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Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision

Brian J.M. Quinn

Boston College Law School, brian.quinn@bc.edu

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Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision

Brian JM Quinn*

Observers note a trend of shareholder lawsuits migrating out of Delaware. This trend is a manifestation of a litigation strategy by plaintiffs' counsel to avoid Delaware's aggressive policing of agency costs in acquisition-related shareholder litigation and to gain control over such litigation by bringing these cases outside of Delaware. To the extent agency costs drive acquisition-related litigation, such litigation can be costly to shareholders without much by way of tangible benefits to them. In addition to being potentially wasteful for shareholders, a sustained outward migration of cases from Delaware to other venues may threaten Delaware's ability to maintain and develop its own corporate law. For these reasons, various stakeholders including shareholders, the judiciary, and policymakers, have an incentive to consider the implications of these multiforum litigation strategies and formulate a response. Some commentators have proposed that firms adopt forum selection provisions in their corporate charters and bylaws as a way of reducing incentives for shareholder plaintiffs to engage in wasteful lawsuits or forum shopping. Notwithstanding the fact that incorporators are free to contract around default rules and adopt innovative self-help provisions, few firms have taken that step. This Article argues that insights from behavioral economics can provide some understanding of why this may be the case. In particular, status quo bias in contracting reduces incentives for incorporators to pursue more creative approaches to drafting the

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corporate contract. However, status quo bias may be overcome through the use of opt-in menus, which have been useful in increasing contractual flexibility in other contexts in corporate law and may prove helpful in overcoming cognitive constraints to innovation. By increasing flexibility in corporate contracts, shareholders should be able to moderate the effects of status quo bias and develop charter terms more likely to reflect their true preferences. Properly structured exclusive forum provisions will reduce incentives to bring wasteful litigation while leaving open opportunities for shareholders to bring valuable lawsuits.

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INTRODUCTION

Delaware and its corporate law are at a crossroads. Observers point out a migration of shareholder lawsuits from Delaware, as litigants in acquisition-related litigation shop for forums outside the state of incorporation as part of a multiform litigation strategy.¹ Through forum shopping, plaintiffs' counsel seeks to avoid Delaware's recent turn towards more aggressive policing of agency costs in acquisition-related shareholder litigation, as well as to improve their relative position in the competition for fees.² Forum shopping by plaintiffs' counsel can be costly to shareholders because it increases the costs of defending and settling litigation where the benefits of such litigation may be all but illusory.

There are a number of possible responses to the outward migration of cases from Delaware. Policymakers may permit the trend to continue; however, over time this exodus could result in a deterioration of Delaware's ability to develop and maintain its own corporate law.³ If Delaware is overly aggressive in attempting to prevent the outward movement of cases, it may result in unanticipated

¹ See, e.g., *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960-61 (Del. Ch. 2010) (noting how plaintiffs' counsel attempt to avoid judicial oversight in Delaware by filing in other forums); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 62 (2009) (analyzing potential availability of forum selection provision for intra-corporate disputes); Sara J. Lewis, Note, *Transforming the Anywhere but Chancery Problem into the Nowhere by Chancery Solution*, 14 STAN. J.L. BUS. & FIN. 199, 199 (2008) (discussing validity of Delaware forum selection provision for intra-entity disputes) *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, M&A J., May 2007, at 17 [hereinafter *Mirvis*] (considering the possibility of exclusion forum provisions to prevent migration of shareholder lawsuits from Delaware courts); see also John Armour et al., *Delaware's Balancing Act*, 87 IND. L.J. (forthcoming 2012) [hereinafter *Delaware's Balancing Act*]; John Armour et al., *Is Delaware Losing Its Cases?* 5 (European Corporate Gov't Inst., Working Paper No. 174, 2010) [hereinafter *Is Delaware Losing Its Cases?*], available at <http://ssrn.com/abstract=1578404>; Joseph Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches: The 2010 Pileggi Lecture* (Rock Ctr. for Corporate Governance at Stanford Univ., Working Paper No. 91, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1690561.

² Acquisition-related litigation that seeks to enjoin announced transactions is common. Thompson and Thomas found that approximately 80% of shareholder lawsuits filed in the Delaware Chancery Court during 1999–2000 allege some violation of fiduciary duties of directors in connection with a merger or sale of the corporation. See Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 137 (2004).

³ Armour et al. also recognize this possibility. Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 44.

negative consequences for Delaware. In attempting to prevent plaintiffs' counsel from seeking alternate forums, Delaware policymakers may provoke severe reactions from relevant constituencies, including the plaintiff's bar, federal regulators, and other states' judiciaries.⁴ Given Delaware's importance in the corporate world, corporate law is presently at a critical inflection point.

Transaction-related litigation is a common feature in the landscape of deal making.⁵ A significant percentage of corporate transactions are accompanied by shareholder litigation. Over the past decade, shareholders have increasingly elected to bring state-law actions against Delaware corporations in jurisdictions outside the state of incorporation. Typically, shareholder plaintiffs file claims in a state where the firm is headquartered or a state in which the firm has significant operations, or both.⁶ The available data clearly evidence a strong trend of avoiding filing shareholder litigation exclusively in the state of incorporation and suggest that plaintiffs are actively avoiding Delaware courts. In the words of Professors Armour, Black, and Cheffins, who were the first to document this trend, "Delaware is losing its cases."⁷

Although plaintiffs appear keen to avoid Delaware courts, they do not necessarily seek to avoid Delaware law. Few plaintiffs, if any, challenge the position of the "internal affairs doctrine" by bringing claims under the corporate law of their chosen forum state.⁸ Relatedly,

⁴ Stelman and Armour et al. recognize the nature of this balancing act and urge caution. See Stelman, *supra* note 1, at 137; see also Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 2.

⁵ The large incidence of transaction-related shareholder litigation in recent months attracted the attention of the financial press. The number of lawsuits filed incident to an announced merger has, according to the Securities Class Action Services, increased from 27 in 2006 to 191 in 2009, and to more than 216 in 2010. See Dionne Searcey & Ashby Jones, *First, the Merger; Then the Lawsuit*, WALL ST. J., Jan. 10, 2011, at C1. For an overview of the incidence of transaction-related litigation, see Thompson & Thomas, *supra* note 2, at 137.

⁶ Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 1, at 3.

⁷ See *id.* at 15. Armour et al. coined the phrase "out-of-Delaware" with respect to current multiforum shareholder litigation.

⁸ The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs — matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders — because otherwise a corporation could be faced with conflicting demands.

Edgar v. MITE Corp., 457 U.S. 624, 645 (1982). The role and application of the internal affairs doctrine in the corporate law is the center of a significant discourse related to the discourse on state competition for incorporations. See, e.g., Deborah A.

there is not yet a movement towards a European “real seat doctrine” with respect to the application of corporate law.⁹ Rather, this pattern of moving litigation away from the state of incorporation reflects an intentional strategy by plaintiffs’ counsel to engage in forum shopping.¹⁰ By filing claims based on Delaware law in foreign jurisdictions, litigants avoid recent attempts by the Delaware courts to raise pleading standards and actively police plaintiffs’ attorney fees while accepting the underlying validity of Delaware’s position with respect to the corporate law.¹¹

The exclusive forum provision is an effective mechanism for addressing the out-of-Delaware trend.¹² Such a provision creates a presumption that shareholder derivative or state-based shareholder class action lawsuits be brought exclusively in the courts of the state of incorporation. The inclusion of an exclusive forum provision in a

DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 L. & CONTEMP. PROBS. 161, 161-72 (1985) (providing an overview of various state accommodations to application of the internal affairs doctrine); see also Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 L. & CONTEMP. PROBS. 135, 140 (2004).

⁹ The “real seat doctrine” is a choice of law principle that applies the law of the corporation’s real seat — its corporate headquarters or significant operations — to the questions of the corporate law. In the United States, courts have traditionally applied the “internal affairs doctrine” to this same question. The internal affairs doctrine applies the law of the state of incorporation to questions of the corporate law without regard to the location of the corporation’s real operations. Since the European Court of Justice’s decision in *Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 ECJ EUR-Lex LEXIS 11 (Mar. 9, 1999), there is a serious question whether the traditional real seat doctrine governing the choice of laws for corporate law in Europe conforms to the European Community Treaty. For a discussion of the difficulties raised by the *Centros* decision with respect to the sustainability of the real seat doctrine, see Werner F. Ebke, *The Real Seat Doctrine in the Conflict of Corporate Laws*, 36 INT’L. L. 1015, 1015-16 (2004).

¹⁰ Professor Stevelman as well as Professors Armour et al. observe that forum shopping likely lies at the heart of this out-of-Delaware trend. See Stevelman, *supra* note 1, at 100; see also Armour et al., *Delaware’s Balancing Act*, *supra* note 1, at 32-35 (observing the out-of-Delaware trend beginning in 2006 following increased judicial scrutiny of attorney fees in transaction-related litigation).

¹¹ For a recent example of a Delaware court policing attorney fee requests see *In re Sauer-Danfoss Inc. S’holders Litig.*, No. 5162-VCL, 2011 WL 2519210, at *1 (Del. Ch. Apr. 29, 2011) (awarding only \$75,000 of a \$750,000 fee request).

¹² See Mirvis, *supra* note 1, at 17; Lewis, *supra* note 1, at 202; Grundfest, *supra* note 1, at 14, 16. *But see* Armour et al., *Delaware’s Balancing Act*, *supra* note 1, at 4-5; Stevelman, *supra* note 1, at 133-35; see also *In re Allion Healthcare Inc. S’holders Litig.*, No. 5022-CC, 2011 WL 1135016, at *4 n.12 (Del. Ch. Mar. 29, 2011) (observing that exclusive forum provisions may not be required); *In re Revlon, Inc. S’holders Litig.*, 990 A.2d 940, 960-61 (Del. Ch. 2010) (recognizing the potential viability of a forum selection provision).

firm's corporate charter reduces incentives for plaintiffs' counsel to engage in the forum shopping that makes the out-of-Delaware litigation strategy valuable for plaintiffs. Bringing the various litigations under the supervision of a single court through the application of an exclusive forum provision improves judicial efficiency and reduces agency costs.

Given the obvious advantages of adopting exclusive forum provisions, it is perplexing that few corporate charters contain such provisions. Less than five percent of firms going public during 2010 included such a provision in their corporate charters.¹³ Experimental results from behavioral economics suggest both reasons for the hesitancy of firms to adopt otherwise value enhancing charter amendments as well as possible solutions. The dominant framework for understanding corporate law teaches us that parties left to freely contract will on balance negotiate efficient terms for their corporate charters.¹⁴ Default terms in corporate law play the role of replicating efficient terms that parties would negotiate in the absence of transaction costs.¹⁵ Behavioral economics suggests the framing of decisions, including the selection of contract defaults, is important in determining outcome of such decisions. Therefore, the presence or absence of default terms often results in status quo bias in contracting, inhibiting innovation even when such innovations might be socially valuable.

This Article proceeds as follows: Part I describes the problem of the out-of-Delaware trend with respect to transaction-related lawsuits. Part II describes four possible yet flawed responses to the out-of-Delaware trend: the hands-off approach; Delaware self-help; elimination of the Delaware carve-out; and the federal judicial panel on multi-district litigation. Part III then argues that including an exclusive forum provision in corporate charters would be an effective response to the out-of-Delaware problem by reducing plaintiffs' counsel's incentive for forum shopping. Part IV reviews the behavioral economics literature to understand why it might be that firms have been reluctant to adopt the exclusive forum provisions. Part V recommends the adoption of a new opt-in provision for the Delaware

¹³ See Fig. 1 and accompanying text for how many firms are going public and Appendix B for a list of firms that went public with exclusive forum provisions.

¹⁴ FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15-22 (1991) (describing corporation as contract framework).

¹⁵ Daniel Kahneman, Jack L. Knetsch & Richard Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 198 (1991) (describing stickiness effects of default positions).

corporate code to overcome behavioral barriers and facilitate the adoption of this efficiency enhancing provision. The Article concludes by making recommendations for further empirical research specifically with respect to the economic effects of forum selection provisions in corporate charters on firm value. More generally, if policymakers pursue a menu approach to corporate contracting with regard to forum selection, that experience can inform the use of opt-in menus in other areas of corporate law where we expect and know that market participants are cognitively constrained.

I. THE OUT-OF-DELAWARE TREND AND MULTIFORUM LITIGATION STRATEGIES

Transaction-related shareholder lawsuits have long been subject to agency cost problems.¹⁶ Over the years, there have been many reform efforts at the federal and state levels intended to control those costs and reduce incentives for abuse. The results of those efforts have been mixed, often resulting in unintended consequences as litigants sought to find ways around restrictions. Recent empirical work by Professors Armour, Black, and Cheffins suggests that plaintiffs are actively seeking to file shareholder litigation in jurisdictions other than Delaware, the state of incorporation.¹⁷ The out-of-Delaware litigation strategy appears to be, first, an effort by plaintiffs' counsel to skirt attempts by the Delaware judiciary to more closely monitor agency costs associated with shareholder lawsuits, in particular by raising pleading standards and policing attorneys' fees. Second, to the extent out-of-Delaware litigation is beyond the reach of the Delaware judiciary, it places out-of-Delaware plaintiffs' counsel in a more competitive position vis-à-vis other plaintiffs' counsel to control the outcome of the litigation. Thus, the multiforum litigation strategy may also be interpreted as a natural response to the competitive pressures of the plaintiff's bar.

The experience of the Burlington Northern Santa Fe Railroad is helpful in understanding the out-of-Delaware trend and the

¹⁶ Professors Weiss & White observe that the Delaware law creates incentives for plaintiffs to bring lawsuits in change of control transactions or in transactions involving controlling shareholders whether or not it appears that the board appeared to violate their fiduciary duties to the corporation. See Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1804 (2004) (providing extensive analysis of transaction-related settlements).

¹⁷ See Armour et al., *Delaware's Balancing Act*, *supra* note 1, 1-2; see also Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 1, at 12-13.

multiforum litigation strategy. On November 3, 2009, Burlington Northern Santa Fe Railroad, a Delaware corporation headquartered in Texas, announced that it would be acquired by an affiliate of Berkshire Hathaway Inc.¹⁸ Four shareholder class actions were filed in Tarrant County, Texas, and three additional shareholder class action lawsuits were filed in Dallas County, Texas the same day as the announcement.¹⁹ Complaints were also filed in the Delaware Chancery Court two days later.²⁰ The Texas and Delaware complaints made nearly identical allegations — that the board of Burlington Northern violated its fiduciary duties of care and loyalty, in particular its duties under *Revlon, Inc. v. MacAndrews & Forbes Holding*, when it agreed to sell the corporation.²¹ Less than a month after the initial actions were filed, the defendants in the Delaware actions moved to have all the actions proceed in a single forum to avoid duplication.²² The

¹⁸ Berkshire Hathaway already owned a 22% block of the railroad. Verified Class Action Complaint at 1, *In re Burlington N. Santa Fe S'holders Litig.*, No. 5043-VCL (Del. Ch. Ct. Nov 5, 2009).

¹⁹ Tarrant County actions: Petition Based Upon Self-Dealing and Break of Fiduciary Duty at 1, *Kinsey v. Burlington Northern Santa Fe Corp.*, No. 348-241465-09 (Tex. Dist. Nov. 3, 2009); Plaintiff's Original Petition at 1, *Graulich v. Boeckmann*, No. 141-241528-09 (Tex. Dist. Nov. 6, 2009); Petition Based Upon Self-Dealing and Break of Fiduciary Duty at 1, *Lewis v. Burlington Northern Santa Fe Corp.*, No. 017-241596-09 (Tex. Dist. Nov. 9, 2009); and Shareholder Class Action Complaint at 1, *Satinoff v. Burlington Northern Santa Fe Corp.*, No. 048-241702-09 (Tex. Dist. Nov. 13, 2009). The Dallas County actions were consolidated under the action *Employee Retirement System of New Orleans v. Burlington Northern Santa Fe Corp.*, No. 09-14950, (Tex. Dist. Nov. 4, 2009) and then later consolidated under the Tarrant County actions as *In re Burlington Northern Santa Fe Corp. Shareholders Class Action Litigation*, No. 348-241465-09.

