing far more deals for compliance with Delaware fiduciary duty law than it was ten years ago. Chancery is also reviewing a far greater proportion of litigated deals with sizeable Delaware targets than it was five years ago. And competing plaintiffs' attorneys are now frequently calling upon the Court of Chancery and the courts of other states to review Delaware-law merger cases at the same time, creating costly jurisdictional contests and the potential for dueling class actions.

2. More intense litigation

Not only are plaintiffs bringing far more deal suits, they are litigating them more intensively and settling them later. This development appears to be a function of better capitalized and more aggressive plaintiffs' attorneys and legal rules governing the approval of class settlements and attorneys' fees that encourage and reward vigorous litigation.

Many of the plaintiffs' firms most active in shareholder deal litigation today specialize in merger cases, employ scores of lawyers in multiple offices, and serve a stable of institutional investor clients.[10] Although such firms still

[9] *See* DAINES & CORNERSTONE RESEARCH, *supra* note 6, at 6 (examining data on public company deals valued at $500 million or more); *see also* Cain & Davidoff, *supra* note 2 (finding that in 2005, only 8.6% of litigated deals with a value of at least $100 million were challenged in multiple forums, compared to 46.5% in 2011). As Daines observed, "The most striking trend in venue choice for M&A litigation is not a flight from or return to Delaware, but that challenges to the same deal in both Delaware and some other venue are now more common." DAINES & CORNERSTONE RESEARCH, *supra* note 6, at 6.

[10] To take a few examples from among many leading plaintiffs' side firms: Robbins, Geller, Rudman & Dowd has 180 lawyers and nine offices;

operate largely on the traditional contingent fee model, they have the resources and skills to pursue a portfolio of deal cases and to bear significant out-of-pocket costs before they collect a fee. As a result, it cannot be assumed that shareholder plaintiffs will settle a case early in the litigation simply to avoid the long haul.

As important, Chancery, which is obligated by its Rule 23 to review proposed class settlements for fairness, can be very skeptical of early settlements.[11] To be sure, Delaware law, like other states' law, generally favors the voluntary resolution of disputes, and many deal suits are settled in the initial stages of litigation.[12] But Delaware courts have long recognized that the general preference for settlement must be balanced against a court's duty to ensure that the interests of the class are fairly served by settlement.[13] Chancery frequently emphasizes its obligation to protect absent class members from the risk that a settlement will primarily serve the interests of defendants and plaintiffs' attorneys.[14] The bar is thus on notice that early settlements will be subject to judicial scrutiny.

Grant & Eisenhofer has 68 lawyers and three offices; and Bernstein, Litowitz, Berger & Grossman has 56 lawyers and four offices. *See* http://www.rgrdlaw.com/firm.html (last visited May 2, 2012); http://www.gelaw.com/attorneys (last visited May 2, 2012); http://www.blbglaw.com/attorneys/search-out (last visited May 2, 2012).

[11] *See* DEL. CH. CT. R. 23(e).

[12] *See* Kahn v. Sullivan, 594 A.2d 48, 58 (Del. 1991) ("Delaware law, as a general proposition, favors the voluntary settlement of contested issues.").

[13] *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1283 (Del. 1989) ("The Court of Chancery plays a special role when asked to approve the settlement of a class or derivative action. It must balance the policy preference for settlement against the need to insure that the interests of the class have been fairly represented."); *see also* Wied v. Valhi, Inc., 466 A.2d 9, 15 (Del. 1983) ("Rules 23 and 23.1 are intended to guard against surreptitious buy-outs of representative plaintiffs, leaving other class members without recourse.").

[14] *See, e.g.*, Brinckerhoff v. Tex. E. Prods. Pipeline Co., LLC, 986 A.2d 370, 374 (Del. Ch. 2010) ("The lure of a premium transaction, the self-evident benefits of settlement to the controller and other defendants, and the prospect of an easy end to the litigation—coupled with a large fee—

Plaintiffs' attorneys are also on notice that they may well be paid more if they litigate more. In awarding fees, Chancery judges pay close attention to how much work plaintiffs' attorneys have done before reaching a settlement.[15] For decades, Chancery judges have recognized that reasonable fees generally range from 10% to 35% of the value of the benefit procured for the class. Lately, however, Chancery judges have provided guidance on what plaintiffs' attorneys need to do to justify fees in the middle or higher end of that range, and it generally involves more litigation. In *In re Emerson Radio Shareholder Derivative Litigation*, for example, the Court noted that fees typically range from 10% to 15% when suits settle early, from 15% to 25% when plaintiffs conduct multiple depositions and engage in some motion practice, and from 25% to 35% when plaintiffs prosecute a case through trial and appeal.[16] In that case, the Court rejected the plaintiffs' attorneys' request for $1.5 million in fees, finding that they had litigated the case only to "mid-stage," warranting an award of $875,000, or 25% of the value of the benefit obtained.[17] The Court reached that conclusion after cataloguing the lawyers' work in detail, noting that they had "obtained a large document production from the defendants, sought and obtained third-party production, took eleven fact depositions, and pursued two discovery motions and a request for clarification."[18]

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create powerful pressures. No one need cross the line of collusion or conscious shirking for these forces to have an effect.").

[15] *See, e.g.*, *In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 WL 1020471, at *33 (Del. Ch. Mar. 23, 2012) (noting, in determining appropriate fee for class counsel, that "[t]he post-MOU [Memorandum of Understanding] hours, at best, only tangentially relate to the benefits conferred by the settlement and for which an award of attorneys' fees is justified in the first instance").

[16] *See In re* Emerson Radio S'holder Derivative Litig., C.A. No. 3392-VCL, 2011 WL 1135006, at *3 (Del. Ch. Mar. 28, 2011).

[17] *Id.* at *4, *6.

[18] *Id.* at *4. For another recent example of a similar analysis, see *In re Celera Corp. Shareholder Litigation*, 2012 WL 1020471, at *31 (awarding a 25% fee to plaintiffs' counsel, who "conducted expedited discovery during a fast-paced transaction, deposed eight witnesses, prepared and submitted

Decisions like *Emerson* signal to the plaintiffs' bar that it will be rewarded for investing heavily in potentially meritorious cases.[19] Partly for this reason, plaintiffs are more frequently choosing in standard deal cases not just to kick the tires of the transaction, so to speak, but also to open up its hood and work up some real elbow grease in examining its propriety. This persistence can take the form of litigating a case to a contested preliminary injunction application, often on a theory of inadequate disclosure, or seeking damages after the transaction closes, even in circumstances in which the case law and Section 102(b)(7)[20] create difficult challenges to ultimately imposing liability.[21]

3. More law

As a result of the increase in the number and intensity of deal challenges, the Court of Chancery is making a lot more law: The number of opinions the Court issued in 2010 was

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a preliminary injunction brief, and settled on the eve of a preliminary injunction hearing"). *Compare id. with In re* Nat'l City Corp. S'holders Litig., C.A. No. 4123-CC, 2009 WL 2425389, at *6 (Del. Ch. July 31, 2009) (awarding a fee of $400,000, a third of plaintiffs' counsel's request, because the benefit of the supplemental disclosure obtained was "miniscule" and because plaintiffs' counsel, "after winning an early motion to expedite, did not press any subsequent motion and only deposed two witnesses").

