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The Law and Economics of Corporate Governance
Changing Perspectives

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1. Delaware corporate law: failing law, failing markets

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INTRODUCTION

For nearly a century Delaware's corporation law has dominated its market. The explanations given for its dominance have varied over the years, and new ones continue to be offered. At the same time that explanations for success have been offered, some commentators have criticized the quality of Delaware law, and have suggested that it is not ideal, and indeed, may be inferior to some other laws. We offer some additional evidence on this point and explore possible reasons for its continuing success in the wake of a decline in quality. Our study focuses on the role of lawyers as advisers on the choice of the state of incorporation.

1. DELAWARE'S DOMINANCE OF THE CHARTERING COMPETITION

Two of us have previously reviewed the history of the competition for corporate chartering business.¹ This competition was possible because virtually all American states followed the English choice of law rule, the 'Internal Affairs Rule', which applies the law of the incorporating jurisdiction to the governance of the corporation, rather than Europe's 'Real Seat Rule', which required incorporation at the location of the corporation's real headquarters.²

¹ William J. Carney and George B. Shepherd, The Mystery of Delaware Law's Continuing Success, 2009 U. Ill. L. Rev. 1. Much of the early part of this chapter is drawn from that article.
1994 *Paramount v. QVC* held that a merger of equals doesn't exist when a controlling shareholder emerges from a merger;\(^65\)

1996 *Solomon v. Pathé Communications Corp.* held that dominant shareholders do not owe fiduciary duties in tender offers to the minority stockholders;

2001 *Glassman v. Unocal* held that Weinberger's entire fairness doctrine does not apply to short-form mergers;

2002 *Pure Resources* qualified the tender offer privilege of *Solomon* to impose fiduciary-like conditions on the use of a tender offer.

2003 *Omnicare* held that a deal lock-up device may be judged coercive or preclusive under *Unocal*;

2005 *In re LNR Property Corp. Shareholders Litigation* treated an arm's length sale as a *Weinberger*-type transaction where the controlling shareholder, who received a pro rata share of the cash proceeds, was allowed to buy an interest in the purchasing entity;

2007 *La. Mun. Police Employees Ret. Sys. v. Crawford* treated a dividend declared in advance of a stock-for-stock merger which, by itself, would not have triggered appraisal rights, as part of the merger consideration, thus ignoring the independent legal significance doctrine.\(^66\)

While experienced M&A lawyers may be able to cope with all of these changes,\(^67\) the fact remains that each of them was a surprise at the time of announcement, and was applied retroactively. More surprises are sure to come.\(^68\)

Even some present and former Delaware judges have expressed concern about the usefulness of at least parts of this taxonomy. William Allen, Jack Jacobs and Leo Strine (the 'Three Chancellors') wrote about the elevation of form over substance in the distinction between sales and 'mergers of equals', which are sufficiently close in result to suggest the

\(^{65}\) *Paramount Communications Inc. v. QVC Network, Inc.*, supra note 63.

\(^{66}\) *Supra* note 35. The court justified this departure from independent legal significance on the basis that payment of the merger was conditioned on shareholder approval of the merger. 918 A.2d at 1191-2.

\(^{67}\) See R. Franklin Balotti, Gazing into the Crystal Ball of Future Developments in Delaware Corporate Law: What if the Past is Not Prologue?, 15 No. 3 The Corporate Governance Adviser 3 (May/June 2007) (describing the standard features of deal terms in 2007).

\(^{68}\) Id. at 3-4 and part II.C.6 infra (exploring whether disclosure obligations will expand beyond those currently required by Federal law). The *Crawford* decision, *supra* note 36 was noted by commentators as a surprise for experienced Delaware practitioners. See Bigler & Rohrbacher, *supra* note 34 at 4.