²⁰ Complaint at 1, *Kahn-Kirby v. Burlington N. Santa Fe Corp.*, No. 5082-VCL, (Del. Ch. Nov. 17, 2009); Verified Class Action Complaint at 1, *Louisiana Mun. Police Emp. Ret. Sys. v. Burlington N. Santa Fe Corp.*, No. 5043-VCL (Del. Ch. Nov. 5, 2009); Complaint at 1, *High Tech Inv. Club v. Burlington N. Santa Fe Corp.*, No. 5044-VCL, (Del. Ch. Nov 5, 2009); Verified Class Action Complaint at 1, *Ferris v. Burlington N. Santa Fe Corp.*, No. 5045-VCL (Del. Ch. Nov. 5, 2009); Verified Class Action Complaint at 1, *August v. Burlington N. Santa Fe Corp.*, No. 5062-VCL, (Del. Ch. Nov. 10, 2009).

²¹ *Revlon, Inc. v. MacAndrews & Forbes Holding*, 506 A.2d 173, 181 (Del. 1986).

²² Defendants filed a motion to proceed in one forum, also known as a Savitt motion, in which defendants asked the Delaware court to coordinate with the Texas court to permit litigation in a single forum so that "Defendants are not required to defend substantially identical . . . class action lawsuits in different states." Motion to Proceed in One Forum at 1, *In re Burlington N. Santa Fe S'holders Litig.*, No. 5043-VCL (Del. Ch. Dec. 1, 2009). Defendants did not move to litigate the case in either state. Defendants moved to ask the court to intervene with competition among the various plaintiff groups in both states. Defendants moved to request that the Delaware court conduct a telephone conversation with the Texas court to resolve the impasse. *See id.*;

substance of the motion was not to seek a particular venue; rather, the motion asked the court to intervene in the competition amongst the various plaintiffs groups and resolve an impasse regarding where the litigation would be conducted.²³ The Texas litigation was stayed in favor of the litigation in Delaware, with the Delaware court ordering the Delaware plaintiffs to coordinate with the Texas plaintiffs with respect to the litigation.²⁴ While litigation was ongoing, shareholders approved the deal on February 11, 2010, and then completed the transaction on February 12, 2010.²⁵ By August 2010, the Texas and Delaware plaintiffs agreed to consolidate and settle their cases.²⁶ The terms of the settlement were typical of “disclosure only settlements.”²⁷ Burlington Northern stipulated that it had amended its disclosures to the shareholders in advance of the shareholder vote principally in response to the Delaware and Texas actions.²⁸ In addition, the settlement included an agreement to pay a fee to plaintiffs’ counsel in Delaware and Texas for their efforts in bringing the suit.²⁹ In effect, the settlement included no substantive changes to the structure of the transaction or the consideration received by selling shareholders, but

see also letter from Joseph A. Rosenthal, Shareholder, Rosenthal, Monhait & Goddess, P.A., to the Honorable J. Travis Laster, Vice Chancellor, Delaware Court of Chancery (Dec. 8, 2009) (on file with the author) (challenging defendants’ jurisdictional motion); letter from Raymond DiCamillo, Director, Richards, Layton & Finger, to The Honorable J. Travis Laster, Vice Chancellor, Delaware Court of Chancery (Dec. 1, 2009) (on file with the author) (supporting defendants’ jurisdictional motion).

²³ Motion to Proceed in One Forum, *supra* note 22, at 6. The defendants moved to request that the Delaware court conduct a telephone conversation with the Texas court to resolve the impasse.

²⁴ *In re Burlington N. Santa Fe S’holders Litig.*, CA No. 5043-VCL, (Del. Ch. Dec. 9, 2009); *see* sources cited *supra* note 22.

²⁵ *See* Burlington Northern Santa Fe, LLC, Schedule 13 D/A (Feb. 16, 2010).

²⁶ Stipulation of Settlement at 15, *In re Burlington N. Santa Fe S’holders Litig.*, No. 5043-VCL (Del. Ch. Aug. 19, 2010); Burlington Northern Santa Fe, LLC, *Current Report (Form 8-K)* (Jan. 20, 2010).

²⁷ Stipulation of Settlement, *supra* note 26, at 8. “Disclosure only” settlements are common in transaction-related litigation. For a discussion of the court’s approach to disclosure only settlements and attorney fees for such settlements, *see In re Sauer-Danfoss S’holders Litig.*, No. 5162-VCL, 2011 WL 2519210, at *17-18 (Del. Ch. Apr. 29, 2011).

²⁸ Stipulation of Settlement, *supra* note 26. This type of “disclosure only” settlement is common in transaction-related litigation. For a discussion of the court’s approach to attorney fees and the disclosure only settlement *see In re Sauer-Danfoss*, 2011 WL 2519210, at *17-18.

²⁹ On October 28, 2010, the Delaware Vice Chancellor awarded \$450,000, which he suggested would be sufficient to cover the costs of litigation in both Delaware and Texas. The Texas plaintiffs subsequently sought \$1.2 million in fees in Texas. Burlington N. Santa Fe, Inc., *Quarterly Report 35 (Form 10-Q)* (Nov. 5, 2010).

it did include an agreement for the defendant to pay the fees of plaintiffs' counsel. While shareholders received no benefit from the lawsuit, they bore the costs in the form of attorneys' fees.

The litigation experience of Burlington Northern is typical of firms on the receiving end of transaction-related litigation. This experience suggests a role for the exclusive forum provision mitigating the out-of-Delaware problem. The trend of plaintiffs bringing shareholder lawsuits against Delaware corporations "anywhere but Chancery" has been noted by a number of observers in recent years.³⁰ These lawsuits are typically state-law fiduciary duty claims based in Delaware law brought in the state of the corporation's headquarters.³¹ Shareholders of Delaware corporations file these lawsuits elsewhere in response to Delaware's efforts to more aggressively monitor agency costs with respect to shareholder lawsuits, as well as in response to the competitive pressures of the plaintiff's bar.³² This strategy may be best understood as an attempt by litigants to arbitrage the differences in the policing of agency costs in settlements between Delaware courts and courts in foreign jurisdictions. By controlling foreign litigation, plaintiffs' counsel place themselves in a position to assert leadership positions in settlement discussions and thus secure access to attorneys' fees when the foreign litigation is ultimately consolidated with litigation in the state of incorporation.³³

³⁰ See Mervis, *supra* note 1, at 17; Stevelman, *supra* note 1, at 60; Grundfest, *supra* note 1, at 8, 18; Lewis, *supra* note 1, at 199.

³¹ All the cases filed in connection with the Burlington Northern Santa Fe transaction were state law fiduciary duty claims based in Delaware law. See cases cited *supra* note 19; cases cited *supra* note 20.

³² See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 1-2; Stevelman, *supra* note 1, at 96-101; see also Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 1, at 5. However, Weiss and White's earlier paper disputes the notion that the Chancery Court effectively monitors agency costs with respect to settlements. See Weiss & White, *supra* note 16, at 1845. Jensen and Meckling define agency costs as: (1) monitoring expenditures by the principal; (2) bonding expenditures by the agent; and (3) any residual loss from any situation when an agent acts on behalf of a will not always act in the best interests of the principal. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

³³ Defendants will often refuse to settle litigation in the state of incorporation unless the plaintiffs' committee secures dismissal in foreign jurisdictions as part of a global settlement. A plaintiff in control of litigation in a foreign jurisdiction therefore may be able to secure fees in exchange for accepting a global litigation settlement in the state of incorporation. The same is true for Delaware counsel if defendants settle litigation in foreign jurisdictions first.

Professors Armour, Black, and Cheffins were the first to empirically document the dramatic shift of litigation outside Delaware.³⁴ A search of the SDC Platinum databases for merger transactions between August 2009 and August 2010 generated 119 transactions involving public company Delaware targets not in bankruptcy with transaction values larger than \$100 million.³⁵ A subsequent review of SEC filings for this sample reveals ninety-seven transactions, or approximately eighty-two percent of the sample, in which there was some acquisition-related litigation that accompanied the deal. Of the transactions that disclosed litigation, eighty-five percent disclosed more than one lawsuit, suggesting a pattern of competition amongst plaintiffs' counsel for the lead plaintiff position and control over the litigation.³⁶ Where there were multiple suits filed, the average number of lawsuits was 5.3 per transaction, with a median of four lawsuits per transaction. In the extreme case, the Blackstone Group's acquisition of Texas-based Dynegy Inc. generated twenty-six lawsuits related to one transaction — twenty claims in Texas and six in Delaware.³⁷

Of the transactions that disclosed transaction-related litigation, fifty-three percent disclosed litigation in multiple states. In cases where multiple complaints are filed in various jurisdictions, nearly thirty percent of cases are first filed in a foreign jurisdiction. The typical non-Delaware location to bring a foreign suit in this sample was the state court where the target had its headquarters. Consistent with findings from Armour, Black, and Cheffins, a substantial proportion of transaction-related litigation against Delaware corporations is never brought to the Delaware courts at all.³⁸ Forty percent of transaction-related litigation is brought only outside of Delaware, and only seven percent of that litigation is brought in Delaware alone.³⁹

³⁴ See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 6; see also Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 1, at 5-6.

³⁵ Database search for merger transactions, Thompson Financial SDC Platinum (Oct. 8, 2010) (excluding buybacks, exchange offers, and partial acquisitions).

³⁶ The phenomena of multiple lawsuits accompanying a corporate transaction is not new and has been previously documented elsewhere. See, e.g., FRANKLIN SECOR WOOD, *SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS* (1944) (documenting multiplicative derivative lawsuits in New York courts); Weiss & White, *supra* note 16 (analyzing litigation patterns).

³⁷ Information on the lawsuit brought in response of this transaction are readily available through the SDC Platinum Database as well as the SEC's website. See database search for merger transactions, *supra* note 35.

³⁸ See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 10-12; Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 1, at 22 (suggesting these percentages have been increasing in recent years).

³⁹ See database search for merger transactions, *supra* note 35.

Table 1: Public Company Mergers 2009-2010⁴⁰

	Number	Percentage of total
Total transactions	119	100%
No litigation	22	18%
Some litigation	97	82%

Table 2: Public Company Mergers with Some Litigation 2009-2010⁴¹

	Number	Percentage of those with litigation
Multiple litigation	82	85%
Litigation in multiple jurisdictions	50	53%
Litigation in Delaware only	8	7%
Litigation outside of Delaware only	41	40%
First filed outside Delaware	29	30%

If the out-of-Delaware trend were a verdict on the substance of Delaware law, then the trend might represent an important short-term shift away from what has become a steady equilibrium in state competition for corporate law. However, rarely do plaintiffs in foreign litigation bring claims that attempt to assert the corporate law of the forum over Delaware law.⁴² Plaintiffs are willing to accept Delaware law, just not Delaware courts. There is not a nascent shareholder plaintiff movement to assert “real seat” doctrine over the traditional internal affairs doctrine. Plaintiffs appear to still accept the internal affairs doctrine as a traditional choice of law provision that governs the relationships between shareholders and the corporation. Therefore, the current litigation trend is not a verdict on the substance of Delaware’s corporate law.

⁴⁰ See database search for merger transactions, *supra* note 35.

⁴¹ *Id.*

⁴² For example, in the New York Supreme Court case *In the Matter of The Topps Company Shareholders Litigation*, the issue in dispute was not whether Delaware law was the appropriate law by which to judge the plaintiff’s claims but whether New York was an appropriate forum given a competing case making similar claims simultaneously before the Delaware courts. See *In re The Topps Co. Inc. S’holders Litig.*, No. 600715/07, 2007 WL 5018882, at *2 (N.Y. Sup. Ct. June 8, 2007).

Indeed, disputes over the proper venue in the context of shareholder litigation differ from venue disputes in, for example, a typical contract case. In a contract case, a plaintiff and defendant may fight over the proper venue to hear a case. The *forum non conveniens* doctrine developed around the traditional strategic litigation model in which a plaintiff sues in a mutually convenient forum and then the defendant files a competing claim in a forum that is advantageous to the defendant alone. The doctrine is highly deferential to the plaintiff's choice of forum, thus preventing defendants from strategically shopping for a forum that would plainly disadvantage the plaintiff.⁴³ However, the doctrine is not wholly applicable in the context of modern shareholder litigation. In modern shareholder litigation, there are typically competing plaintiff groups who fight over the control of litigation and selection venue. Courts must sift through arguments from the competing groups seeking control of the litigation. Defendants are often agnostic as to the venue, but seek certainty and economy with respect to litigation.⁴⁴ In that context, *forum non conveniens* arguments are not altogether applicable. The questions are not necessarily related to defendants' litigation strategies, as they are asserting some degree of control over competing plaintiffs. Control over litigation and access to fees are an important motivating factor in this competition amongst plaintiff groups.⁴⁵ Such was the case in the Burlington Northern Santa Fe litigation where the defendants and the courts of Texas and Delaware were placed in the position of having to mediate among the competing groups of plaintiffs' counsel in two states vying for control over the litigation.⁴⁶ This was also the case in litigation related to the acquisition of The Topps Company, Inc. in 2007, where competing groups of plaintiffs in New York and Delaware

⁴³ See *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970) (observing that a defendant should not be permitted to defeat a plaintiff's choice of forum simply by commencing litigation involving the same cause of action in another jurisdiction).

⁴⁴ Defendant's Savitt motion asked only that the court work with judges in the multiple Texas courts to determine an appropriate venue. Defendants did not express a preference to hear the case in Texas or Delaware. See letter from Raymond DiCamillo to The Honorable J. Travis Laster, *supra* note 22 (supporting defendants' jurisdictional motion).

⁴⁵ 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, 680 (1986) [hereinafter *Understanding the Plaintiff's Attorney*] (describing the central role of fees in motivating shareholder litigation); see also Weiss & White, *supra* note 16, at 1829-30.

⁴⁶ See sources cited *supra* notes 18-20.

battled over control of litigation.⁴⁷ In both cases, the defendants were essentially agnostic with respect to the location of the litigation while plaintiff groups fought each other over control. Rather than the fight over venue being between plaintiff and defendant as is normal in *forum non conveniens* cases, in the shareholder litigation context, the fight over venue is often one where the defendant is agnostic with respect to the forum, and the fight is amongst competing groups of plaintiffs' counsels who seek to control the litigation.

The shareholder lawsuits that are of concern in this Article are of a particular type: acquisition-related lawsuits. These suits are fall into two general categories: first, suits brought in conjunction with change of control transactions where the board is alleged to have failed to fulfill its fiduciary obligations under *Revlon*; and second, suits brought in conjunction with cash-out transactions with controlling shareholders where directors are alleged to have violated their fiduciary duties to minority shareholders.⁴⁸ Professors Weiss and White observe that Delaware law creates incentives for plaintiffs to bring lawsuits in change of control transactions or in transactions involving controlling shareholders, whether or not the board violated its fiduciary duties to the corporation.⁴⁹ In such litigation, the ultimate settlements may often include minor changes in disclosures, lowering the value of termination fees, or nominal increases in consideration.⁵⁰ In all situations, settlements include payment of plaintiff attorneys' fees.⁵¹ Weiss and White examined settlements of transaction-related lawsuits and found that, in cases where plaintiffs' counsel claimed to have negotiated cash settlements for shareholders:

“[P]laintiffs' attorneys frequently were able to free ride on the improved terms negotiated by SNCs [special litigation committees] or on the price improvements that resulted from competing bids, that they rarely claimed a major share of the credit for the improvements, and that they never persisted in

⁴⁷ See *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 953 (Del. Ch. 2007); *In re The Topps Co. S'holders Litig.*, 2007 WL 5018882, at *1-2.

⁴⁸ Weiss & White, *supra* note 16, at 1804.

⁴⁹ *Id.*

⁵⁰ See *id.* at 1818, 1837; see also *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 947 (Del. Ch. 2010) (describing transactional tweaks as part of the “settlement technology”).