[19] *See In re Emerson Radio*, 2011 WL 1135006, at *4 (commenting that because representative counsel seeks to maximize fees per hour, rather than absolute fees, "awarding increasing percentages helps off-set representative counsel's natural incentive to shirk"); Transcript of Settlement Hearing at 76–77, Campbell v. Talbots, Inc., C.A. No. 5199-VCS (Del. Ch. Dec. 20, 2010) (noting that higher fees will often be awarded when plaintiffs "push[] defendants right to the eve of trial," indicating that "there was more risk taken"); *see also* David Marcus, *The Cost of Doing Business*, THE DEAL, May 2012, at 22, 31 (noting that rulings may "award[] higher fees to lawyers who litigate aggressively even if they don't win").

[20] 8 DEL. GEN. CORP. L. § 102(b)(7). Section 102(b)(7) validates charter amendments that limit or eliminate director liability for losses caused by actions that did not violate the director's duties of loyalty or good faith.

[21] Practitioner commentary confirms this trend. *See* Boris Feldman, *Shareholder Litigation After the Fall of the Iron Curtain*, 45 REV. OF SECS. & COMMODITIES REG. 7, 9 (2012) ("Historically, once the deal closed, the suits went away. . . . Now, merger suits survive the closing.").

roughly 60% greater than the number it issued in 1990.[22] The Court is issuing more opinions resolving motions to dismiss and preliminary injunction applications, and thus more opinions discussing the proper exercise of fiduciary duties in connection with an extraordinary transaction. And because class action settlements require court approval, Chancery is also necessarily examining (at least to some extent) the discharge of those duties even in cases that settle before a motion to dismiss or preliminary injunction application is resolved.

It stands to reason that this increase in the number of written opinions has been accompanied by an increase in the number of oral rulings, a supposition consistent with the anecdotal experience of practitioners. But whether the Court is actually making more oral rulings or not, its oral rulings have become far more widely available in the last ten years because of the advent of electronic filing and the widespread adoption of PDF technology and e-mail. As a practical matter, the Court is issuing far more law, and more readily accessible law, than it was twenty years ago.

4. Court-approved, sometimes court-selected, class counsel

With few exceptions, the cases challenging mergers are brought as shareholder class actions. Because the rules governing class actions generally allow such actions to proceed only if a court determines that the lead plaintiff and its counsel can adequately represent the interests of the class, courts must pass on the appointment of class counsel.[23] As a result, the Court of Chancery typically approves the counsel litigating Delaware deal claims.

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[22] A search of the Westlaw database of Chancery decisions (admittedly an imperfect proxy for the category) reveals 181 decisions in 1990 and 288 in 2010, an increase of 59%.

[23] *See* DEL. CH. R. 23(a)(4) ("One or more members of a class may sue or be sued as representative parties on behalf of all only if . . . the representative parties will fairly and adequately protect the interests of the class."); *see also, e.g.*, FED. R. CIV. P. 23(a)(4), (g).

Chancery's general practice has been to approve the lead counsel and supporting organizational structure agreed upon by the plaintiffs pursuing the merger challenge if their proposal is unopposed.[24] That practice reflects the Court's recognition that a relatively small group of expert plaintiffs' firms file and prosecute most merger challenges brought in Delaware.[25] As an illustration, the 100 shareholder class action complaints brought in Chancery in the first four months of 2012 were filed by only 11 firms, and just four of those firms filed 84 of the complaints.[26] The plaintiffs' lawyers bringing these suits are repeat players, specialists who devote their professional lives to testing announced mergers for compliance with Delaware fiduciary duty law.

Nevertheless, when counsel's performance is inadequate or plaintiffs' firms dispute who should serve as lead counsel, Chancery may step in.[27] In several recent cases, the Court has expressly recognized its duty to ensure skilled and

[24] *See, e.g.*, Wiehl v. Eon Labs, C.A. No. 1116-N, 2005 WL 696764, at *3 (Del. Ch. Mar. 22, 2005) ("This court has frequently stated its position that the plaintiffs' lawyers should work out the lead counsel or other leadership structure among themselves.").

[25] *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 954–55 (Del. Ch. 2010) ("Our tradition of respecting the ability of plaintiffs' counsel to self-organize depends on the Court's confidence in the law firms and practitioners who appear frequently before us. It depends in particular on our confidence in the Delaware lawyers who build (and sometimes burn) reputational capital with the Court.").

[26] Research on file with the author. The concentration of plaintiffs' firms bringing and prosecuting shareholder deal suits is not recent, though it may be intensifying. Thompson & Thomas found that in 1999 and 2000, the same 16 plaintiffs' firms were involved in 75% of the shareholder deal suits filed in the Court of Chancery. Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 185 (2004). After examining a sample of shareholder suits from the late 1960s through the late 1980s, Romano also concluded that the practice was concentrated. *See* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 57 n.2 (1991) ("Shareholder litigation is highly specialized, and a few firms dominate the practice.").

[27] *In re Revlon*, 990 A.2d at 954–55 ("This Court has the power and obligation to revisit and alter the leadership structure for a representative action if existing counsel fail to provide adequate representation.").

diligent prosecution of class claims for breach of fiduciary duty. In those cases, it has exercised in various ways its power to select or replace lead counsel. For example, in the litigation challenging the proposed sale of Del Monte Foods Co., the Court ordered the plaintiffs' firms jockeying to be lead counsel to submit litigation plans outlining their strategies, the range of likely outcomes, and, for each likely outcome, their expected fees.[28] In another case, the Court appointed as new lead counsel a firm that "frequently represents paying clients" and "ha[d] built up reputational capital with the Court."[29]

While these situations are not typical, they reflect Chancery's growing involvement in resolving contests for lead counsel status. Twenty years ago, Chancellor Allen observed that it was necessary only "on occasion" for the Court to resolve lead counsel disputes,[30] and ten years ago Vice Chancellor Lamb found that observation still apt.[31] But the last few years have witnessed a measurable uptick in the frequency of lead-counsel disputes that must be resolved by the Court.[32] The rising number of failed negotiations has

[28] *See* Order, *In re* Del Monte Foods Co. S'holder Litig., Consol. C.A. No. 6027-VCL (Del. Ch. Dec. 23, 2010).

[29] *In re Revlon*, 990 A.2d at 945, 962–63.

[30] Silverstein v. Warner Commc'ns, Inc., Nos. 11285 & 10671, 1991 WL 12835, at *2 (Del. Ch. Feb. 5 1991) ("Happily, in most complex corporate or securities litigation in this jurisdiction, class counsel agree upon appropriate roles and the court is not drawn into such disputes. This will not always be the case and it will on occasion be necessary for the court to manage class litigation to the extent of designating lead counsel.").