⁵¹ Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: An Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 7-8 (1991) (describing plaintiffs' counsel in shareholder lawsuits as entrepreneurial).

challenging the terms negotiated by an SNC or the terms proposed by a competing bidder.”⁵²

Put in blunt terms, most transaction-related litigation is more about getting access to fee distributions than it is about improving shareholder value or protecting the rights of shareholders. The typical shareholder plaintiff in transaction-related litigation is a small-stakes shareholder with little or no economic incentive to monitor the activities of counsel.⁵³ Consequently, attorneys rather than shareholder plaintiffs are the real parties in interest in many transaction-related lawsuits.⁵⁴ This type of litigation is highly susceptible to agency costs because the interests of counsel will not always align with the interests of their purported clients, the shareholders.⁵⁵

Multiforum litigation strategies are a response to recent attempts to police agency costs in transaction-related litigation and competitive pressures amongst plaintiffs’ counsel. On the one hand, recent efforts by the Delaware courts to more aggressively police settlements means that courts will more closely scrutinize settlements, including fees. Courts are willing to limit what they consider to be excessive fees.⁵⁶ On the other hand, bringing claims in courts outside the state of incorporation has two benefits from the point of view of plaintiff counsel: First, courts in foreign jurisdictions are less likely to closely scrutinize resulting settlements;⁵⁷ and second, even if multiple cases are consolidated in the state of incorporation, by controlling the

⁵² See Weiss & White, *supra* note 16, at 1829.

⁵³ Macey & Miller, *supra* note 51, at 5.

⁵⁴ The role of plaintiff counsel as the true party in interest in shareholder lawsuits is well understood. See, e.g., *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 549-50 (1949) (observing the problem of incentives present in shareholder litigation: “[W]hile the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them.”); John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 888 (1987) (recognizing the central importance of the plaintiff attorney as a “bounty hunter” in bringing litigation); Coffee, Jr., *Understanding the Plaintiff’s Attorney*, *supra* note 45, at 678 (observing that it is well understood that the shareholder plaintiff has only a nominal stake in the outcome); see also Reiner Kraakman et al., *When Are Shareholder Lawsuits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1736-37 (1993) (observing that the real parties in interest are more likely to be attorneys with nominal shareholders in tow).

⁵⁵ See Coffee, Jr., *Understanding the Plaintiff’s Attorney*, *supra*, note 45, at 679-80.

⁵⁶ See *In re Sauer-Danfoss Inc. S’holders Litig.*, No. 5162-VCL, 2011 WL 2519210, at *20 (Del. Ch. Apr. 29, 2011); *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 642 (Del. Ch. 2005).

⁵⁷ Armour et al., *Delaware’s Balancing Act*, *supra* note 4, at 28-29, 31.

foreign litigation, attorneys assure themselves a seat at the settlement table and a portion of the fee.⁵⁸ Together, these two benefits form a powerful incentive for plaintiffs to actively seek alternate forums in which to litigate.

To the extent plaintiffs are engaging in forum shopping by actively avoiding the Delaware forum, Stevelman and Armour, Black, and Cheffins have correctly identified a worrying trend from the perspective of shareholders, Delaware policymakers, and society, though each for different reasons.⁵⁹ From the point of view of shareholders and society, the multiform litigation strategy raises settlement costs of marginally valuable lawsuits and thus represents a deadweight loss to society.⁶⁰ Shareholders, as well as courts, have an interest in reducing the costs of unnecessary litigation. A plaintiff's litigation strategy based on bringing state claims outside the state of incorporation may be unnecessarily costly to shareholders who ultimately must directly or indirectly pay the costs of settlement. To the extent that courts in multiple jurisdictions are required to hear and adjudicate the same claims, the cost of an excessive amount of litigation can represent a waste of judicial resources, both in the state of incorporation as well as in the foreign court.⁶¹ From the perspective of Delaware policymakers, a plaintiff's multiform litigation strategy poses a long-term threat to Delaware's ability to determine its own corporate law.⁶²

Although shareholder lawsuits can serve as an important governance device, they remain vulnerable to agency cost problems.⁶³

⁵⁸ *In re Allion Healthcare Inc. S'holders Litig.*, No. 5022-CC, 2011 WL 1135016, at *5-6 (Del. Ch. Mar. 29, 2011) (discussing the issue of fee splitting with out of state litigation in both the Burlington Northern Santa Fe as well as Allion Healthcare litigations). See generally Weiss & White, *supra* note 16, at 1829-30 (noting that attorney fees were generally available in settlements).

⁵⁹ See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 2; Stevelman, *supra* note 1, at 61-62.

⁶⁰ Kraakman et al. posit that if a suit yields a positive recovery net of all costs that the corporation must bear as a consequence of suit, the suit is a net benefit to the corporation. Kraakman et al., *supra* note 54, at 1736. However, in typical transaction-related litigation where the settlement includes modest additional disclosures, or nominal changes to merger terms as well as legal fees, such settlements are not likely to generate a net benefit for the corporation. *Id.*

⁶¹ Judicial economy and waste is a primary motivating factor for the doctrine of *forum non conveniens*. See *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970).

⁶² See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 4.

⁶³ The dynamics of the relationship between the plaintiff attorney and shareholder in the shareholder lawsuit are not dissimilar from the dynamics in the relationship

The small-claims nature of shareholder litigation results in collective action problems because individual shareholders refuse to bear the costs of litigation on their own.⁶⁴ The plaintiff's attorney helps resolve this coordination problem by becoming the real party-in-interest in the litigation.⁶⁵ While this resolves coordination problems, shareholders subsequently have little incentive to monitor the actions of the attorney acting as their agent.⁶⁶ Many reform efforts at the federal and state levels have attempted to control agency costs associated with shareholder litigation;⁶⁷ however, the outcomes of

between plaintiff attorneys and plaintiffs in other small stakes class action litigation. The agency cost problems associated with the shareholder lawsuit and potential reforms to mitigate agency problems have been the subject of a rich discussion over many years. See Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 536 (1991); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 76 (1985); Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 45, at 726; James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1594 (2006); Mark J. Loewenstein, *Shareholder Derivative Litigation*, 24 DEL. J. CORP. L. 1, 3 (1999); Macey & Miller, *supra* note 51, at 3; Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J.L. ECON. & ORG. 55, 57 (1991); Thompson & Thomas, *supra* note 2, at 138; Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs on Securities Class Actions*, 104 YALE L.J. 2053, 2056-57 (1995); Weiss & White, *supra* note 16, at 1799.

⁶⁴ See *supra* note 63 and accompanying text.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ Security for expenses bonds of the 1940s and 1950s led to a movement of shareholder cases from the state courts to the federal courts as litigants sought to avoid the higher costs of filing state based claims. See Henry W. Ballantine, *Abuses of Shareholders Derivative Suits: How Far is California's New "Security for Expenses" Act Sound Regulations?*, 37 CALIF. L. REV. 399, 399 (1949); see also George D. Hornstein, *The Death Knell for Stockholders' Derivative Suits in New York*, 32 CALIF. L. REV. 123, 143-44 (1944). The Private Securities Litigation Reform Act of 1995 ("PSLRA") created incentives for litigants to move federal securities class action claims to state courts to avoid the strictures of the PSLRA's lead plaintiff provision. See Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 274 (1998) (noting the shift of cases to state courts following PSLRA enactment). Following enactment of the PSLRA, there is evidence that plaintiff counsels responded to the Act's efforts to eliminate professional plaintiffs by closely associating themselves with institutional investors, leading to "pay-to-play" issues. See David H. Webber, *Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions?*, 90 B.U. L. REV. 2031, 2033 (2010); see also Stephen J. Choi, Drew T. Johnson-Skinner & A.C. Pritchard, *The Price of Pay to Play in Securities Class Actions* (Univ. of Mich. Law Sch. Empirical Legal Studies Ctr., Working Paper No. 2, 2009), available at <http://law.bepress.com/umichlwps/empirical/art2>.

those efforts have been mixed, often resulting in unintended consequences as litigants seek to find ways around restrictions.⁶⁸

Delaware courts have become more aggressive in policing perceived agency costs associated with the shareholder lawsuit and have taken a number of steps to control them. First, Delaware courts have declined to mechanically apply a “first-filed” rule when making a determination as to the lead plaintiff.⁶⁹ Second, when Delaware courts make determinations about the identity of the lead plaintiff and its counsel, the courts have placed an increased emphasis on quality of the filings. In doing so, the courts encourage parties to consider the quality of the complaint before proceeding to file, thereby slowing the rush by plaintiffs to file first. In addition, the Delaware courts consider the relative economic stakes of competing plaintiffs, the absence of conflicts between institutional and smaller stockholders, competence of counsel, and the willingness of counsel to litigate the claim vigorously.⁷⁰ Finally, the Delaware courts have become increasingly aggressive in the policing of plaintiffs’ fees, particularly with respect to cookie-cutter challenges to controlling shareholder transaction cases where the legal standards tend to guarantee plaintiffs with a settlement irrespective of the underlying facts.⁷¹ Professors Armour, Black,

⁶⁸ See *supra* note 67 and accompanying text.

⁶⁹ See *In re Chambers Dev. Co. S’holders Litig.*, No. 12508, 1993 WL 179335, at *255 (Del. Ch. May 20, 1993) (deciding whether to issue a stay in favor of a first-filed action in a case where 21 claims were brought in a six-week time period); see also *TCW Tech. Ltd. v. Intermedia Commc’ns, Inc.*, Nos. 18336, 18289, 18293, 2000 WL 1654504, at *8-9 (Del. Ch. Oct. 17, 2000) (“Although it might be thought, based on myth, fables, or mere urban legends, that the first to file a lawsuit in this Court wins some advantage in the race to represent the shareholder class, that assumption . . . has neither empirical nor logical support.”).

⁷⁰ See *Biondi v. Scrushy*, 820 A.2d 1148, 1162 (Del. Ch. 2003) (“The importance of quality lawyering at the pleading stage of derivative cases is obvious, given the higher pleading burdens applicable to derivative complaints. For this reason, Delaware law places more emphasis on quality than speed when assessing derivative complaints.”); *TCW Tech*, 2000 WL 1654504, at *3 (“Too often judges of this Court face complaints filed hastily, minutes or hours after a transaction is announced, based on snippets from the print or electronic media. . . It is not the race to the courthouse door, however, that impresses the members of this Court when it comes to deciding who should control and coordinate litigation on behalf of the shareholder class. In fact, this Court and the Delaware Supreme Court have repeatedly emphasized the importance of plaintiffs’ counsel taking the time to use the ‘tools at hand’. . . to develop a record sufficient to craft pleadings with particularized factual allegations necessary to survive the inevitable motions to dismiss.”).

⁷¹ *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 972 (Del. Ch. 1996) (reducing request for fees and describing considerations that courts take into account when determining reasonable fee for counsel); see also *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 606 (adopting general rule not to award attorneys risk

Cheffins note that following internal studies of plaintiff fee awards during the late 1990s, Delaware reassessed its attitude toward fee awards.⁷² Observing that high levels of fee awards made Delaware an attractive location for plaintiffs' counsel to bring weak claims, the courts adopted a new, more "parsimonious" attitude towards fees.⁷³ This attitude has taken the form of more aggressive review of fees in transaction-related cases and, when appropriate, reduction of fees requested by plaintiffs.⁷⁴

The out-of-Delaware litigation strategy appears to be an effort by plaintiffs' counsel to skirt attempts by the Delaware judiciary to more closely monitor agency costs associated with shareholder lawsuits. Many states still follow the first-filed doctrine, thus ensuring that an early filer in a foreign jurisdiction gets control of the litigation.⁷⁵ In addition, foreign courts are less likely to require that plaintiffs plead with particularity or fully develop the record before filing the shareholder suit. The combination of a strict application of the first-filed doctrine and lower pleading standards can result in an incentive for plaintiff counsel to quickly file cookie-cutter complaints in foreign jurisdictions. Furthermore, not every foreign court will follow Delaware's lead with respect to fees or process by which it selects a lead plaintiff. Finally, the prospect that a state court judge unfamiliar with the application of Delaware's corporate code may fail to dismiss weak claims at an early stage of the litigation creates potential settlement value for plaintiff counsel. A multiforum litigation strategy relies on the disparate application of law and differing attitudes towards procedural questions to generate settlement value for plaintiff counsel bringing the suit.

Delaware corporations are more vulnerable to a multiforum litigation strategy than corporations incorporated in other states. More than fifty-sixty percent of Fortune 500 firms are incorporated in

premium for *Lynch* cases).

⁷² Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 29-31.

⁷³ *Id.* at 31.

⁷⁴ See, e.g., *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d at 639 (reducing fee award); see also *In re Sauer-Danfoss Inc. S'holders Litig.*, No. 5162-VCL, 2011 WL 2519210, at *17 (Del. Ch. Apr. 29, 2011) (detailing fee levels to provide sister jurisdictions helpful guidance related to appropriate fee levels).

⁷⁵ *In re The Topps Co. S'holders Litig.*, No. 600715/07, 2007 WL 5018882, at *3 (N.Y. Sup. Ct. June 8, 2007) (favoring plaintiff in New York courts because they were first-to-file). Other states, such as Mississippi, also recognize a rule that "first to file an action has a right to prosecute it to its conclusion." See *Long v. McKinney*, 897 So. 2d 160, 166 (Miss. 2004); Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Action Counsel by Auction*, 102 COLUM. L. REV. 650, 656 (2002).

Delaware and the vast majority maintain their headquarters in a state other than Delaware.⁷⁶ As a result, publicly traded Delaware firms generally have sufficient contacts for personal jurisdiction before at least two courts, allowing plaintiffs to bring suits out of Delaware.⁷⁷ Publicly traded firms that are not incorporated in Delaware tend to be incorporated in the same state in which they maintain their headquarters.⁷⁸ These firms are less likely to have personal jurisdiction in other courts and are therefore less vulnerable to shareholder suits in foreign jurisdictions. Given the particular vulnerability of Delaware firms to multiforum litigation strategies, a policy response may be appropriate.

II. POSSIBLE BUT PROBLEMATIC RESPONSES TO THE OUT-OF-DELAWARE TREND

If plaintiffs are engaged in multiforum litigation strategies that are not socially beneficial, the next proper question is what response is merited. Any solution must balance encouraging shareholders to pursue real claims with discouraging low-value or frivolous legal claims to the extent such actions do not result in real benefits for stockholders. To date, policymakers have not been able to find the balance. The history of representative litigation regulation and reform can be characterized as a “cat-and-mouse” game, with regulations being followed by unexpected consequences as plaintiffs’ counsel seeks alternate avenues to assert claims. It may well be that any effort to curtail the plaintiff’s access to foreign jurisdictions and stem the out-of-Delaware trend may simply result in unanticipated problems in the future.

A. Hands-Off Approach

Given the challenge presented by the out-of-Delaware trend, the first option for Delaware policymakers is to do nothing. If foreign

⁷⁶ DIV. OF CORPS., DEL. SEC’Y OF STATE, 2010 ANNUAL REPORT 1 (2010), available at <http://corp.delaware.gov/10CorpAR.pdf>.

⁷⁷ See generally *Burger King v. Rudzewicz*, 471 U.S. 462, 474 (1985) (holding that contacts and connection with forum state should be such that defendant should “reasonably anticipate being haled into court there”); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 298 (1980) (finding that unilateral acts by plaintiff not sufficient to satisfy requirement of contact with forum state); *Int’l Shoe v. Washington*, 326 U.S. 310, 316-17 (1945) (finding that a defendant need only have minimum contacts with the forum state).

⁷⁸ Robert M. Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1598 (2002).

courts are willing to entertain plaintiffs bringing relatively weak claims against Delaware corporations in their jurisdictions, Delaware should not be concerned. At some point, after foreign courts develop a reputation for being relatively lax with attorneys' fees, they will become overwhelmed with litigation. In response, those courts will follow what the Delaware judiciary has done and begin to more aggressively police agency costs. Shareholder plaintiffs with legitimate corporate law questions and no interest in forum shopping will still find their way to Delaware courts to have important questions of corporate law decided. This hands-off approach suggests a belief that the market will sort itself out over the long run and that Delaware policymakers should not be concerned with short-term fluctuations associated with the out-of-Delaware trend.

However, the hands-off approach seriously undervalues the importance of shareholder litigation, including litigation brought on behalf of professional plaintiffs, in developing and maintaining the Delaware corporate common law. Indeed, cases brought on behalf of professional plaintiffs — those that observers might argue are most susceptible to agency costs — are some of the most important in Delaware common law. *Aronson v. Lewis*,⁷⁹ *Weinberger v. UOP*,⁸⁰ and *Kahn v. Lynch Communications*,⁸¹ three of the most cited opinions in Delaware corporate law, are examples of cases brought by an entrepreneurial plaintiff's bar on behalf of professional plaintiffs.⁸² If Delaware adopts an attitude that discounts the importance of claims, it

⁷⁹ *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

⁸⁰ *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

⁸¹ *Kahn v. Lynch Commc'n Sys. Inc.*, 638 A.2d 1110 (Del. 1994). William L. Weinberger, Harry Lewis, and Alan R. Kahn are among the most prolific professional plaintiffs with respect to Delaware corporate law. Mr. Lewis and Mr. Kahn have filed hundreds of lawsuits and are responsible for more than 150 written judicial opinions, including a U.S. Supreme Court opinion and at least dozen Delaware Supreme Court opinions. A review of the memoranda and trial opinions on the Delaware Supreme and Chancery Court websites from January 2009 through September 2010 reveals that 14% of all the memoranda or trial opinions in the Delaware Chancery Court and the Delaware Supreme Court include citations to either Lewis or Kahn opinions. Kahn continues to be an active litigant bringing shareholder lawsuits regularly in Delaware and other jurisdictions. In a recent Delaware opinion, Messrs. Lewis, Weinberger, and Kahn were deemed "quasi-mythical" for their status as serial plaintiffs in shareholder lawsuits. See *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 944 n.3 (Del. Ch. 2010). Although Messrs. Weinberger and Lewis are no longer active litigants, Mr. Kahn and his family remain active shareholder litigants. See, e.g., *Linda Parnes Kahn v. Kolberg Kravis Roberts & Co.*, 23 A.3d 831 (Del. 2011) (holding that a *Brophy* claim does not require an element of harm).

⁸² See Macey & Miller, *supra* note 51, at 7 (describing plaintiffs' counsel in shareholder lawsuits as entrepreneurial).

risks hindering the flow of cases required to continually develop and maintain its corporate law.⁸³ Doing nothing in the face of the out-of-Delaware trend, therefore, is not a viable option for Delaware policymakers.⁸⁴

B. Delaware Self-Help

Some observers, including members of the Delaware judiciary, do not necessarily view the out-of-Delaware trend as particularly alarming.⁸⁵ They propose a self-help approach to ameliorating some of the potential ill effects of the multiforum litigation strategies.⁸⁶ Central to the self-help approach are so-called “Savitt motions.”⁸⁷ In a Savitt motion, parties, often defendants, file motions in multiple jurisdictions asking judges to confer with each other and permit the litigation to proceed in a single jurisdiction, while staying or dismissing litigation in the alternate jurisdictions.⁸⁸ However, even supporters recognize that this ad hoc approach to self-help is not a foolproof solution.⁸⁹ The approach relies on judges in various

⁸³ Armour et al. argue that Delaware is already losing important cases because of the out-of-Delaware trend, thus impairing Delaware’s ability to determine its own corporate law. See Armour et al., *Delaware’s Balancing Act*, *supra* note 1, at 72-73.

⁸⁴ Given its recent more aggressive attitude towards the policing of agency costs in shareholder lawsuits, it is unlikely that the Delaware judiciary would consider reversing course. Backing off oversight of the plaintiff’s bar and its aggressive policing stance may have the effect of reducing incentives to bring cases in foreign jurisdictions, but there is no indication the Delaware courts would accept such a radical departure from current practice. For an example of the Chancery Court policing fees, see *In re Sauer-Danfoss S’holders Litig.*, No. 5162-VCL, 2011 WL 251910, at *1 (Del. Ch. Apr. 29, 2011).

⁸⁵ See, e.g., *In re Allion Healthcare Inc.*, No. 5022-CC, 2011 WL 1135016, at *4 (Del. Ch. Mar. 29, 2011) (expressing a personal preference for a voluntary approach to resolving this issue).

⁸⁶ *Id.*

⁸⁷ *Nierenberg v. CKx, Inc.*, No. 5545-CC, 2011 WL 2185614, at *1 (Del. Ch. May 27, 2011).

⁸⁸ *See id.*

⁸⁹ Chancellor Chandler stated his preferred response to this problem while recognizing its limitations in *Allion*:

My personal preferred approach, for what it’s worth, 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 one another and agree upon where the case should go forward. In other words—and I mentioned this during an earlier oral argument in this case—my preference would be for defendants to ‘go into all the Courts in which the matters are pending and file a common motion that would be in front of all of the judges that are implicated, asking those judges to please confer and

jurisdictions coordinating litigation in the interests of comity and judicial efficiency. There is no guarantee that judges will agree to coordinate cases, especially high profile cases.⁹⁰

Another approach to Delaware self-help is the voluntary certification of corporate law questions by foreign courts to the Delaware Supreme Court.⁹¹ From the point of view of Delaware policymakers, losing the ability to update Delaware's corporate law is a significant threat posed by multiform litigation. If, however, foreign courts certify questions of corporate law to the Delaware Supreme Court, that threat is significantly reduced. Given that parties in Delaware trial courts have the right to appeal directly to the Delaware Supreme Court, courts are generally hesitant to certify questions before final adjudication of the issues, preferring to decide questions on complete records.⁹² However, foreign courts lack the same access to the Delaware Supreme Court and are less likely to have expertise in the corporate law than their Delaware counterparts.⁹³ Consequently, Justice Ridgely suggested that, under those circumstances, foreign trial courts should be permitted to certify novel questions of the corporate law to the Delaware Supreme Court in order to reduce uncertainty with respect to corporate law questions that arise in foreign courts.⁹⁴ Using a certification procedure, a foreign court confronted with an issue of first impression could certify the issue to the Delaware Supreme Court and receive a

agree upon, in the interest of comity and judicial efficiency, if nothing else, what jurisdiction is going to proceed and go forward and which jurisdictions are going to stand down and allow one jurisdiction to handle the matter. . . . Of course . . . judges in different jurisdictions might not always find common ground on how to move the litigation forward. Nevertheless, this would be, I think, one (if not the most) efficient and pragmatic method to deal with this increasing problem. It is a method that has worked for me in every instance when it was tried.

In re Allion Healthcare Inc. S'holders Litig., 2011 WL 1135016, at *4 n.12.

⁹⁰ For example, in *Topps Shareholders Litigation*, cases were filed in both New York and Delaware. The New York judge refused to defer prosecution of the New York cases in favor of the Delaware cases. The Delaware Vice Chancellor similarly refused to defer prosecution. See *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 953 (Del. Ch. 2007); *In re The Topps Co. S'holders Litig.*, No. 600715/07, 2007 WL 5018882, at *7 (N.Y. Sup. Ct. June 8, 2007).

⁹¹ Henry duPont Ridgely, *Avoiding the Thickets of Guesswork: The Delaware Supreme Court and Certified Questions of Corporation Law*, 63 SMU L. REV. 1127, 1132-33 (2010); see also Francis Pileggi, *The Delaware Supreme Court and Certified Questions*, DEL. CORP. & COM. LITIG. BLOG (Feb. 11, 2011), <http://www.delawarelitigation.com/2011/02/articles/commentary/the-delaware-supreme-court-and-certified-questions/>.

⁹² See Ridgely, *supra* note 91, at 1133.

⁹³ See *id.*

⁹⁴ See *id.* at 1133, 1140.

definitive ruling on the law. In that way, Delaware would maintain some degree of control over the development of its own law while still providing plaintiffs with maximum flexibility in deciding where to file claims.⁹⁵ Although this approach is worth pursuing, absent changes to facilitate foreign trial courts certifying questions directly to the Delaware Supreme Court, this approach will likely remain unworkable for the foreseeable future.

C. Elimination of the Delaware Carve-Out

If self-help approaches are inadequate and coordinated action is necessary to address the question of agency costs in multiforum shareholder litigation, Delaware might encourage federal lawmakers to revisit the “Delaware carve-out” and simply federalize all shareholder lawsuits.⁹⁶ The Private Litigation Securities Reform Act of 1995 (“PLSRA”) and the subsequent Securities Litigation Uniform Standards Act of 1998 (“SLUSA”) were intended to reduce abusive shareholder litigation.⁹⁷ SLUSA, in particular barred most securities class actions from being brought in state courts.⁹⁸ SLUSA includes, however, a carve-out that “preserve[s] state-law actions brought by shareholders against their own corporations in connection with extraordinary corporate transactions requiring shareholder approval, such as mergers and tender offers, regardless whether the corporations issued nationally traded securities.”⁹⁹ Congress could intervene and prevent plaintiff forum shopping by eliminating the right to bring state-law actions in the foreign courts.

⁹⁵ For example, the legality of the “just say no” defense against takeovers was, until recently, questionable under Delaware law. The issue had never been fully litigated to an opinion before a Delaware trial court. The only opinion on the question was a federal case, *Moore Corporation, Inc. v. Wallace Computer Services, Inc.*, 907 F. Supp. 1545 (D. Del. 1995). Because the opinion in *Moore* did not come from a Delaware state court, the district court’s opinion that purported to uphold under Delaware law the “just say no” defense was not precedential. Consequently, until *Air Products & Chemicals Inc. v. Airgas, Inc.*, 16 A.3d 48, 122 (Del. Ch. 2011), was decided in 2010, there was considerable uncertainty about the question. Had the parties in *Moore* possessed the ability to certify a question to the Delaware Supreme Court, the question would have been resolved with more certainty. See *Moore*, 907 F.Supp. at 1583; *Airgas*, 16 A.3d at 122.

⁹⁶ Professor Fisch suggests federalizing all state law derivative claims as an option for improving the efficiency of selecting lead counsel. Fisch, *supra* note 75, at 723-24.

⁹⁷ Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, §§ 101-108, 109 Stat. 737, 737-758.

⁹⁸ SLUSA added section 16(d) of the Securities Act and section 28(f) of the Securities Litigation Uniform Standards Act. 15 U.S.C. § 78bb(f)(4) (1998).

⁹⁹ *Madden v. Cowen & Co.*, 576 F.3d 957, 971 (9th Cir. 2009).

Federal courts are well equipped to handle thorny questions of the proper forum for representative litigation. The U.S. Judicial Panel on Multidistrict Litigation (“MDL Panel”) has proven capable of sorting out questions of forum shopping that often accompany mass tort and other representative litigation.¹⁰⁰ The MDL Panel serves to centralize representative litigation and thus avoid duplication of discovery, prevent inconsistent pretrial rulings, and finally to conserve the resources of the parties and the courts.¹⁰¹ The MDL Panel may be ideally suited to help resolve the problem of competing forums in the context of representative shareholder litigation. By eliminating the Delaware carve-out and essentially federalizing shareholder litigation in its entirety, Congress could staunch the out-of-Delaware trend.

There are good arguments in favor of a federal corporate law and an increased federal role in corporate governance.¹⁰² Indeed, shareholders and firms themselves might be indifferent to the prospect of litigating corporate law claims in federal courts rather than state courts. To the

¹⁰⁰ 28 U.S.C. § 1407 (1976).

Under § 1407, Congress gave the Panel broad powers to transfer groups of cases to a single district court for the purpose of conducting pretrial proceedings without consideration for personal jurisdiction over the parties and without having to meet the venue requirements of 28 U.S.C. § 1404 The Panel considers only two issues in resolving transfer motions under § 1407 in new dockets. First, the Panel considers whether common questions of fact among several pending civil actions exist such that centralization of those actions in a single district will further the convenience of the parties and witnesses and promote the just and efficient conduct of the actions. Second, the Panel considers which federal district and judge are best situated to handle the transferred matters. In deciding those issues, the Panel exercises its considerable and largely unfettered discretion within the unique circumstances that each motion presents.

John G. Heyburn II, *A View from the Panel: Part of the Solution*, 82 TUL. L. REV. 2225, 2227-28 (2002).

¹⁰¹ See Heyburn, *supra* note 100, at 2229.

¹⁰² See, e.g., Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437 (1992) (advocating an expansion of federal regulation to govern the problem of managerial opportunism); Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625 (2004) (arguing that the threat of federalization of corporate law is valuable for ensuring robust development of corporate law at the state level); Roberta S. Karmel, *Is it Time for a Federal Corporate Law?*, 57 BROOK. L. REV. 55 (1991) (suggesting that policymakers revisit the question of federal corporate law); Mark J. Loewenstein, *The SEC and the Future of Corporate Governance*, 45 ALA. L. REV. 783 (1993) (arguing for an increased federal role in corporate governance); Joel Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947 (1990) (arguing for a minimal level of federal intervention in corporate law).

extent the federal courts provide a forum and a mechanism for efficiently adjudicating competing claims and making determinations about the identity of lead plaintiffs, shareholders and firms might well prefer litigating in federal courts.

Of course, federalizing the adjudication of state corporate law poses an immediate threat to Delaware's dominant position with respect to corporate law. Consequently, neither Delaware policymakers nor Delaware's chief advocates in Congress can be expected to support elimination of the Delaware carve-out. Absent a congressional mandate, the federal courts are unlikely to intervene on their own.¹⁰³ Congress has not revisited the question of a federal corporate law in some time.¹⁰⁴ Absent advocacy in Congress for a change with respect to the role of federal courts, it is unlikely that Congress will consider federalization in the near future. The most obvious candidate to advocate on behalf of such a change is Delaware and its supporters in Congress. It is highly unlikely, however, that in an effort to address the problem of the out-of-Delaware trend that any Delaware policymakers would actually promote federalization of the adjudication of corporate law questions as a solution.

D. Interstate MDL Panel

Rather than rely on the federal MDL Panel, Delaware might promote a more formal relationship among the states that receive the most shareholder litigation: New York, California, and Texas. Interstate compacts exist for a number of reasons, including establishment of administrative agencies to resolve interstate resource management issues, public transportation, and economic development.¹⁰⁵ In rare cases, states enter into interstate agreements to settle litigation, as was the case with the 1998 master tobacco litigation settlement.¹⁰⁶ A formal interstate compact could mimic, at the state level, the work of the federal MDL Panel by establishing a state-level panel on multistate

¹⁰³ See *Santa Fe Indus. v. Green*, 430 U.S. 462, 479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.").

¹⁰⁴ See Karmel, *supra* note 102, at 57-62 (providing a brief history of federal corporate law efforts).

¹⁰⁵ See Jill E. Hasday, *Interstate Compacts in a Democratic Society: The Problem of Permanency*, 49 FLA. L. REV. 1, 4 (1997); see also Michael S. Greve, *Compacts, Cartels, and Congressional Consent*, 68 MO. L. REV. 285, 288-89 (2003).

¹⁰⁶ See Greve, *supra* note 105, at 348.

litigation, including shareholder litigation.¹⁰⁷ This state-level panel would be empowered to help resolve in a uniform manner the knotty question of which plaintiff amongst competing plaintiffs should control the litigation. Such a panel would also be responsible for deciding the appropriate forum for the resolution of intracorporate disputes. It is likely that such a panel would have a bias in favor of sending claims, particularly those with the most interesting legal issues, back to the Delaware judiciary for resolution. This would ensure that the state of incorporation controls the development of its own corporate law while constraining agency costs.

Establishing a state-level panel to resolve questions of forum for intracorporate disputes might be a high priority for Delaware policymakers and the Delaware Bar.¹⁰⁸ At this point, however, only Delaware has a real stake in resolving the out-of-Delaware problem in its favor. Other states have little incentive to expend political or administrative capital to resolve a problem affecting only Delaware. Consequently, it is unlikely that an interstate MDL could realistically garner sufficient support to proceed.

III. THE EXCLUSIVE FORUM PROVISION

Unlike the above approaches, the exclusive forum provision in corporate charters is a viable mechanism for addressing the out-of-Delaware problem.¹⁰⁹ The exclusive forum provision creates a judicial presumption that shareholder litigation alleging violations of fiduciary duties on the part of the board, or asserting any rights under the corporate charter, be litigated exclusively in the state of incorporation. Because the provision reduces the incentive for plaintiffs' counsel to engage in forum shopping, it is likely a value-enhancing charter amendment. Were such provisions widely adopted and regularly enforced by foreign jurisdictions, the exclusive forum provision could

¹⁰⁷ Interstate compacts are permitted with the consent of Congress. U.S. CONST. art. I, § 10, cl. 3. (Compacts Clause).