[31] Hirt v. U.S. Timberlands Serv. Co., LLC, C.A. No. 19575, 2002 WL 1558342, at *2 (Del. Ch. July 9, 2002) (quoting *Silverstein*, 1991 WL 12835, at *2).

[32] Anecdotes from practice suggest that the frequency with which competing blocs of plaintiffs' firms litigate lead counsel fights has increased at least several fold in recent years, reflecting the influx of more and more active plaintiffs' lawyers. The limited data tends to confirm the observation. *Hirt v. U.S. Timberlands Serv. Co., LLC, id.*, a 2002 decision by Vice Chancellor Lamb, is the authoritative case laying out the factors to be considered in selecting lead counsel. While *Hirt* was cited only twice in

given Chancery more opportunities to appoint as lead counsel the firms it believes will not merely adequately represent the class, but will best do so. The general point is that Chancery practice has evolved such that the Court may rely on a specialized corps of court-approved, court-supervised, and sometimes even court-selected attorneys who focus their litigation activity solely on enforcing Delaware's fiduciary standards in the arena of mergers and acquisitions.[33]

5. Court-approved settlements

Another consequence of the class character of shareholder deal litigation is that the Court of Chancery is obligated to review, and empowered to reject, any proposed settlement. The requirement that a settlement meet with judicial approval is not unique to merger litigation; it is a universal condition for the settlement of class claims.[34] But the requirement ensures that Chancery judges substantively review the roughly 70% of shareholder merger challenges filed in the Court that ultimately settle, whether those cases are litigated to a decision of any sort or not. Given the frequency and volume of Delaware merger litigation,[35]

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decisions resolving lead counsel disputes issued before 2009, it has been cited six times in such decisions since 2009.

[33] Indeed, plaintiffs' attorneys expressly compare their subjection of nearly every deal to some level of court review to the work of enforcement attorneys at government agencies. Randy Baron of Robbins, Geller, Rudman & Dowd, LLP, recently said of the explosion in deal litigation, "So what? In every one of these deals, shareholders are at an information disadvantage. No one wants to pay the SEC for a lawyer who has the subpoena power to get all of the information and put it before a three-judge panel." Former Chancellor William B. Chandler echoed that observation: "Neither the SEC nor any other entity polices the fiduciary duties of private actors. We've effectively left that role to private attorneys general." *See* Marcus, *supra* note 19, at 27.

[34] DEL. CH. R. 23(e); *see also, e.g.*, FED. R. CIV. P. 23(e).

[35] *See supra* notes 1–9 and accompanying text; *see also About the Delaware Division of Corporations*, DEL. DIV. OF CORPS., http://corp.delaware.gov/aboutagency.shtml (last visited May 2, 2012)

Chancery judges are now reviewing a significant fraction of all deals with a domestic public target.

Chancery takes seriously its obligation to safeguard the interests of the class. The Court's careful evaluation of the settlement recently presented in the shareholder litigation challenging Quest's proposed acquisition of Celera Corp. is illustrative.[36] In a 7,354-word opinion, the Court carefully examined the value of the purported benefits of the settlement to the class (therapeutic changes to the merger agreement and supplemental disclosures) and the strength of the plaintiffs' fiduciary duty and securities fraud claims before approving the settlement.[37] And in another recent case, the Court strongly suggested to the parties that it would not approve a settlement for only supplemental disclosures because the plaintiffs' claims of inadequate disclosure were not colorable and because the plaintiff had not pursued apparently litigable claims that the process leading to the deal was flawed.[38] As these cases show, settlement review in Chancery is substantive, not merely a rubber stamp.

6. Routinely expedited proceedings

Deal litigation in the Court of Chancery is routinely expedited to ensure that plaintiffs have the opportunity to explore the sufficiency of the disclosures issued to

(reporting that more than 50% of all U.S. public companies and 63% of Fortune 500 companies are incorporated in Delaware).

[36] *See In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 WL 1020471 (Del. Ch. Mar. 23, 2012).

[37] *See id.* at *20–*30.

[38] *See* Transcript of Status Conference at 3–4, Scully v. Nighthawk Radiology Holdings, Inc., C.A. No. 5890-VCL (Del. Ch. Dec. 17, 2010); *see also id.* at 17 ("What happened here is the plaintiffs filed a case that really had legs. And I told you guys you had legs."). After the Court suggested its potential skepticism of a disclosure-only settlement, the parties presented a disclosure-only settlement to an Arizona court in which another shareholder challenge to the same deal had been filed. The Arizona court approved the settlement. *See id.* at 4–5.

shareholders in advance of a proposed merger.[39] This practice reflects Chancery's "preference for having disclosure claims brought as motions for a preliminary injunction before the shareholder vote, as opposed to many months after."[40] That preference is grounded in the recognition that "[a]n injunctive remedy . . . specifically vindicates the stockholder right . . . to receive fair disclosure of the material facts necessary to cast a fully informed vote . . . in a manner that later monetary damages cannot."[41]

The Court's willingness to expedite review of any colorable claim of inadequate disclosure, coupled with the

[39] *See* Randy J. Holland, *Delaware's Business Courts: Litigation Leadership*, 34 J. CORP. L. 771, 777 (2009) ("The Court of Chancery is renowned for the unparalleled alacrity with which it conducts trial and decides important issues of corporate law. Former Chancellor William T. Allen has observed that '[i]t is not unusual for the validity of a hugely complex corporate decision to be determined in Chancery within 60 days.'" (quoting William T. Allen, *Whence the Value-Added in Delaware Incorporation?*, CORP. EDGE (Div. of Corp., Dover, Del.), Fall 1997, at 4)).

[40] *In re* Transkaryotic Therapies, Inc., 954 A.2d 346, 360 (Del. Ch. 2008) (alterations omitted) (quoting Globis Partners, L.P. v. Plumtree Software, Inc., C.A. No. 1577-VCP, 2007 WL 4292024, at *10 (Del. Ch. Nov. 30, 2007)).