¹⁰⁸ Messrs. Lebovitch, Silk, and Friedman, all prominent members of the Delaware plaintiffs bar, advocate for a state-level system of determining control over multiforum litigation. See MARK LEBOVITCH, JERRY SILK & JEREMY FRIEDMAN, MAKING ORDER OUT OF CHAOS: A PROPOSAL TO IMPROVE ORGANIZATION AND COORDINATION IN MULTI-JURISDICTIONAL MERGER-RELATED LITIGATION 7 (2011), available at http://www.blbglaw.com/misc_files/MakingOrderoutofChaos.

¹⁰⁹ See *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960-961 (Del. Ch. 2010); Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 4, 64; Mirvis, *supra* note 1, at 17-18; Lewis, *supra* note 1, at 202-03; Stevelman, *supra* note 1, at 65; see also Grundfest, *supra* note 1, at 3, 8, 20.

help reduce plaintiffs' incentives to race to courthouses outside of Delaware after announcements of mergers or corporate sales.

An exclusive forum provision provides defendants the ability to have a state-law based derivative suit or a shareholder class action brought in a court outside the state of incorporation dismissed.¹¹⁰ Currently, defendants in foreign jurisdictions may typically seek a stay or dismissal only as a matter of judicial discretion. Foreign courts will often accommodate such motions in the interests of comity and judicial efficiency.¹¹¹ However, not all courts will do so.¹¹² In jurisdictions that follow a strict interpretation of the first-filed doctrine, courts may be hesitant to exercise their discretion to defer to second-filed cases in another jurisdiction.¹¹³ The exclusive forum provision affords defendants in foreign courts procedural opportunities to cut short the competition amongst plaintiffs' counsels and to have litigation in foreign courts dismissed or stayed in favor of litigation in the state of incorporation.

¹¹⁰ The language adopted by Netsuite Inc. in its 2007 Certificate of Incorporation provides a useful example of an exclusive forum provision. The Netsuite provision reads as follows:

Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the DGCL, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article [. . .].

NETSUITE INC., AMENDED AND RESTATED CERTIFICATE OF INCORPORATION, art. VI.8 (2007). Professor Grundfest identifies the language used by Netsuite as part of the "Grundfest Cluster" of firms adopting exclusive forum provisions. Grundfest traces the origin of this language to language used by Oracle in its bylaws and subsequently to Financial Engines, Inc. Grundfest was a member of board of directors of both Oracle and Financial Engines. See Grundfest, *supra* note 1, at 3.

¹¹¹ For example, in the *Burlington Northern Santa Fe Litigation*, the Texas based litigation was ultimately stayed in favor of the Delaware litigation. See Letter from Raymond DiCamillio to Vice Chancellor J. Travis Laster, *supra* note 22.

¹¹² See, e.g., *In re The Topps Co. S'holder Litig.*, No. 600715/07, 2007 WL 5018882, *7 (N.Y. Sup. Ct. 2007) (refusing to defer to contemporaneously-filed litigation in Delaware).

¹¹³ *Id.* at 3 (noting approvingly fact that plaintiff in New York court had filed his claim in extremely rapid fashion thus indicating his zeal to litigate matter).

To the extent acquisition-related litigation in foreign jurisdictions represents a tax on transactions, excessive litigation can be a deadweight loss to society. Transaction-related litigation that does not result in higher prices being paid to shareholders but does result in the payment of attorneys' fees and some nominal disclosures may simply represent litigation agency costs.¹¹⁴ The settlement costs of transaction-related litigation are directly and indirectly borne by shareholders of the selling firm. Therefore, shareholders have an incentive to reduce the amount of litigation while still subjecting important corporate transactions to some degree of judicial review.¹¹⁵ By limiting litigation to a single forum, firms and shareholders can still subject themselves to review, but in the case of Delaware, also benefit from the court's interest in policing litigation agency costs.

Limiting plaintiffs' access to foreign courts is, in the short-term, in the best interests of policymakers who are interested in protecting Delaware's dominant position with respect to corporate law. Widespread adoption of exclusive forum provisions in corporate charters would assure that Delaware maintains an adequate "flow" of cases to its courts.¹¹⁶ A constant flow of cases assures Delaware of control over the maintenance and development of its corporate law and thus its dominant position as a national standard for the corporate law. However, such a move does not come without potential consequences over the long-term.¹¹⁷

A. Enforceability

Although limiting access to foreign forums may be an attractive proposition to shareholders and firms, enforceability of exclusive forum provisions is controversial.¹¹⁸ Since the early the 1970s in *Bremen v. Zapata Off-Shore Co.*, U.S. courts have adopted a deferential attitude toward exclusive forum provisions included in contracts.¹¹⁹

¹¹⁴ Thompson & Thomas, *supra* note 2, at 135 (describing litigation agency costs). For an example of litigation agency costs as they relate to disclosure-only litigation, see *In re Sauer-Danfoss S'holders Litig.*, No. 5162-VCL, 2011 Del. Ch. LEXIS 64, at *2-4 (Del. Ch. Apr. 29, 2011).

¹¹⁵ Of course, the collective action problems inhibit shareholders from monitoring plaintiff counsel directly. See, e.g., Macey & Miller, *supra* note 51 (discussing collective action problem that inhibits shareholder monitoring of plaintiff counsel).

¹¹⁶ See Armour et al., *Delaware's Balancing Act*, *supra* note 1, at 44 (noting importance of "flow" of cases to maintain and develop corporate common law).

¹¹⁷ For discussion of potential risks, see *infra* Part V.

¹¹⁸ See sources cited *supra* note 12.

¹¹⁹ This deference even includes when such provisions are included in the "fine

Nevertheless, the question of whether courts will accept application of the exclusive forum provision in the corporate setting is still unresolved. Based on the reasoning in *Galaviz v. Berg* as well as past practice with respect to the enforcement of forum provisions, it is likely that an exclusive forum provision in a certificate of incorporation, or adopted as an amendment to a certificate of incorporation, is enforceable.¹²⁰

In *Bremen*, the U.S. Supreme Court endorsed the presumptive validity of forum selection clauses.¹²¹ In order to overcome the presumption of enforceability, the objecting party must first establish: “(i) it is a result of fraud or overreaching; (ii) enforcement would violate a strong public policy of the forum; or (iii) enforcement would, in the particular circumstances of the case, result in litigation in a jurisdiction so seriously inconvenient as to be unreasonable.”¹²² Since *Bremen*, contracting parties and courts are comfortable relying on exclusive forum provisions in contracts.¹²³ State courts are also generally willing to enforce choice of forum provisions in the context of contractual disputes.¹²⁴

print” in a take-it-or-leave contract. See *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9-10 (1972) (overturning traditional “ouster doctrine” in favor of deference to contractual choices with respect to location of appropriate forum).

¹²⁰ See *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1172-75 (N.D. Cal. 2011) (analyzing charter provision or amendment to charter approved by majority of shareholders differently from unilaterally adopted bylaw).

¹²¹ See *Bremen*, 407 U.S. at 8; see also *Stewart Org., v. Ricoh Corp.*, 487 U.S. 22, 33 (1988) (“Though state policies should be weighed in the balance, the authority and prerogative of the federal courts to determine the issue, as Congress has directed by § 1404(a), should be exercised so that a valid forum-selection clause is given controlling weight in all but the most exceptional cases.”).

¹²² See *Hadley v. Shaffer*, No. Civ.A. 99-144-JJF, 2003 WL 21960406, at *4 (D. Del. 2003); see also *Aveta, Inc. v. Colon*, 942 A.2d 603, 607 n.7 (Del. Ch. 2008) (citing *HealthTrio, Inc. v. Margules*, No. 06C-04-196, 2007 WL 544156, at *3 (Del. Super. Ct. 2007)).

¹²³ This is also true where parties are entering into contracts involving corporate acquisitions. Matthew D. Cain & Steven M. Davidoff, *Delaware’s Competitive Reach*, 9 J. EMPIRICAL LEGAL STUD. (forthcoming 2012) (manuscript at 4), available at <http://ssrn.com/abstract=1431625> (finding that during period of 2004–2008, more than 60% of merger agreements in sample selected Delaware as exclusive forum for disputes related to agreement); see also Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choice of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1978, 1988 (2006) (analyzing data from 2002 suggesting flight from Delaware choice of law and forum in merger agreements).

¹²⁴ *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 589 (1991) (acknowledging that although not historically favored, forum selection clause post-*Bremen* are prima facie valid).

Following *Bremen*, Delaware, Texas, New York, and California have all accepted the presumption of enforceability for forum provisions in contracts with limited restrictions.¹²⁵ In Delaware, forum selection clauses are “presumptively valid and have been regularly enforced.”¹²⁶ Texas also looks favorably on forum selection clauses in contracts and generally gives them “full effect . . . absent a strong showing that [they] should be set aside.”¹²⁷ For their part, New York courts have found forum selection provisions to be “*prima facie* valid.”¹²⁸ New York courts are inclined to enforce choice of forum provisions agreed to by parties in contract even when such an election works to the detriment of citizens of New York.¹²⁹ Finally, California courts

¹²⁵ See *infra* notes 130-35 and accompanying text.

¹²⁶ *Capital Grp. Cos. v. Armour*, No. Civ.A 422-N, 2004 WL 2521295, at *6 (Del. Ch. Nov. 3, 2004); see also *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 961 n.8 (Del. Ch. 2010) (noting in dicta the likelihood that Delaware courts would enforce forum selection provisions in corporate charters); *Green Isle Partners, Ltd. v. Ritz-Carlton Hotel Co.*, No. 18416, 2000 WL 1788655, at *2 (Del. Ch. 2000). *But see Aveta, Inc. v. Colon*, 942 A. 2d 603, 607-11 (Del. Ch. 2008) (ruling that despite contract with Delaware forum selection, the forum was inconvenient for both the court as well as the plaintiff because the plaintiff had no contacts with Delaware, the issue was based on Puerto Rican law, and the plaintiff spoke no English and did not understand what he was signing).

¹²⁷ *In re AIU Ins. Co.*, 148 S.W.3d 109, 117 (Tex. 2004) (“[s]ubjecting a party to trial in a forum other than that agreed upon and requiring an appeal to vindicate the rights granted in a forum-selection clause is clear harassment” that injures not just the non-breaching party, but the broader judicial system, injecting inefficiency by enabling forum shopping, wasting judicial resources, delaying adjudication on the merits, and skewing settlement dynamics contrary to the parties’ contracted-for expectations. Accordingly, forum selection clauses — like arbitration agreements — can be enforced through mandamus); see also *In re AutoNation, Inc.*, 228 S.W.3d 663, 668 (Tex. 2007) (enforcing Florida forum selection clause “unless the opposing party clearly shows that enforcement would be unreasonable or unjust, or that the clause is invalid for reasons such as fraud or overreaching”).

¹²⁸ *British W. Indies Guar. Trust Co., v. Banque Internationale A Luxembourg*, 172 A.D.2d 234, 234 (N.Y. App. Div. 1991) (“It is well-accepted policy that forum selection clauses are *prima facie* valid. In order to set aside such a clause, a party must show that enforcement would be unreasonable and unjust or that the clause is invalid because of fraud or overreaching, such that a trial in the contractual forum would be so gravely difficult and inconvenient that the challenging party would, for all practical purposes, be deprived of his or her day in court.”).

¹²⁹ See *Boss v. Am. Express Fin.*, 844 N.E.2d 1142, 1144 (2006) (“We express no opinion on the merits of plaintiffs’ argument. It could and should have been made to a court in Minnesota — the forum the parties chose by contract. If New York’s interest in applying its own law to this transaction is as powerful as plaintiffs contend, we cannot assume that Minnesota courts would ignore it, any more than we would ignore the interests or policies of the State of Minnesota where they were implicated. In short, objections to a choice of law clause are not a warrant for failure to enforce a choice of forum clause.”).

presumptively enforce forum selection clauses unless the plaintiff seeking to defeat such a clause can show that enforcement of the clause would be unreasonable or might deprive the litigants of substantive rights already available to them under California law.¹³⁰ While forum selection provisions are presumptively valid in contract before state and federal courts throughout the United States, this presumption is generally subject to reasonable limitations.¹³¹

Although the presumptive validity of forum selection clauses in contracts is well established, the validity of exclusive forum provisions in certificates of incorporation is still relatively uncertain. If courts accept the construct of the corporate charter as a contract, then there is reason to believe that they will regularly enforce such provisions. The legal academy has long analyzed the corporate charter as a voluntary contract among the corporation, managers, and shareholders.¹³² Courts have — for longer than the academy — recognized the essential contractual nature of the corporate charter.¹³³ Delaware and other states also view shareholder rights delineated in a corporate charter as contractual in nature.¹³⁴ For example, in *Air*

¹³⁰ See *Lu v. Dryclean-U.S.A. of Cal., Inc.*, 14 Cal. Rptr. 2d 906, 907-08 (Ct. App. 1992) (“Given the importance of forum selection clauses, both the United States Supreme Court and the California Supreme Court have placed a heavy burden on a plaintiff seeking to defeat such a clause, requiring it to demonstrate that enforcement of the clause would be unreasonable under the circumstances of the case.”); see also *Nedlloyd Lines B.V. v. Superior Court*, 834 P.2d 1148, 1152 (Cal. 1992) (holding that an arm’s length choice-of-law provision between commercial entities will not be enforced if it violates a fundamental California public policy and California has materially greater interests than the chosen state); *Miller-Leigh LLC v. Henson*, 62 Cal. Rptr. 3d 83, 86-87 (Ct. App. 2007) (same). *But see* *Am. Online, Inc. v. Superior Court*, 108 Cal. Rptr. 2d 699, 708 (Ct. App. 2001) (“California courts will refuse to defer to the selected forum if to do so would substantially diminish the rights of California residents in a way that violates our state’s public policy.” The California Supreme Court refused to enforce a forum selection clause that would have sent class action litigation to Virginia, a state that does not recognize the validity of class actions with respect to consumer protection).

¹³¹ See sources cited *supra* note 121.

¹³² See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) (applying contract metaphor to corporate charter).

¹³³ *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. 518, 592 (1819) (“The charter . . . is a contract within in the meaning of that clause of the constitution of the United States.”); see also *Piqua Branch of State Bank of Ohio v. Knoop*, 57 U.S. 369, 382 (1854) (taking it as “well settled” that charter of private corporation is in nature of contract between State and corporation); *Korzen v. Local Union 705*, 75 F.3d 285, 288 (7th Cir. 1996) (noting that the corporate charter is a contract and that breach of the charter is a “straightforward claim for breach of contract under state common law”).

¹³⁴ See, e.g., *Ellingwood v. Wolf’s Head Oil Ref. Co.*, 38 A.2d 743, 747 (Del. Ch. 1944) (finding that shareholder rights are contract rights); *Morris v. Am. Pub. Util.*

Products and Chemicals Inc. v. Airgas, Inc., Chancellor Chandler noted that “[c]orporate charters . . . are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply.”¹³⁵ Therefore, courts will likely approach analysis of an exclusive forum provision in a corporate charter in the same way they apply forum provisions in contracts — subject to the same constraints.¹³⁶

A recent case tested the enforceability of exclusive forum provisions in corporate bylaws.¹³⁷ In *Galaviz v. Berg*, the plaintiff brought a derivative claim against the board members of Oracle Corporation in a California federal court.¹³⁸ The complaint alleged that the board violated its fiduciary duties to the corporation and its shareholders when it permitted the company to overbill the government, resulting in harm to the corporation.¹³⁹ The board moved to dismiss in order for the claim to be heard in Delaware. The basis for this motion was a corporate bylaw adopted unilaterally by the board that purported to limit the forum for bringing any derivative claims on behalf of the corporation to the Chancery Court in Delaware.¹⁴⁰ The plaintiffs argued that enforcement of the bylaw discouraged the pursuit of derivative claims and deprived the plaintiffs of the substantial protections of California law. The *Galaviz* court found that the plaintiffs failed to demonstrate that moving the case to Delaware would deny them of any substantial justice, but nevertheless denied the defendant’s motion to dismiss.¹⁴¹ According to the court, the forum bylaw failed an essential test of contract — the lack of assent.¹⁴²

Co., 122 A. 696 (Del. Ch.1923) (noting that corporate charter is contract); *Casumpang v. ILWU, Local 142*, 13 P.3d 1235 (Haw. 2000) (holding that corporate charter is contract); *Sutter v. Sutter Ranching Corp.*, 14 P.3d 58, 64 n.25 (Okla. 2000) (holding that corporate charter is contract); *Nat. Bd. of Exam. v. Am. Osteopathic Ass’n*, 645 N.E.2d 608, 617 (Ind. 1994) (noting contractual relationship between stockholders and corporation in non-profit corporation); *AP Smith Mfg. Co. v. Barlow*, 98 A.2d 581, 588 (N.J. 1953) (noting contractual relationship between stockholders and corporation, and between stockholders *inter se*).

¹³⁵ See also *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (citing *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990)).

¹³⁶ Lewis conducts an extensive review of the literature and concludes that California courts would determine in most circumstances that exclusive forum provisions in corporate charters are enforceable. See Lewis, *supra* note 1, at 199-200.

¹³⁷ *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1174 (N.D. Cal. 2011).

¹³⁸ *Id.* at 1171.

¹³⁹ *Galaviz* is not a typical acquisition-related lawsuit. *Id.* at 1171-72.

¹⁴⁰ *Id.* at 1171.

¹⁴¹ *Id.* at 1173-75.

¹⁴² *Id.* at 1174.

Because the board unilaterally adopted the bylaw after the alleged bad act, the bylaw lacked sufficient assent to form a contract.¹⁴³ Had the forum provision been adopted by the shareholders as a bylaw or included in the corporate charter before the violation, the court would have reached a different conclusion.¹⁴⁴

Of course, the typical contract claim implicating an exclusive forum provision differs from shareholder lawsuits in important ways. In the typical contract case, the plaintiff seeking to vindicate its rights is a citizen of the state where the case is brought, and the court has personal jurisdiction over the defendant. In such cases, the court will have a strong policy interest in assuring that the citizen-plaintiff who brought the suit is able to vindicate her rights. Notwithstanding the strong policy interest in protecting the rights of their own citizens, courts regularly defer to choice of forum provisions in contract disputes and order stays or dismissals in favor of foreign proceedings.¹⁴⁵ In shareholder lawsuits, however, the plaintiff is not necessarily a citizen of the state in which the suit is brought.¹⁴⁶ Shareholders are often widely dispersed throughout the economy; the class as a whole often “has no cognizable interest in having a court of another state adjudicate a claim involving” the corporate law of the state of incorporation.¹⁴⁷ When claims are filed in both the state of incorporation and a second state, there may be little policy justification, other than the fact that the case in the foreign jurisdiction is first-filed (sometimes by only hours), to justify why it should not be stayed in favor of claims filed by other shareholder plaintiffs in the state of incorporation. A first-filing in a foreign jurisdiction does not carry with it a logical presumption that litigation in state of incorporation is inconvenient for the shareholder class or

¹⁴³ The Oracle bylaw states: “9.07 Derivative Action: The sole and exclusive forum for any actual or purported derivative action brought on behalf of the Corporation shall be the Court of Chancery in the State of Delaware.” Oracle Corp., Amended and Restated Bylaws 9 (July 26, 2006) available at <http://www.oracle.com/us/corporate/investor-relations/bylaws-176730.pdf>.

¹⁴⁴ *Galaviz*, 763 F. Supp. 2d at 1174 (N.D. Cal. 2011) (noting that corporate bylaw unilaterally adopted by the board lacks necessary shareholder consent).

¹⁴⁵ New York will enforce forum and choice of law provisions even if it results in fewer legal protections for the citizen plaintiffs. California, on the other hand, will refuse to give selection and choice of law provisions force if the result is a diminution of substantive legal rights available to California plaintiffs under California law.

¹⁴⁶ In *Topps*, the shareholder plaintiff was an Ohio resident who brought the claim against a Delaware corporation in the New York courts. *Topps Co.* was headquartered in New York. See *In re The Topps Co. S'holders Litig.*, 924 A.2d 951, 961 (Del. Ch. 2007).

¹⁴⁷ *Id.* at 961.

the corporation (in the case of a derivative suit), though it might be for the purported class representative.¹⁴⁸ These differences favor enforcement by foreign courts of the exclusive forum provision in shareholder lawsuits.

It is not necessary for courts to uniformly enforce such provisions for them to be valuable to firms. Adoption of exclusive forum provisions in certificates of incorporation may be a useful avenue for reducing the incentive for plaintiff counsel to engage in forum shopping. To the extent exclusive forum provisions reduce those incentives, forum selection provisions may be valuable additions from the point of view of shareholders as well as Delaware policymakers.

B. Paucity of Adoptions

Firms are reluctant to adopt exclusive forum provisions in corporate charters despite the obvious utility. The enabling character of corporate law makes it possible for firms to tailor the content of their corporate charters in many ways, including the inclusion of a forum selection provision.¹⁴⁹ Nevertheless, few firms have done so. Of the 430 Delaware firms filing for initial public offerings (“IPOs”) during 2010, only twenty-one (4.9%) included an exclusive forum provision in their corporate charters.¹⁵⁰ During 2010, a number of high profile Delaware firms went public, including Toys “R” Us, Inc., General Motors Company, and Tesla Motors, Inc.¹⁵¹ None of these firms included an exclusive forum provision in their corporate charters

¹⁴⁸ A shareholder class representative who argues that litigation in the state of incorporation is inconvenient may not be capable of providing adequate representation for the class.

¹⁴⁹ Delaware Code title 8, section 102(b)(1) permits for the inclusion of:

(1) Any 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, or any class of the stockholders, or the governing body, members, or any class or group of members of a nonstock corporation; if such provisions are not contrary to the laws of [Delaware].

¹⁵⁰ See Appendix B. Grundfest identifies 39 exclusive forum provisions in corporate charters and bylaws. For reasons raised in *Galaviz*, I do not investigate the adoption of exclusive forum bylaws. See Grundfest, *supra* note 1, at 9. SEC filings analyzed include that of Howard Hughes Corp., a spin off from General Properties. If one counts those two offerings as a single offering, then the number of firms electing to include exclusive forum provisions drops to 20 of 4294, or 4.7%.

¹⁵¹ General Motors Co., Prospectus (Form S-1) (August 18, 2010); Tesla Motors, Inc., Prospectus (Form S-1) (May 25, 2010); Toys “R” Us, Inc., Prospectus (Form S-1) (May 28, 2010).

upon an IPO.¹⁵² Given that firms have always possessed the ability to include such a provision in their charters but have nonetheless neglected to do so, the paucity of adoptions suggests that there may be some market failure inhibiting widespread adoption of such a value-enhancing amendment.

Figure 1: IPO Market and Exclusive Forum Provisions

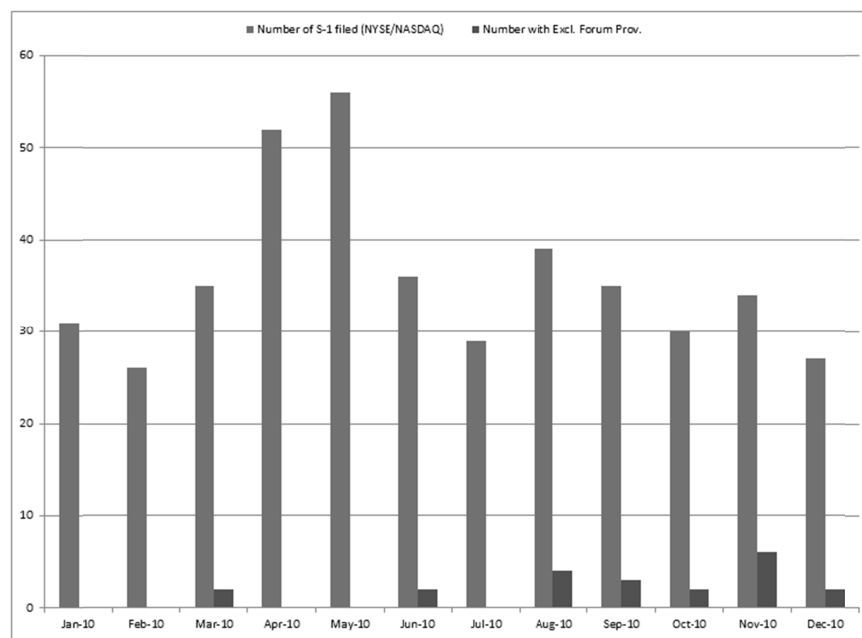


Figure 1 above shows IPO filings in 2010 as well as the number of IPOs where firms have included exclusive forum provisions in their corporate charters. The data reflects the low rate of adoption of exclusive forum provisions in conjunction with IPOs. To the extent there were adoptions during 2010, they appear to be correlated with two stimuli. First, the issuance of a Delaware Chancery Court opinion in March 2010 that raised the possibility of firms adopting forum provisions in their charters as a method for reducing incentives for plaintiffs' counsel to engage in forum shopping.¹⁵³ Second, a number

¹⁵² See sources cited *supra* note 151.

¹⁵³ The opinion in *In re Revlon* was issued on March 16, 2010, two weeks before Primerica, Inc.'s initial public offering. See *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 940 (Del. Ch. 2010).

of firms, including Oracle, appear to have taken a cue in adopting forum provisions in charters and corporate bylaws from Professor Grundfest, who began discussing this issue and promoting the exclusive forum provision in the second half of 2010.¹⁵⁴ Both of these stimuli are important contributors to a potential information cascade that may effect the willingness of managers and shareholders to adopt an exclusive forum provision.¹⁵⁵ Notwithstanding the recent attention made possible by the Delaware court decision and the works of important corporate governance scholars, the failure of firms to more widely adopt a value enhancing amendment is confusing.

IV. BEHAVIORAL ECONOMICS AND INSIGHTS TO THE ADOPTION PROBLEM

The hesitancy of firms to adopt the exclusive forum provision in spite of its obvious utility presents a puzzle. The reluctance of firms to adopt value-enhancing exclusive form provisions at an IPO suggests there may be market failures. Those market failures can, at least in part, be explained by the work of behavioral economics. Behavioral economics also suggests a number of potential prescriptions for overcoming status quo bias including both default rules and opt-in menus. Although parties are permitted to negotiate around default terms, opt-out default rules are often adopted as “quasi-immutable” standard terms.¹⁵⁶ Menus (“opt-in” rules) can play a similar role in the establishment of standard terms while avoiding some of the status quo bias that accompanies either the absence or presence of a default rule.

¹⁵⁴ Professor Grundfest has called the firms associated with his advice to adopt forum provisions the “Grundfest cluster.” See Grundfest, *supra* note 1, at 3. Professor Grundfest was a director of Oracle as well as Financial Engines; both firms have adopted a version of the exclusive forum provision. See Grundfest, *supra* note 1, at 3; see also Steven Davidoff, *A Litigation Plan that Would Favor Delaware*, *Dealbook*, N.Y. TIMES (Oct. 26, 2010, 9:30 AM), <http://dealbook.nytimes.com/2010/10/26/a-litigation-plan-that-would-favor-delaware/> (describing Professor Grundfest’s proposal that firms adopt exclusive forum provisions). In promoting adoption of the exclusive forum provision, Prof. Grundfest is acting as a standards entrepreneur, or “informational cascade facilitator.” See Robert J. Shiller, *Conversation, Information, and Herd Behavior*, 85 AM. ECON. REV. 181, 185 (1995).

¹⁵⁵ An information cascade occurs “when [it becomes] optimal for an individual, having observed the actions of those ahead of him, to follow the behavior of the preceding individual without regard to his own information.” Sushil Bikchandani, David Hirschleiferet & Ivo Welch, *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. POL. ECON. 992, 994 (1992).

¹⁵⁶ Professor Korobkin coined term “quasi-immutable” with respect to default terms in contracts. Russell B. Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 665 (1997) [hereinafter *Status Quo Bias*].

While menus do not encourage highly idiosyncratic customization of charter terms, they do encourage parties to consider and engage in some degree of customization of charter terms. How a decision is framed affects the outcome; in the words of Professor Ian Ayres, “menus matter”.¹⁵⁷ A new section 102(b)(8) menu of the Delaware Code may help overcome status quo bias in contracting and facilitate the widespread adoption of this value-enhancing charter provision.

The dominant framework for understanding corporate law is the efficient market model that envisions corporations as contractual in nature.¹⁵⁸ This framework makes a number of assumptions about human behavior — perfect information, rational preferences that can be valued, and self-interestedness — that provide an elegant framework for analyzing human behavior with respect to contracting.¹⁵⁹ In *Problem of Social Cost*, Ronald Coase posited that when the assumptions of the efficient market model hold, the initial distribution of entitlements should not matter as parties will eventually bargain to reach an efficient outcome or one market actor’s preference is maximized.¹⁶⁰ This contractarian model endorses an approach to corporate law that assumes shareholders will bargain for the most efficient arrangement of rules governing the allocation and use of capital in the firm.¹⁶¹

The contractarian model often turns out to be a poor predictor of the behavior of real people who tend to stray from the model’s assumptions. Cognitive psychologists observe predictable patterns of departure in controlled experiments.¹⁶² Real people differ from our assumptions in the market model in a number of key respects. First, people are said to be “boundedly rational.”¹⁶³ This refers to fact that

¹⁵⁷ Professor Ayres notes that “[m]erely by changing the default, lawmakers — courts and legislators — can affect the equilibrium.” See Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 4 (2006).

¹⁵⁸ Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976) (observing that the firm is a legal fiction that serves as a nexus of contractual relationships).

¹⁵⁹ Professor Thaler has given the man of the efficient market the moniker “homo economicus”. See RICHARD THALER, *THE WINNER’S CURSE* 34 (1992).

¹⁶⁰ See Ronald Coase, *The Problem of Social Cost*, 3 J.L. ECON. & ORG. 1, 2-4 (1960).

¹⁶¹ See generally Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) (arguing that shareholders will bargain for the most efficient set of corporate rules).

¹⁶² For a representative sample of experimental results from cognitive psychology, see JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 23-84 (Daniel Kahneman et al. eds., 1982) [hereinafter JUDGMENT UNDER CERTAINTY].

¹⁶³ See Herbert A. Simon, *Bounded Rationality*, in UTILITY AND PROBABILITY 15 (John

people have a limited capacity to absorb and process information,¹⁶⁴ consequently, real people will often rely on “rules of thumb” or heuristics to assist in their decision-making processes.¹⁶⁵ Second, real people have limited willpower and depart from their long-term self-interests.¹⁶⁶ Dieters and smokers can attest that real people’s rational preferences are not stable, but change with time and circumstances.¹⁶⁷ Finally, real people regularly demonstrate characteristics of altruism and fairness.¹⁶⁸ The results of these limitations are regular deviations from results predicted by the efficient market model.¹⁶⁹ Together, these deviations in human behavior from the model can help us understand why, despite the apparent efficiency enhancing aspects of exclusive forum provisions, firms have not adopted such provisions. In particular, endowments, a concept derived from behavioral economics, appear to matter. Where one starts often dictates the final result. Consequently, how decisions are framed, including the decision whether to include an exclusive forum provision in a corporate charter, can affect the outcome.

In their well-known experiment illustrating the “endowment effect,” Professors Kahneman, Knetch, and Thaler observed how individuals demand much more to give up an object than they are willing to pay for it.¹⁷⁰ The professors randomly distributed mugs (valued at approximately \$6) to students in a classroom. They designated students with mugs as sellers and students without mugs as buyers.

Eatwell et al. eds., 1990); see also Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449, 1449 (2003).

¹⁶⁴ Simon, *supra* note 163 (taking into account cognitive limitations of decision-makers).

¹⁶⁵ Daniel Kahneman & Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases*, in *JUDGMENT UNDER UNCERTAINTY*, *supra* note 162, at 3-4.