[41] *In re* Staples, Inc. S'holders Litig., 792 A.2d 934, 960 (Del. Ch. 2001); *see id.* ("Delaware case law recognizes that an after-the-fact damages case is not a precise or efficient method by which to remedy disclosure deficiencies. A post-hoc evaluation will necessarily require the court to speculate about the effect that certain deficiencies may have had on a stockholder vote and to award some less-than-scientifically quantified amount of money damages to rectify any perceived harm."); *In re* 3Com S'holders Litig., C.A. No. 5067-CC, 2009 WL 5173804 (Del. Ch. Dec. 18, 2009) ("Under Delaware law, a material disclosure violation typically creates a *per se* irreparable harm . . . ."); *see also In re* Transkaryotic Therapies, Inc., 954 A.2d 346, 362 (Del. Ch. 2008) (denying monetary or equitable relief for inadequate disclosure claims asserted post-closing). Landes and Posner note that one efficiency advantage of a declaratory judgment is that, unlike in an ordinary ex post lawsuit, the court and the parties expend resources determining only liability, not liability and remedy. William M. Landes & Richard A. Posner, *The Economics of Anticipatory Adjudication*, 23 J. LEGAL STUD. 683, 699 (1994). A Chancery ruling resolving disclosure claims before a shareholder vote has the same advantage—if the court finds liability, the appropriate specific or equitable remedy is obvious, even if the appropriate legal remedy is not.

recent massive expansion in deal litigation, has produced a new phenomenon: the systematic real-time testing of merger proxies for material deficiencies by court-supervised plaintiffs' attorneys. In cases that are litigated to a preliminary injunction application, the Court definitively determines before shareholders vote whether the inadequacies alleged by plaintiffs are in fact material. But even in cases that settle before an injunction application is resolved (the majority of the cases), the settling parties customarily inform the Court immediately of the terms of the settlement-in-principle so that the Court can make a preliminary evaluation of whether the agreed-upon supplemental disclosure provides a sufficient basis for settlement.[42]

What this means is that nearly all merger proxies for public company deals with Delaware targets are now subject to two layers of prospective review: a "litigation review" in Chancery to test compliance with fiduciary duties imposed by Delaware law, as well as the review-and-comment process conducted by the SEC pursuant to its regulatory mandate to enforce the federal securities laws.[43]

7. A specialized court

Finally, the simplest observation of all: although Chancery's jurisdiction is not limited to corporate law matters, it is fair to say that its jurisdiction is specialized

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[42] *See* DAINES & CORNERSTONE RESEARCH, *supra* note 6, at 2 fig. 1, and at 8, 10 (finding that 95.5% of $500 million-plus deals announced in 2010 and 2011 were challenged by shareholder suits, 69% of those suits settled, and in 82% of those settlements the only relief was supplemental disclosure).

[43] *See* 17 C.F.R. 240.14a-6 (2012) (requiring a soliciting party to file a preliminary proxy statement with the SEC at least ten calendar days before sending or giving a definitive proxy statement to security holders); *see also* Div. of Corp. Fin., *Filing Review Process*, SEC, http://www.sec.gov/divisions/corpfin/cffilingreview.htm (last visited May 2, 2012). If the SEC is not satisfied with a company's proxy statement, it may seek injunctive relief to enforce the proxy provisions of the Securities Exchange Act of 1934 and the regulations promulgated thereunder. *See* 15 U.S.C. 78u(d) (2012).

rather than general and that its work is done by experts in corporate governance, fiduciary duty, and M&A law. Even ten to fifteen years ago, before litigation became a predictable response to every deal announcement, corporate law matters made up three-quarters of the Court's docket, and of those, four-fifths raised questions of fiduciary law.[44] In addition, the five Chancery judges are appointed on the basis of their expertise in Delaware corporate law and cannot help but become even more expert by virtue of their deep and continuous exposure to that law and their obligation to interpret and expound it daily and at length.[45]

II

Taken individually, none of these observations about the growth of shareholder deal litigation and its implications for the Court of Chancery are controversial. Indeed, some—such as those concerning the Court's obligations and powers with respect to class actions—do not even identify special characteristics of the Court. Together, however, they mark Chancery as an unusual and remarkably effective regulatory machine. The Court of Chancery is a common law court, of

[44] Thompson & Thomas, *supra* note 26, at 166.

[45] *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 120–21 (2004) ("In contrast to judges in other states, however, Delaware chancellors frequently have considerable prior corporate experience as practitioners. Once on the bench, there is a substantial pay-off for Delaware chancellors who continue to master corporate law. Delaware chancellors sit at 'the center of the corporate law universe.' Unlike other courts, which face corporate cases only episodically, such cases make up a very high percentage of the Delaware chancellors' docket. The frequency with which they face such cases provides a strong incentive for Delaware's chancellors to master both doctrine and the business environment in which the doctrine works. In particular, there is a strong reputational incentive for doing so. Sitting without juries in a court of equity, Delaware chancellors put their reputation on the line whenever they make a decision. Because so many major corporations are incorporated in Delaware, chancery court cases are often high profile and the court's decisions therefore are subject to close scrutiny by the media, academics, and practitioners. The reputation of a Delaware chancellor thus depends on his or her ability to decide corporate law disputes quickly and carefully." (footnotes omitted)).

course. As a dedicated court of equity, it has a pedigree centuries older than does the administrative agency. But it is an exceptional court because it can be fairly described this way: as a governmental entity, directed by expert decision makers and assisted by a cadre of government-supervised enforcement attorneys, armed with substantial rulemaking and adjudicating authority over the conduct and disclosure of transactions within its jurisdictional compass, and charged with using that authority to regulate a broad field of economic activity. Because Chancery sees and has the power to regulate a vast amount of M&A activity, its perspective is not episodic or narrow, but constant and, if not complete, very substantially representative. In all of these respects, it resembles a regulatory agency.

This hypothesis invites a brief comparison of the lawmaking powers of courts and administrative agencies. Like courts, many agencies have adjudicatory authority and can announce broadly applicable principles of law in the course of exercising that authority. Unlike courts, however, agencies may rely also on prospective general rulemaking to advance their regulatory agenda.

Rulemaking has been described as "the issuance of regulations or the making of determinations which are addressed to indicated but unnamed and unspecified persons or situations."[46] Commentators and judges have been nearly unanimous in recognizing rulemaking as a method of promulgating generally applicable rules that is superior to case-by-case adjudication.[47] Because an agency engages in rulemaking to constrain and influence the future conduct of generic actors, it formulates rules with a broad set of scenarios in mind, and with particular attention to the case

[46] Ralph F. Fuchs, *Procedure in Administrative Rulemaking*, 52 HARV. L. REV. 259, 265 (1938).

[47] *See, e.g.*, NLRB v. Wyman-Gordon Co., 394 U.S. 759, 779 (1969) (Douglas, J., dissenting) ("Rule making is no cure-all; but it does force important issues into full public display and in that sense makes for more responsible administrative action."); *see also id.* at 781–82 (Harlan, J., dissenting); David L. Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 HARV. L. REV. 921 (1965).

that, in its considered view, the proposed regulation is most likely to affect. In contrast, a court develops generally applicable rules only as a byproduct of evaluating the past conduct of specific actors. In addition, in considering the desirability of a proposed rule, agencies are required to solicit comment from the parties that will be affected, while courts are generally limited to the submissions of the parties in the particular case before them. For these reasons, rules resulting from rulemaking are generally thought to be more effective regulatory instruments—because their benefits and costs in the mine run of cases are more thoroughly examined before adoption.