¹⁶⁶ Christine Jolls, Cass R. Sunstein & Richard H. Thaler, *A Behavioral Approach to Law and Economics*, in *BEHAVIORAL LAW & ECONOMICS* 13, 14-16 (Cass R. Sunstein ed., 2000).

¹⁶⁷ *Id.* at 15.

¹⁶⁸ *Id.*

¹⁶⁹ These deviations have been recognized by other observers. For example, Professor Greenfield recognized the significant deviations that actual corporate contracting takes from the efficient contractarian ideal resulting corporate contracts that fail to reflect the true preferences of the parties. See Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 UC DAVIS L. REV. 581, 584-86. (2001).

¹⁷⁰ See Daniel Kahneman, Jack L. Knetsch, and Richard H. Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, in *CHOICES, VALUES, AND FRAMES* 160-163 (Daniel Kahneman & Amos Tversky eds., 2000). Thaler coined the term “endowment effect.” See Richard H. Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39, 44 (1980).

Although the market model predicts that through a series of market transactions the mugs should end up in the hands of those who value them the most, this was not the observed outcome.¹⁷¹ Students who randomly received the mugs systematically demanded more than buyers were willing to pay for them, preventing the expected trades from occurring;¹⁷² participants immediately changed their valuations of the mug once they added it to their own “endowment”.¹⁷³ This well-known experiment demonstrates that human preferences are not stable.¹⁷⁴ The observed change in valuation preferences is a manifestation of loss aversion: the disutility of giving something up once it has been added to one’s endowment is greater than the utility of acquiring it.¹⁷⁵ Once parties add an object to their endowment, “[T]he disadvantages of a change [in the status quo] loom larger than its advantages.”¹⁷⁶ This asymmetry with respect to the value of losses leads to reinforcement of the status quo, or a “status quo bias.”¹⁷⁷

Endowments are observable not only in objects; people demonstrate similar endowments across a range of scenarios, including in the context of contracting.¹⁷⁸ Although one logically does not expect to see people demonstrate similar entitlements towards contractual terms during negotiations, they do. In the process of negotiating contract terms, one might expect parties to negotiate to optimal results notwithstanding the presence of a default rule or standard form provision in a contract. Korobkin conducted experiments to test whether the presence of a standard form provision in a contract resulted in any evidence of an endowment effect with respect to those terms.¹⁷⁹ He found that they did.¹⁸⁰

¹⁷¹ See JUDGMENT UNDER UNCERTAINTY, *supra* note 162, at 1330-33.

¹⁷² See *id.*; see also Kahneman et al., *supra* note 15, at 197-98.

¹⁷³ See sources cited *supra* note 172.

¹⁷⁴ See Daniel Kahneman & Amos Tversky, *Loss Aversion in Riskless Choice*, in CHOICES, VALUES, AND FRAMES 143, 145 (Daniel Kahneman & Amos Tversky eds., 2000).

¹⁷⁵ See JUDGMENT UNDER UNCERTAINTY, *supra* note 162, at 1326. These results are robust and have been confirmed by multiple experimental studies.

¹⁷⁶ Kahneman et al., *supra* note 15, at 200.

¹⁷⁷ *Id.*

¹⁷⁸ See Russell B. Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227, 1271 (2003); Russell B. Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1586 (1998) [hereinafter *Psychological Power*]; Korobkin, *Status Quo Bias*, *supra* note 156, at 656.

¹⁷⁹ See Korobkin, *Endowment Effect and Legal Analysis*, *supra* note 178, at 1274; Korobkin, *Psychological Power*, *supra* note 178, at 1605; Korobkin, *Status Quo Bias*, *supra* note 156, at 633-37.

In his experiments, Korobkin asked participants to play the role of attorneys representing a fictitious overnight carrier in a contract negotiation. Participants were given a variety of scenarios along with default terms that would govern in the absence of explicit contracting.¹⁸¹ Subjects were then asked to express their preference for contract terms that deviated from the stated default term.¹⁸² If the negotiating parties did not demonstrate an endowment effect with respect to default rules in contract negotiations, one would expect parties to regularly depart from the default term approximately fifty percent of the time and not show a significant preference for what was essentially a randomly determined default rule.¹⁸³ In fact, the subjects demonstrated a preference for the default term governing the parties' relationship more than seventy-five percent of the time.¹⁸⁴ When told that particular terms were default terms, parties tended not to depart from the default rule, irrespective of the content of those defaults.¹⁸⁵ Korobkin identified this bias towards default rules as a manifestation of the endowment effect.¹⁸⁶

When parties are faced with a choice to either accept a default rule or negotiate around the existing default rule, parties generally accept the default as a means to minimize costs regardless of the rule's substance.¹⁸⁷ A recent study of opt-in default rules by Professor Listokin examined opt-in provisions in corporate charters and found evidence of status quo bias with respect to the exclusion and inclusion of fair price provisions (state antitakeover provisions).¹⁸⁸ Parties are not likely to negotiate fair price provisions on their own. Listokin found that when the default rule is silent with respect to the inclusion

¹⁸⁰ See Korobkin, *Endowment Effect and Legal Analysis*, *supra* note 178, at 1274; Korobkin, *Psychological Power*, *supra* note 178, at 1605; Korobkin, *Status Quo Bias*, *supra* note 156, at 640.

¹⁸¹ Korobkin, *Status Quo Bias*, *supra* note 156, at 631-35.

¹⁸² Subjects were asked to express these preferences in terms of their maximum willingness to pay to deviate from the contract default as well as their minimum willingness to accept in order to convince them to deviate from the contract default. *See id.* at 636.

¹⁸³ *Id.* at 631-35.

¹⁸⁴ Different groups were assigned to different default rules, thus ensuring that during negotiations the content of the default rule the overall results. *See id.* at 644.

¹⁸⁵ *See id.* at 631.

¹⁸⁶ *See id.* at 631 (noting the illusory nature of endowment effect in contract negotiations).

¹⁸⁷ See Richard Thaler, *Towards a Positive Theory of Consumer Choice*, in CHOICES, VALUES, AND FRAMES, *supra* note 170, at 280-81.

¹⁸⁸ Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination*, 6 J. EMPIRICAL LEGAL STUD. 279, 284 (2009).

of fair price provisions only twenty percent of firms include them in their corporate charters at IPOs.¹⁸⁹ On the other hand, where fair price provisions are the default rule and parties are required to opt-out of them, ninety-eight percent of firms include them in their corporate charters at IPOs.¹⁹⁰ Finally, where fair price provisions are available in the forum of an opt-in menu, fifty-six percent of firms elect to include them.¹⁹¹ The presence or absence of a default rule in the corporate code appears to result in an endowment effect influencing negotiations over the content of corporate charters.¹⁹²

Professors Kahan and Klausner observed a similar pattern in the content of corporate charters.¹⁹³ Kahan and Klausner noted that adherence to standard form terms in corporate charters resulted in a high degree of uniformity and herd behavior with respect to the content of corporate charters.¹⁹⁴ Although parties are free to tailor their corporate contracts, they regularly opt not to and instead adopt “plain vanilla” charters that rely heavily on default rules.¹⁹⁵ Kahan and Klausner attribute the high degree of uniformity to the network benefits of standardization of corporate terms.¹⁹⁶ However, it is equally likely that status quo bias plays an important role in the process of selecting contractual terms.¹⁹⁷ Kahan and Klausner recognize that in the process of contracting, although “parties have no formal property (or other) rights in a standard term, the standard terms form an

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ See Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U. L.Q. 347, 361 (1996); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 822 (1995) [hereinafter *Corporations*].

¹⁹⁴ See Kahan & Klausner, *supra* note 193, at 361; Klausner, *supra* note 193, at 822.

¹⁹⁵ For an example of a typical corporate charter, see the corporate charter of eBay Inc. eBay Inc., Certificate of Incorporation, (Form S-1) (July 15, 1998).

¹⁹⁶ Kahan & Klausner note that the presence of network benefits can also inhibit innovation and generate contractual inertia that permits suboptimal terms to persist over time. See Kahan & Klausner, *supra* note 193, at 349, 361; see also Klausner, *Corporations*, *supra* note 193, at 790. Professors Kahan and Klausner found similar results when investigating corporate indentures. See Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 726 (1997).

¹⁹⁷ Klausner observes that “when network externalities are present, we cannot rely on the market to select optimal terms initially.” Klausner, *Corporations*, 193, at 808.

expectational baseline” akin to the endowment effect.¹⁹⁸ The result is a bias against innovation in corporate contracting.¹⁹⁹

One can observe status quo bias in still other areas of corporate law. Contractual inertia plays an important role in preserving Delaware’s dominant position with respect to incorporations. Prior to an IPO of stock, the vast majority of firms are incorporated in their home states.²⁰⁰ The IPO provides firms an opportunity to change the location of their incorporation. Professor Daines studied the incorporation choices of firms at the IPO stage and found that ninety-seven percent of firms elected to incorporate either in Delaware or in their home state.²⁰¹ Ninety-five percent of firms that elected to incorporate in a state other than their home state selected Delaware.²⁰² Rather than there being a vigorous competition amongst states for incorporations of firms at the IPO stage, what appears to happen is that at the IPO, firms will elect to reincorporate in Delaware, presumably following advice given by their counsel, or they will remain incorporated in their home state.²⁰³ Daines describes the competition for incorporations not as a nationwide market but as a series of “linked duopolies, or two-way run-offs between Delaware and other states.”²⁰⁴ Daines attributes this result to a “home state bias.”²⁰⁵ The most likely reason for this pattern of incorporations relates to selection of counsel and counsel’s inertia with respect to their contracting patterns.²⁰⁶ Daines suggests that firms hiring local counsel for their IPO will likely end up with local incorporations, while firms hiring national counsel will likely end up re-incorporating in Delaware.²⁰⁷

¹⁹⁸ See Kahan & Klausner, 193, at 361.

¹⁹⁹ See *id.* at 362.

²⁰⁰ Daines, *supra* note 78, at 1577 (2002).

²⁰¹ Daines studied a sample of over 6,000 IPOs between 1978–2000, constituting approximately 75% of all IPOs during that period. *Id.* at 1562, 1570.

²⁰² Nevada was the closest competitor to Delaware with respect to incorporations of out-of-state firms with only 34 of 3,400 during the 1990–97 period. *Id.* at 1575.

²⁰³ *Id.* at 1604.

²⁰⁴ *Id.* at 1601.

²⁰⁵ *Id.* at 1577.

²⁰⁶ *Id.* at 1581.

²⁰⁷ *Id.* In another example of how this “home “ bias plays out, one can consider legal tools made available to prospective clients, like California-based Wilson Sonsini’s online Term Sheet Generator. See *WSGR Term Sheet Generator*, WILSON SONSINI GOODRICH & ROSATI, <http://www.wsgr.com/WSGR/Display.aspx?SectionName=practice/termsheet.htm> (last visited Sept. 28, 2011). The term sheet generator is an online tool intended to assist entrepreneurs as they raise capital for their start-up firms. The generator walks clients through a series of menus in order to guide the creation of a term sheet. One of the early questions asks the entrepreneur where she would like to

Although reliance on plain vanilla corporate charters with relatively little tailoring may simplify the process of charter formation, such charters do not guarantee firms will systematically adopt efficient terms. Status quo bias may be responsible for deterring efficient innovation. Take, for example, the incorporation decision to use an IPO law firm. Typically law firms assign the drafting of the corporate charter in the IPO to a junior attorney or paralegal working off a form charter. The American Bar Association (“ABA”) Model Forms and Commentary provides examples of form charters often used by IPO firms.²⁰⁸ The Delaware model charter offered by the ABA is a plain vanilla form with few proposed opportunities for tailoring.²⁰⁹ Junior legal professionals working from these forms face a high degree of asymmetry in payoffs between modifying the standard form for improved efficiency, but risking mistakes and keeping the standard form with its inefficiencies and ensuring no mistakes. If an ex post review finds that the innovations were costly to clients, the lawyer responsible may face severe professional consequences. On the other hand, the personal benefits of innovating are limited. As a result of this asymmetry, legal professionals drafting of IPO charters almost exclusively follow the standard form.

It is not just junior legal professionals who face an asymmetry in potential payoffs. A law firm that advises its clients to depart from the standard form faces potential liability and loss of future client business if the advice turns out to be imprudent or incorrect. The ex post standard against which the firm’s decisions to depart from the standard form is one of what a reasonable attorney in similar circumstances might recommend for a client and not necessarily what corporate charter term might be most efficient.²¹⁰ Although firms and attorneys may have incentives to innovate when it comes to critical “bet the company decisions”, such incentives are not as strong with respect to decisions that are less immediately critical to the

incorporate the business and three choices are given: Delaware, California, or Other. In providing these three choices, the lawyers make it more likely that firms will decide to accept either a Delaware or a home state — in this case California — incorporation rather than any other states. This is consistent with what Daines observed in his study.

²⁰⁸ AMERICAN BAR ASSOCIATION, PUBLIC COMPANY ORGANIZATIONAL DOCUMENTS: MODEL FORMS AND COMMENTARY 57-58 (2009).

²⁰⁹ *Id.*

²¹⁰ Korobkin, *Endowment Effect and Legal Analysis*, *supra* note 178, at 1279-80 (2003) (distinguishing his results from Arlen, et al.’s finding no endowment effect with respect to corporate agents); Korobkin, *Status Quo Bias*, *supra* note 156, at 631.

corporation, such as decisions where to incorporate and the content of the corporate charter.²¹¹

This payoff asymmetry is responsible for an endowment effect with respect to the content of form charters.²¹² Consequently, one can and should expect a high degree of status quo bias influencing the content of corporate charters and inhibiting efficient innovation. The contractarian approach to the content of incorporation decisions is thus illusory. Where status quo bias plays a role in deterring innovation and efficient contracting in corporate charters, there may be a valuable role for policymakers in promoting efficient innovation through a legislative approach.

Default rules and the framing of choices in the context of incorporation decisions matter.²¹³ Knowing that default rules can become “quasi-immutable” also raises the stakes on regulatory decisions by policymakers.²¹⁴ Policymakers must be aware that few incorporators will deviate from the default rules selected by the

²¹¹ Professor Davidoff argues that lawyers necessarily innovate policy in order to attract and keep clients. That is true with respect to certain activities involving strategic or bet-the-company decisions. However, it is less likely to be true with respect to more mundane legal tasks, like incorporations. See Steven M. Davidoff, *The Failure of Private Equity*, 83 S. CAL. L. REV. 481, 533 (2009) (noting the shift in choice of law and choice of forum provisions in private equity buyout agreements); Korobkin, *Status Quo Bias*, *supra* note 156, at 631; Korobkin, *The Endowment Effect and Legal Analysis*, *supra* note 178, at 1279-80 (distinguishing his results from Arlen, et al.’s finding no endowment effect with respect to corporate agents). Kahan and Klausner note that “worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.” See Kahan & Klausner, *supra* note 193, at 355-56 (citing JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 158 (1936)). Carney, Shepherd, & Shepherd argue that Delaware dominates incorporations because lawyers are ignorant of other states’ laws and regardless of quality of foreign state innovations lawyers will not recommend foreign states for incorporation because they are unfamiliar with them. See William J. Carney George B. Shepherd, and Joanna Shepherd, *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, HARV. BUS. L. REV. (forthcoming 2011).

²¹² It may also be the case that lawyers face real litigation risks in the form of malpractice claims. In the event of litigation, the lawyers who may have innovated will face asymmetric payoffs in the form of legal sanction and/or loss of future client business. The existence of a negative uncertainty generates an incentive not to engage in innovation. See Korobkin, *Status Quo Bias*, *supra* note 178, at 657 (describing regret avoidance and its influence on status quo bias in contracting).

²¹³ Contextual-dependence has been widely observed in decision-making. See Amos Tversky & Itamar Simonson, *Context-Dependent Preferences*, 39 MGMT. SCI. 1179, 1179 (1993) [hereinafter *Context-Dependent*]; see also Itamar Simonson & Amos Tversky, *Choice in Context: Tradeoff Contrast and Extremeness Aversion*, 29 J. MARKETING RES. 281, 281 (1992) [hereinafter *Choice in Context*].