Making generally applicable rules through rulemaking is also preferable in several procedural respects to making such rules through adjudication. With notice-and-comment rulemaking, all affected parties may participate in the development of regulation. Affected parties are also given clearer advance notice of regulation, so that they may order their affairs accordingly. Most important, prospective enforcement avoids the inequitable retroactive application of a new rule to the hapless litigant who finds herself on the wrong side of a recently updated regulation.[48]

The genius of Chancery lies in its innovative deployment of traditional common law methods to recreate and improve the policymaking toolbox of a regulatory agency. The argument here is that the Court has largely captured the substantive and procedural benefits of notice-and-comment rulemaking while at the same time remaining entirely faithful to the best traditions of equitable and common law judging. The Court's deep expertise in, and broad exposure to, issues of corporate law in the transactional context enable it to announce binding rules that do not reflect an excessive focus on the facts of particular, perhaps unrepresentative, cases.

[48] For a general discussion of the advantages of announcing generally applicable rules through rulemaking, as compared with adjudication, see 1 KENNETH CULP DAVIS & RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 6.7 (3d ed. 1994), and Shapiro, *supra* note 47, at 929–42.

A. In praise of dictum

Rules announced in dicta are often criticized as careless judicial utterances, made with insufficient attention to their application in the gamut of cases.[49] Commenting on the dangers of dictum, Judge Pierre Leval of the Second Circuit Court of Appeals observed, "Two of the most difficult challenges in lawmaking are understanding the facts that call for regulation and understanding what effect the imposition of any rule will have on those facts. . . . [But] when a court asserts a rule of law in dictum, the court will often not have before it any facts affected by that rule."[50] In that situation, a court of general jurisdiction will not have the benefit of seeing the implications of the rule it announces in even one concrete factual context, much less the most common factual context in which the rule will apply.[51]

But I argue here in praise, not criticism, of Chancery dictum. As Myron Steele, the Chief Justice of the Delaware Supreme Court and a former Vice Chancellor, has explained, "the Delaware courts recognize the need to wait for a live controversy to resolve an issue definitively," but nevertheless "frequently craft dicta to give valuable guidance to deal lawyers . . . on uncertain but vital areas of corporate law."[52] Accordingly, the Court of Chancery often announces in

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[49] The classic formulation of this criticism appears in *Cohens v. Virginia*, 19 U.S. 264, 399 (1821): "The question actually before the Court is investigated with care, and considered in its full extent. Other principles which may serve to illustrate it, are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated."

[50] Pierre N. Leval, *Judging Under the Constitution: Dicta About Dicta*, 81 N.Y.U. L. REV. 1249, 1262 (2006).

[51] *See* Valley Forge Christian Coll. v. Am. United for Separation of Church and State, Inc., 454 U.S. 464, 472 (1982) (observing that "a concrete factual context" is "conducive to a realistic appreciation of the consequences of judicial action").

[52] *See* Myron T. Steele & J.W. Verret, *Delaware's Guidance: Ensuring Equity for the Modern Witenagemot*, 2 VA. L. & BUS. REV. 189, 207 (2007); *see id.* at 217–18 (listing five instances in which dicta on corporate law uttered by the Delaware courts has been cited in corporate law practice guides or treatises).

dictum—frank dictum, not dictum disguised as holding—new rules intended to influence the conduct of future transactions. In *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, for example, Chancellor Chandler carefully explained how a controlled company could structure a sale to a third party so as to obtain the benefit of the business judgment rule in a challenge to the transaction by the minority stockholders.[53] Because the Chancellor ultimately concluded that the procedure he described had not been followed in the transaction before him, his conclusion that such a procedure, if followed, would qualify a transaction for business judgment review played no functional role in his decision. In another recent case, *In re Smurfit-Stone Container Corp. Shareholder Litigation*, Vice Chancellor Parsons answered the long-outstanding question whether a board's approval of the sale of a corporation for consideration split evenly between cash and stock in the acquirer is subject to deferential business judgment review or to heightened scrutiny under the *Revlon* line of cases.[54] Again, because the Vice Chancellor decided that the board's conduct survived even heightened *Revlon* scrutiny, his conclusion that the transaction was properly subject to such scrutiny played no functional role in his decision.[55]

These were rulings on important questions that provided clear guidance to transactional lawyers on the proper way to structure corporate transactions. But the legally innovative

[53] *In re* John Q. Hammons Hotels Inc. S'holder Litig., C.A. No. 758, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).

[54] *In re* Smurfit-Stone Container Corp. S'holder Litig., C.A. No. 6164, 2011 WL 2028076 (Del. Ch. May 24, 2011); *see* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994); *In re* Santa Fe Pacific Corp. S'holder Litig., 669 A.2d 59 (Del. 1995). Under *Revlon*, a board overseeing the sale of control of a corporation has a fiduciary obligation to obtain the best value reasonable available to the shareholders. *See Revlon*, 506 A.2d at 182.

[55] Vice Chancellor Parsons candidly acknowledged that his conclusion was dicta. *See In re Smurfit-Stone*, 2011 WL 2028076, at *11 ("[E]ven if I assume without deciding that the *Revlon* standard applies, the result would be the same.").

part of the decisions—the new rules they announced—were dicta through and through.

But not ordinary dicta. The rules articulated in these cases (and many others like them) are not fairly susceptible to the criticism that they were announced without reflection or an appropriate canvass of their practical implications. To the contrary, these rules are careful and considered. They are the product of the reasoned reflection of expert judges seeking to minimize uncertainty in corporate law—and thus to reduce the risk of fiduciary duty violations in the conduct of future transactions. In announcing such dicta, the Court of Chancery has the benefit not only of the briefing and facts in the case before it, but recourse as well to its massive reservoir of experience with similar cases, built up by virtue of its specialized docket and its now nearly complete exposure to the relevant universe of cases.[56]

Considered recourse to dictum allows Chancery to prospectively regulate fiduciary conduct, without requiring the litigants before it to bear the cost (through retrospective application) of prospective rulemaking. Equally importantly, Chancery utters its dictum with full appreciation of the broad range of cases that will be affected, largely sidestepping the pitfalls of dictum that have been identified by commentators such as Judge Leval. Chancery's use of dicta is thus substantially in the nature of an agency issuing enforcement guidelines or interpretative rules—policymaking devices that agencies routinely and effectively use to influence (if not yet bind) the behavior of actors

[56] *See* Landes & Posner, *supra* note 41, at 713. Landes and Posner argue that in the U.S., courts typically engage in anticipatory adjudication less frequently than do administrative agencies because most courts, unlike agencies, "have general rather than specialized jurisdictions." *Id.* It is therefore generally more costly for courts to avoid errors when engaging in anticipatory adjudication (by, for example, issuing advisory opinions or dicta, or ruling on a preliminary injunction application). Landes and Posner predict that specialized courts "would allow anticipatory adjudication more freely" than traditional Anglo-American courts of general jurisdiction. *Id.* at 714. The Court of Chancery's receptivity to preliminary injunction applications and its relatively frequent and unabashed use of dicta support their thesis.

subject to the agency's regulatory mandate. It may be that the retroactive application of new rules is a necessary if unfortunate byproduct of the traditional common law system, but—as Judge Friendly pointed out a generation ago—the avoidance of such inequitable retroactivity is one of the distinct advantages of agency rulemaking.[57] The Chancery system captures much of that advantage within the confines of a conventional common law regime.

B. Notice—and Comment

To extend the regulatory analogy further, Chancery's rulemaking is usefully informed by a species of notice-and-comment engagement with the actors affected by its rules. The members of the Court make time to participate in conferences dedicated to corporate and transactional law (such as this Symposium) where they hear from, and are heard by, those who study, structure, and litigate transactions.[58] In addition, the Court enjoys the insights of a large and sophisticated network of commentators who propose, predict, and critique developments in M&A law. The Court's work is subject to analysis, review, and discussion in a wide range of scholarly and professional

[57] *See* NLRB v. Majestic Weaving Co., 355 F.2d 854, 860–61 (1966) (Friendly, J.) ("[T]he problem of retroactive application has a somewhat different aspect in cases not of first but of second impression, where an agency alters an established rule defining permissible conduct which has been generally recognized and relied on throughout the industry that it regulates. As a result of the nature of the task Congress has confided to the agencies and the vagueness of the directions it has given, they are, and ought to be, much likelier to engage both in new departures and in alterations than courts with their more limited 'molecular motions,' and this makes it peculiarly important for them to take full advantage of their power to act prospectively, whether by rulemaking or adjudication." (citation omitted)).

[58] *See* Steele & Verret, *supra* note 52, at 196 ("Members of the Delaware judiciary frequently speak at conferences hosted by the ABA, law schools, and a variety of other legal institutions."); Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, app. A (2006) (cataloguing 71 appearances between 2003 and 2006 by Delaware judges at public forums on corporate law).

publications and blogs.[59] Moreover, members of the Court have a long tradition of authoring and responding to scholarly articles on corporate law subjects.[60] As Chief Justice Steele observed, Chancery judges "use . . . speeches and articles to signal the evolutionary direction of Court of Chancery . . . jurisprudence" in an effort to increase predictability in adjudication.[61] Chancery is for these reasons unusual among courts, perhaps unique, in the intensive way in which it interacts with the community that it regulates.

The professional and scholarly network that evaluates Chancery's work permits early consideration and fine-tuning of doctrinal developments. A few examples: In 2005, the Court suggested (in dicta) that a single standard of judicial review should apply to controlling stockholder freeze-outs irrespective of whether the transaction was achieved by a merger or tender offer.[62] This "unified standard," if adopted, would replace the existing regime under which squeeze-out deals completed via tender offer could be judged according to the deferential business judgment standard while deals completed by merger are always evaluated under the strict entire fairness standard, even when executed with the same

[59] These include the scholarly *Delaware Journal of Corporate Law*, the practitioner-oriented magazine *The Deal*, and such blogs as *The Deal Professor*, http://dealbook.nytimes.com/category/deal-professor; *M&A Law Prof Blog*, http://lawprofessors.typepad.com/ mergers; *Delaware Corporate & Commercial Litigation Blog*, http://www.delawarelitigation.com; *The Harvard Law School Forum on Corporate Governance and Financial Regulation*, http://blogs.law.harvard.edu/corpgov; *Deal Journal*, http://blogs.wsj.com/deals; *The Conglomerate: Business, Law Economics & Society*, http://www.theconglomerate.org; and *ProfessorBainbridge.com*, http://www.professorbainbridge.com.

[60] *See, e.g.*, Leo E. Strine, Jr., *Towards a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006) (commenting on Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005)).

[61] *See* Steele & Verret, *supra* note 52, at 196.

[62] *See In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 643–47 (Del. Ch. 2005).

procedural protections for minority shareholders.[63] The Court's dicta responded to and advanced a long-running debate over the wisdom of the "unified standard"—an issue of significant practical importance—which continues today.[64] When the issue is resolved, it will be with the benefit of both notice to M&A practitioners and informed commentary by interested lawyers and scholars. Similarly, when the Court suggested (again in dictum) that so-called "*Revlon* duties" perhaps should apply to "end-stage" stock-for-stock transactions—even though *Revlon* has traditionally applied only to cash deals—practitioners and scholars responded with commentary, criticism, and conference debate.[65] That

[63] *See id.; see also In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 434–45 (Del. Ch. 2002) (describing the divergent treatment of minority squeeze-outs effected by merger rather than tender offer).

[64] In *Cox*, then-Vice Chancellor (now Chancellor) Strine cited scholarly articles by prominent corporate law professors and noted that his proposal was consistent with their proposals for eliminating or easing the doctrinal tension he identified. *See In re Cox*, 879 A.2d at 646 nn.92 & 93 (citing Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Stockholders*, 152 U. PA. L. REV. 785, 827–28 (2003), and a working paper subsequently published as Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005)). *Cox* was in turn cited and discussed in scholarly articles examining Delaware's treatment of controlling stockholder transactions. *See, e.g.*, Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U. J.L. & BUS. 399, 440–42 (2008); Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775, 847–907 (2007); Peter V. Letsou & Steven M. Haas, *The Dilemma That Should Have Never Been: Minority Freeze Outs in Delaware*, 61 BUS. LAW. 25, 28, 29 & n.24 (2005). In 2010, Vice Chancellor Laster endorsed *Cox*'s "unified standard" to a squeeze-out effected by a unilateral tender offer, but found the procedural protections for minority shareholders insufficient to warrant deferential business judgment review of the transaction. *See In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 400 (Del. Ch. 2010).

[65] *See* Transcript of Preliminary Injunction Ruling at 4–7, Steinhardt v. Howard-Anderson, C.A. No. 5878-VCL (Del. Ch. Jan. 24, 2011); *see also, e.g., VC Laster Occam's* [sic] *Ruling Could Significantly Alter When Revlon Rules Apply*, DEALLAWYERS.COM (Jan. 26, 2011), http://www.deallawyers.com/Blog/2011/01/vc-laster-issues-ruling-that-could-significantly-alter-when-revlon-rules-apply.html; *Delaware Chancery Court Evaluates 50/50 Stock and Cash Deal Under Revlon*, DAVIS POLK & WARDWELL (May 27, 2011), http://www.davispolk.com/briefing/corporategovernance/blog.aspx?entry=46.

dictum is another example of Chancery's practice of giving notice and inviting comment as a prelude to potential rulemaking.

This ongoing dialogue with the regulated community, outside of the context of any particular case, informs the Court's decision making and provides members of that community the opportunity to understand where the Court may be headed. Much in the spirit of an informed agency notice-and-comment process, the Court's engagement with those it regulates adds richness and legitimacy to its rulemaking function, whether exercised through narrow adjudication or dictum.

C. Expert Adjudication

Chancery practice, by virtue of the Court's expanding yet specialized docket, has also evolved to largely eliminate certain disadvantages inherent in making law through case-by-case adjudication. Frederick Schauer has observed that the common law approach to rulemaking suffers from the "availability heuristic," a cognitive bias that causes decision makers to be overly influenced by proximate examples.[66] Ideally, a judge would craft a rule based on an informed assessment of the full set of future circumstances that would be governed by that rule. But in fact, common law judges in particular—like decision makers in general—are often "mesmerized by the case before them."[67] As a result, they fashion a rule that works best, or at all, only if the instant case is a representative one, which of course it seldom is. As Schauer notes, to the extent that the common law judging is impaired by the availability heuristic, "it is not just great cases and hard cases that make bad law, but simply the deciding of cases that makes bad law."[68]

The Chancery system largely cures for the availability heuristic. As set out above, the Court now sees, if not all, a

[66] Frederick Schauer, *Do Cases Make Bad Law?*, 73 U. CHI. L. REV. 883, 894–95 (2006).

[67] *Id.* at 894.

[68] *Id.* at 885.

significant fraction of deals and deal cases. It has only five judges, so each one has something approaching a comprehensive view of the field. The judges consult with one another on thorny new matters, further ensuring that each has a substantially complete view of the field.[69] Nearly all of the cases are presented in some sense on the merits, since the Court must review settlements of shareholder class actions for fairness. And the cases are almost always litigated by lawyers with some expertise in Delaware law, who know from professional experience whether the facts of a particular case are typical, idiosyncratic, or somewhere in between.

For all of these reasons, the Court of Chancery is unusual among common law courts (though quite like a regulator) in having experience with practically the entire problem set, and the aid of expert enforcement attorneys, as it resolves individual cases. The judges of Chancery also know that they will almost certainly be called upon to apply their own precedents to a different set of facts, more likely sooner than later. In these circumstances, the Court is less likely to be swayed in its rulemaking by the facts at hand and more likely to craft rules that will operate efficiently in a broad range of scenarios, thus abating the decision-making costs of the availability heuristic.

Chancery practice also cures for another bias that distorts conventional common law development. This is the "selection effect," the idea, now well-established in the scholarly literature, that because easy or straightforward claims are rarely disputed, those that end up in court represent a skewed sample of events—the rare cases in which both sides think they have the better of the law and

[69] David Marcus, *From Blood Transfusions to Poison Pills: William Chandler Reflects on 22 Years at Delaware's Court of Chancery and a New Beginning at Wilson Sonsini*, THE DEAL, Sept. 18, 2011, at 35, 37 ("One of the great secrets of the Court of Chancery is that although we are individual trial court judges, we work almost like an appellate court that sits en banc, in that we confer and consult about our cases. . . . It helps us avoid making mistakes [and] helps assure that factor of coherence in the law . . . ." (quoting Chandler)).

the facts.[70] Because the mine run of cases does not get litigated, a typical common law judge is privy to only a narrow field of cases in a particular area of the law. The selection effect, however, exerts only a weak influence on the composition of Chancery's docket. This is because virtually every deal is challenged, and virtually every challenged deal is examined by the Court in either a hearing on the merits or on the fairness of a class settlement. The Court thus enjoys the same privileged perspective as a regulator, which sees a broad set of cases within its jurisdiction and can therefore reliably determine whether extensive or only limited review is necessary in a particular case.

In addition, the absence of the selection effect enhances Chancery's ability to fine-tune its case law. So long as the selection effect defines the docket, litigation will be rare in areas of the law that are moderately clear.[71] But that is demonstrably false in the context of shareholder deal litigation. Case after case asserts claims relating to issues that seem to be governed by well-settled law, such as the size of termination fees,[72] or the adequate disclosure of financial

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[70] Schauer, *supra* note 66, at 909–10; *see also* Daniel Kessler, Thomas Meites, & Geoffrey Miller, *Explaining Deviations from the Fifty-Percent Rule: A Multimodal Approach to the Selection of Cases for Litigation*, 25 J. LEGAL STUD. 233, 234 (1996) (explaining that the selection effect hypothesis predicts that "cases selected for litigation are likely to be the difficult and uncertain ones—that is, the cases in which the true quality of the claim is close to the quality level need for the plaintiff to win if the claim were to be tried—because the clear-cut cases will be more likely to settle before trial (or may never evolve into filed cases at all)").

[71] *See* George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984); Theodore Eisenberg, *Testing the Selection Effect: A New Theoretical Framework with Empirical Tests*, 19 J. LEGAL. STUD. 337 (1990); Leandra Lederman, *Which Cases Go to Trial? An Empirical Study of Predictors of Failure to Settle*, 49 CASE W. RES. L. REV. 315 (1999).

[72] *See, e.g.*, *In re* Micromet, Inc. S'holders Litig., C.A. No. 7197-VCP, 2012 WL 681785, at *9 (Del. Ch. Feb. 29, 2012) (rejecting a challenge to a package of deal protections with the observation that "a similar combination of deal terms, including a no-shop provision, matching and information rights, a termination fee of roughly 3% of equity value, a top-up option, and a poison pill exemption, recently were approved by this

projections.[73] Chancery judges take these cases seriously, exhaustively examining the basis for the claims in long opinions. Truly summary dispositions are rare. This constant reconsideration of settled aspects of fiduciary duty law permits the Court to correct errors in, and to modify at the margin, M&A law in a way that research on the selection effect predicts is not usually available to common law judges working within the confines of most common law doctrines.

The Court of Chancery has thus evolved into a lawmaking body that, while remaining true to a judicial model, exhibits a policymaking flexibility typically associated with administrative agencies. When promulgating standards of conduct governing fiduciaries in the transactional context, the Court has the ability to develop doctrine in a manner that mitigates systematic infirmities in conventional common law rulemaking. This constitutes a unique innovation in U.S. jurisprudence.

Court"). Plaintiffs' persistence in litigating the seemingly well-trod issue of termination fee size reflects the Court's determination to evaluate termination fees on a context-specific case-by-case basis. For example, in a 2007 case, the Court acknowledged that it has frequently found reasonable termination fees in the range of 3% of deal value, but insisted that the inquiry whether a fee is reasonable in a particular case is "fact intensive" and that "[t]hough a '3%' rule for termination fees might be convenient for transaction planners, it is simply too blunt an instrument, too subject to abuse, for this Court to bless as a blanket rule." La. Mun. Employees' Ret. Sys. v. Crawford, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

[73] "Delaware law does not require disclosure of inherently unreliable or speculative information." Globis Partners, L.P. v. Plumtree Software, Inc., C.A. No. 1577-VCP, 2007 WL 4292024, at *10 (Del. Ch. Nov. 30, 2007). But plaintiffs routinely challenge a company's decision not to disclose a discounted cash flow valuation analysis even though they cannot show such an analysis was, or could have been, based on reliable financial projections. *See, e.g.*, *id.* at *13; *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 110–11 (Del. Ch. 2007); *In re* JCC Holding Co., Inc., 843 A.2d 713, 720–21 (Del. Ch. 2003).

III

The success of the Chancery system depends on its exposure to, and adjudication of, a large and representative docket of cases challenging transactions with Delaware-incorporated targets. The large size of the docket affords the Court the necessary opportunities to develop and refine corporate law in the transactional context. The representative character of the docket allows the Court to maintain a sense of the distribution of fact patterns, so that it can formulate rules with an accurate sense of which legal issues arise in transaction cases, and how frequently. And a large and representative docket allows the Court to use dictum effectively and to mostly avoid the availability and selection biases exhibited by courts of general jurisdiction.

This suggests that some meaningful level of shareholder deal litigation is useful, not only for policing the conduct of fiduciaries in the transactional context, but also for maintaining Chancery's ability to develop a sophisticated and comprehensive body of M&A law. But what level of litigation is ideal? Today, more than nine out of ten deals are attacked in court. Regardless of how transactional planners structure a deal, they can count on a shareholder suit.

The risk of overregulation is real, and the Court understands this.[74] Just a few months ago, the Court referred to the explosion in deal litigation in explaining its decision to deny a motion to expedite a fiduciary challenge: "I don't think for a moment that 90 percent—or based on recent numbers, 95 percent of deals are the result of a breach of fiduciary duty. I think that there are market imbalances here and externalities that are being exploited."[75] The Court concluded that it therefore "needs to think carefully about balancing" the social benefits of effective fiduciary litigation

[74] Armour et al., *supra* note 8, at 45 ("We do not consider that increases in the rate of corporate litigation to nearly 100% can seriously be justified as controlling agency costs and consequently interpret these trends as likely harmful to shareholders.").

[75] Transcript of Teleconference at 12, Stourbridge Investments LLC v. Bersoff, C.A. No. 7300-VCL (Del. Ch. Mar. 13, 2012).

against the substantial costs, particularly in an environment where every deal draws a challenge, even when the defendants have made sure to "build the right record during [their] transaction planning."[76]

Limiting plaintiffs' access to expedited proceedings for claims that do not raise colorable allegations of inadequate disclosure (or other kinds of irreparable harm) is one tool available to the Court of Chancery to manage the risk of overregulation. Other levers at the Court's disposal are the frequency with which it grants motions to dismiss and the amount of fees that it awards to class counsel. But (unlike most regulatory agencies), Chancery must contend with the possibility that managing its docket to cure for overregulation will not reduce socially wasteful litigation, but simply displace it to other state courts. Plaintiffs, after all, may bring their challenges under Delaware law in any court with jurisdiction over their claims and the defendants, and—as the figures above show—are increasingly doing so.

The problem of multijurisdictional litigation is "pretty severe," as former Chancellor William B. Chandler has observed.[77] Extensive litigation of Delaware fiduciary claims in the courts of other states imposes significant costs on litigants and society.[78] It also imposes costs on Chancery. Each case lost to another state is a lost opportunity to expand and refine Delaware fiduciary law. And because the courts of other states necessarily have less experience applying Delaware law, out-of-Delaware cases may be more opaque to defendants trying to predict and manage transactional risk.[79] The rise of multijurisdictional deal

[76] *Id.*

[77] Marcus, *supra* note 69, at 39.

[78] *See id.* (quoting Chandler as saying of multijurisdictional litigation, "It's costly to the company, it's costly to the shareholders of the company, and it's costly to the court systems because you have a limited amount of resources and you're spending them twice."); *see also* Jennifer J. Johnson, *Securities Class Actions in State Court* 46–47 (Lewis & Clark Law School, Legal Research Paper No. 2011-17) (discussing costs multi-jurisdictional deal litigation imposes on courts and defendants).

[79] *Anywhere but Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, M&A JOURNAL, May 2007, at 17; *see also* Armour et al.,

litigation thus simultaneously interferes with the development of Delaware law and diminishes predictability in its enforcement.

There are a number of promising solutions to the problem, ranging from various procedural options that would consolidate multijurisdictional litigation in Delaware;[80] to exclusive forum provisions in corporate charters, perhaps supported by a statutory endorsement of such provisions in the manner Professor John Coffee proposes elsewhere in this Symposium;[81] to an interstate agreement mirroring the federal approach to multidistrict litigation.[82]

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supra note 8, at 38 (describing as "plausible" Mirvis's suggestion that deal challenges have greater settlement value outside Delaware due to greater variation in outcomes).

[80] These include moving to stay actions filed in the state whose law does not apply or asking both courts to confer and agree to order continued proceedings in only one jurisdiction. (The latter "single forum" motion was devised by my firm.) *See* Ted Mirvis, Presentation at the Practicing Law Institute: Multi-Jurisdictional Issues in Stockholder/Deal Litigation 21 (June 12, 2012) (on file with author); C. BARR FLINN & KATHALEEN ST. J. MCCORMICK, YOUNG CONAWAY STARGATT & TAYLOR, LLP, THE DELAWARE COURT OF CHANCERY ENDORSES ONE FORUM MOTIONS AS A SOLUTION TO MULTI-JURISDICTIONAL LITIGATION (Fall 2011); *see also In re* Allion Healthcare, Inc. S'holders Litig., C.A. No. 5022-CC, 2011 WL 1135016, at *4 n.12 (Chandler, C.) ("My personal preferred approach . . . is for defense counsel to file motions in both (or however many) jurisdictions where plaintiffs have filed suit, explicitly asking the judges in each jurisdiction to confer with another and agree upon where the case should go forward."); Nierenberg v. CKx, Inc., C.A. No. 5545-CC, 2011 WL 2185614, at *1.

[81] John C. Coffee, Jr., *The Delaware Court of Chancery: Continuity, Change—and Competition*, 2012 COLUM. BUS. L. REV. 387, 400 (2012); *see also Anywhere but Chancery*, *supra* note 79, at 17–18 (quoting Ted Mirvis as proposing exclusive forum provisions in corporate bylaws or charters); Sara J. Lewis, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 STAN. J.L. BUS. & FIN. 199 (2008).

[82] Marcus, *supra* note 69, at 39 ("One solution might be if all the states entered into a compact, sort of like the federal multijurisdictional, multidistrict litigation. Maybe you could work out something where all of the states agree that there might be some institution or agency that decides [where] it ought to be litigated if litigation is filed in two different states." (quoting Chandler)); *see also* Mirvis, *supra* note 80, at 34 (raising the possibility of the coordinated or unilateral adoption by state

Whatever the ultimate solution, the argument of this Essay suggests a further reason why the correct solution must be to direct Delaware-law fiduciary cases to Delaware. The judges of the Court of Chancery have devised a system that marries the best attributes of judicial and administrative lawmaking. The success of the Court's approach can be measured by its influence. It is no exaggeration to say that the Court of Chancery is an invisible presence in every boardroom where a public company deal is being considered, silently promoting compliance with its refined standards of fiduciary conduct. This constitutes a remarkable regulatory achievement. It should be recognized and protected by confiding to Chancery the prerogative to manage the docket and ultimately the destiny of Delaware-law fiduciary duty litigation.

legislatures of statutes limiting venue to the state whose law governs the claim).