²¹⁴ See Korobkin, *Psychological Power*, *supra* note 178, at 1615-16.

legislature because incorporators tend to adopt “plain vanilla” charters with little tailoring. Consequently, the content of these plain vanilla charters will rely almost exclusively on the default terms of corporate law as determined by policymakers.

V. THE ROLE OF AN AMENDMENT IN OVERCOMING BEHAVIORAL CHALLENGES

In this Part, I recommend the adoption of a new section 102(b)(8) to the Delaware Corporate Code. Structured as a “menu,” this optional provision permits firms to include exclusive forum provisions in their corporate charters.²¹⁵ The proposed amendment is not a complete bar against bringing cases in foreign jurisdictions, but it is designed to deter wasteful suits while leaving the door open for the adjudication of valuable claims. First, the choice of forum provision creates a presumption that the state of incorporation is the proper forum for the adjudication of intracorporate disputes. Second, the proposed provision permits shareholders representing more than ten percent of the outstanding shares to waive the provision in favor of pursuing litigation in a foreign jurisdiction.²¹⁶ The structure of this proposed amendment is neither a mandatory nor a default provision. Rather, the proposed amendment is structured as an opt-in menu, and is thus a minimally intrusive option for improving private contracting of between shareholders and corporations. By relying on an opt-in menu provision, the proposed amendment facilitates the adoption of a new standard provision that helps drafters overcome status quo bias while still leaving parties with sufficient flexibility to make their own determinations about the proper forum for the adjudication of their intracorporate disputes.

A. *An Opt-in Menu Is More Appropriate Than a Default Rule in the Corporate Setting*

A mandatory rule may prove too much. At the core of modern corporate law is the understanding that the relationship between shareholders and the firm is inherently contractual.²¹⁷ This means that, to the extent possible, policymakers should refrain from imposing mandatory rules for all firms. When policymakers step in, they should

²¹⁵ See *infra* Appendix A (suggesting draft language of such a provision).

²¹⁶ *Id.*

²¹⁷ See Easterbrook and Fischel, *supra* note 14, at 1.

do so in a way that is minimally invasive.²¹⁸ A mandatory rule with respect to the forum for adjudication of intracorporate disputes is not necessary. Although a market failure is likely responsible for the lack of contractual innovation with respect to forum provisions in charters, this obstacle is not impassible. There is no reason to believe that parties will not be able to overcome these market failures on their own once market actors are able to resolve the cognitive biases presently hindering innovation.

Although default rules are not mandatory, if we believe that default rules tend to become quasi-immutable, then setting a default rule may not be consistent with our core value of permitting members of the firm to establish the boundaries of their own relationships.²¹⁹ When default rules become quasi-immutable, the results of contracting are far more susceptible to status quo bias and less likely to reflect the true preferences of the parties.²²⁰ The power of status quo bias in contracting is real. By merely changing the default rule, one can affect the equilibrium outcomes.²²¹ While parties may agree to particular terms — or plain vanilla charters — one cannot with confidence assert that these contracting results represent efficient outcomes. Although we may take care when establishing default rules to ensure they are efficient by effectively depriving shareholders of the ability to contract for alternate outcomes, the establishment of a default rule — even one that may be socially optimal — contravenes values central to corporate law.²²²

Opt-in menus may be useful in helping policymakers reach socially optimal outcomes while maintaining sufficient flexibility to facilitate individual tailoring. Professor Ayres correctly notes that “merely tell[ing] private parties that an alternative outcome is acceptable [through the use of menus] may have dramatic consequences.”²²³ More liberal use of menus in corporate law, may well have the effect of improving outcomes from an efficiency point of view. Delaware’s corporate code already provides for a number of opt-in menu provisions, such as classified boards and limited liability, and the

²¹⁸ See Ayres, *supra* note 157, at 4.

²¹⁹ See Korobkin, *Status Quo Bias*, *supra* note 178, at 610-11 (showing default rules to be quasi-immutable); Listokin, *supra* note 188, at 280 (demonstrating that default rules are sticky).

²²⁰ See Korobkin, *Status Quo Bias*, *supra* note 178, at 655.

²²¹ See Ayres, *supra* note 157, at 4 (noting that “[m]erely by changing the default, lawmakers — courts and legislators — can affect the equilibrium”).

²²² *Id.* at 5 (cautioning care in setting defaults).

²²³ *Id.* at 6.

legislature has taken actions to promote the adoption of other value increasing innovations through the use of opt-in menus.²²⁴ For example, in response to increasing desire by shareholders for flexibility with respect to shareholder voting provisions, the Delaware legislature adopted sections 141(b) and 216 of the Delaware Code.²²⁵ Taken together, these “majority voting provisions” make it possible for shareholders to voluntarily adopt value-enhancing voting regimes.²²⁶ The new sections do not require firms to adopt majority voting provisions or bylaws and are thus not mandatory. They do, however, provide an avenue to facilitate the voluntary adoption of such provisions, which a large number of firms did in the wake of the passage of the legislation.²²⁷

In the same way that opt-in menus facilitate the adoption of majority voting provisions, opt-in provisions can facilitate the adoption of forum selection provisions in corporate charters. The opt-in menu accomplishes this by framing the decisions available to incorporators. In the absence of a menu, incorporators must free-draft a provision; however, incorporators are influenced by the endowment effect.²²⁸ A menu that facilitates the adoption of a forum selection provision reduces endowment effects with respect to plain vanilla charters and encourages tailoring necessary for innovation.

Increased tailoring through the use of menus furthers two important goals: first, reinforcing the core value of private ordering in corporate contracting; and second, facilitating increased adoption of such provisions through tailoring improves social efficiency. As with selecting default rules, reliance on menus to facilitate decision-making and encourage innovation is inherently a value-driven exercise.²²⁹ Consequently, when legislatures decide on the content of menu

²²⁴ Title 8, section 102(a) of the Delaware Code lists the mandatory terms required in any corporate charter, while section 102(b) lists a menu of opt-in provisions that incorporators may include in a charter, but are not required to do so. *See also* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1292 (2010).

²²⁵ DEL. CODE ANN. tit. 8, §§ 141(b) 216 (1953).

²²⁶ *See id.*

²²⁷ According to RiskMetrics, more than 70% of the S&P 500 companies have implemented some version of majority voting provision. *See* Ted Allen, *Delaware Court Upholds Dismissal of Majority Voting Lawsuit*, RISKMETRICS GROUP BLOG (Aug. 19, 2010, 11:51 AM), <http://blog.riskmetrics.com/gov/2010/08/delaware-court-upholds-dismissal-of-majority-voting-lawsuit.html>.

²²⁸ *See* Litoskin, *supra* note 188, at 306.

²²⁹ *See* On Amir & Orly Lobel, *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy*, 108 COLUM. L. REV. 2098, 2100 (2008).

options, they should take a careful approach to deciding the content of default rules.²³⁰

B. Risks Associated with the Legislative Option

There are reasonable objections, as well as potential risks, associated with pursuing a legislative option to resolving the out-of-Delaware trend. First and foremost is the objection that because the law already permits shareholders and firms to contract for an exclusive forum in the state of incorporation, adding a menu option to the corporate code is unnecessary. There is reason to suspect that status quo bias is responsible for the lack of innovation with respect to corporate charters and the forum provision. Although it is possible that incorporators will adopt the forum provision as a standard term over time, it is by no means certain that the market can overcome market failures without modest interventions. Even if firms move over the long-term to adopt forum provisions, from the point of view of Delaware policymakers, the out-of-Delaware trend poses a more immediate threat to the state's dominant position in the corporate law arena. Delaware policymakers may not be willing to wait for an uncertain outcome if waiting means that Delaware places its dominant position with respect to corporate law at risk.

A second reasonable objection to the legislative option is that public discussion about and promotion of the exclusive forum provision by influential persons can influence the development of a new standard without the reliance on a legislative intervention.²³¹ This objection suggests that proponents of exclusive forum provisions can generate an information cascade sufficient to overcome status quo bias amongst incorporators of firms and thus cause a change in the standard term.²³² An information cascade can occur “when [it becomes] optimal for an individual, having observed the actions of those ahead of him, to follow the behavior of the preceding individual without regard to his own information.”²³³ Where decision-makers are cognitively constrained, information cascades can be important in the adoption of

²³⁰ See Jennifer Arlen, Matthew Spitzer & Eric Talley, *Endowment Effects Within Corporate Agency Relationships*, 31 J. LEGAL. STUD. 1, 5 (2002); Russell B. Korobkin & Thomas Ulen, *Law and Behavioral Science*, 88 CALIF. L. REV. 1051, 1104 (2000) (encouraging care in deciding default rules given status quo bias).

²³¹ Shiller calls standards entrepreneurs “informational cascade facilitators.” Robert J. Shiller, *Conversation, Information, and Herd Behavior*, 85 AM. ECON. REV. 181, 185 (1995). I refer to informational cascade facilitators as standards entrepreneurs.

²³² Bikchandani et al., *supra* note 155, at 994.

²³³ *Id.*; see also Shiller, *supra* note 231, at 182.

new standards. When faced with a decision, the decision-maker observes others who have previously had an opportunity to evaluate the same question. The cognitively constrained decision-maker can conserve resources by freeriding off the investigations of others. A simple example of an information cascade can be found in fashion fads.²³⁴ A standards entrepreneur plays a central role in creating a critical mass of adopters of a fashion.²³⁵ Once a critical mass of earlier adopters have followed a fashion or fad, late adopters can conserve cognitive resources by following early adopters rather than investigate the fashion or making an independent determination about the underlying quality of the fashion.²³⁶

With respect to the forum provision, there are already standards entrepreneurs at work.²³⁷ There is a possibility that the work of these entrepreneurs advocating on behalf of the adoption of forum provisions may be sufficient to generate an information cascade for the adoption of forum provisions. To the extent standards entrepreneurs focus on promoting the adoption of exclusive forum provisions in corporate bylaws, the recent *Galaviz* decision may cut short those efforts.²³⁸ Though the court in *Galaviz* indicated that it would likely approve of an exclusive forum provision found in a certificate of incorporation, it struck down an exclusive forum provision adopted unilaterally by a board in a bylaw.²³⁹ The initial response from law firms in the wake of the *Galaviz* decision cautioned a go-slow approach with respect to exclusive forum provisions, which is consistent with Korobkin's view that lawyers are vulnerable to loss aversion and are not innovators.²⁴⁰

Another possible objection to the adoption of an optional exclusive forum provision is that the ability of shareholders to bring lawsuits in

²³⁴ See Bikchandani et al., *supra* note 155 at 1014.

²³⁵ See *id.*

²³⁶ See *id.*

²³⁷ Professor Grundfest has been an active advocate of forum provisions in charters and corporate bylaws and is a standards entrepreneur as it relates to the exclusive forum provision. See, e.g., Grundfest, *supra* note 1 (presentation analyzing the development of exclusive forum provisions).

²³⁸ *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1172-75 (9th Cir. 2011).

²³⁹ *Id.*

²⁴⁰ See, e.g., *Restricting Shareholder Derivative Suits to Delaware: Stop, Look, and Listen*, WILSON SONSINI GOODRICH & ROSATI (Jan. 5, 2011), http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgalert_delaware_shareholder_derivative_suits.htm (recommending “[i]n light of the unsettled state of the law on this issue, we recommend that companies think twice before attempting to amend their bylaws to limit derivative suits to any particular forum or venue”).

alternate forums is important to constrain overreaching by the Delaware judiciary.²⁴¹ According to this objection, access to alternate forums to interpret Delaware law is an effective constraint on judicial overreaching by the Delaware courts.²⁴² If all cases must be heard in Delaware, the Delaware courts would have little to restrain them from overreaching.²⁴³ This is a reasonable concern. The real constraint on potential over-reaching by the Delaware courts, however, is not state competition or the judiciaries of other states.²⁴⁴ Rather, it is the federal government and access to the federal courts.²⁴⁵ The tension between state-based corporate law regimes and the Federal oversight of securities regulation acts as an important balance to one another.²⁴⁶ The proposed optional forum provision amendment is consistent with the language of SLUSA's Delaware carve-out and does not purport to further restrict shareholders' ability to bring federal claims in federal courts. Continued access to the federal courts, therefore, is an important constraint on possible overreaching by the Delaware judiciary and is not affected by the proposed amendment.

At the same time, the proposed provision itself is self-limiting such that Delaware courts should not have an incentive to overreach. First, the provision proposed in this Article provides for the waiver of the applicability of the forum provision by either the board or a greater than ten percent shareholder.²⁴⁷ Significant shareholders do not have an incentive to engage in forum shopping and will likely seek to adjudicate intracorporate disputes in locations that are in the best interests of large blocks of stockholders as well as the corporation. By providing for a waiver by the board or shareholders representing more than ten percent of the outstanding shares, the provision creates flexibility in the event there is a reasonable expectation by the board

²⁴¹ Stevelman, *supra* note 1, at 131-32.

²⁴² *Id.*

²⁴³ *Id.* at 135 (noting the limitations of a mandatory approach to litigating in Delaware).

²⁴⁴ Daines, *supra* note 78, at 1610.

²⁴⁵ Stevelman, *supra* note 1, at 131-32. Professors Jones and Roe note the central importance of the federal government in the question of corporate governance. This tension plays an important role in constraining potential overreach by Delaware and is thus central to a proper functioning of our system of corporate governance. See Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 627 (2004); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003). This observation is consistent with Professor Daines's observation that there is not nationwide competition for corporate incorporations. See Daines, *supra* note 78, at 1610.

²⁴⁶ Jones, *supra* note 245, at 627; see also Roe, *supra* note 245, at 591.

²⁴⁷ See *infra* Appendix B.

or a significant shareholder that the Delaware courts might not be an appropriate forum to adjudicate an intracorporate dispute.²⁴⁸

Second, the exclusive forum provision does not create an absolute bar to the adjudication of suits in foreign jurisdictions. Such provisions are only presumptively enforceable. The limits of this presumption are delineated by *Bremen v. Zapata Off-Shore Co.*²⁴⁹ Upon a motion to dismiss, foreign courts will always retain the ability to make an independent determination about the reasonableness of the forum provision and its conformity with public policy.²⁵⁰ In the event that Delaware overreaches, a foreign jurisdiction can respond by not enforcing the forum selection provisions. The existence of the presumption, however, remains a powerful disincentive for plaintiffs to engage in forum shopping.

A final objection to the adoption of the proposed amendment is the possibility of unintended consequences. Other attempts at constraining agency costs in shareholder litigation have resulted in unintended consequences; there is no reason to suspect that the adoption of an opt-in menu provision will be exempt from that experience. For example, it is possible that, in response to the adoption of exclusive forum provisions by firms, plaintiffs might pursue different litigation strategies. Presently, plaintiffs bringing claims in foreign jurisdictions typically ask the court of the foreign jurisdiction to apply Delaware law to the adjudication of their claim. Rather than litigate Delaware claims in foreign jurisdictions, in response to the presence of an exclusive forum provision, litigants might take up “real seat doctrine” arguments.²⁵¹ By engaging in more direct challenges to the internal affairs doctrine as a way of defeating the exclusive forum clause, plaintiffs might be able to keep cases alive long enough to generate uncertainty and settlement value.

To the extent plaintiffs are successful in challenging the applicability of the internal affairs doctrine as a choice of law principle, litigation success could be destabilizing to Delaware’s dominant position in the

²⁴⁸ Of course, the board may always waive the forum selection provision by simply not seeking to move to dismiss a case in a foreign jurisdiction.

²⁴⁹ *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10 (1972).

²⁵⁰ *Id.*

²⁵¹ See sources cited *supra* note 8. Although many believe that the internal affairs doctrine is well-settled in the corporate law, progressive corporate law scholars have advocated challenges to the internal affairs doctrine in favor of regulation of corporations more akin to the “real seat doctrine” that governs in many international jurisdictions. See Greenfield, *supra* note 8, at 136-38 (advocating move away from the internal affairs doctrine).

corporate arena.²⁵² Thus, the proposed amendment brings with it the risk of an unintended consequence that could potentially threaten Delaware's dominant position in the corporate law arena. Of course, the consequence of not taking action in response to the out-of-Delaware trend is the long-term erosion of Delaware's ability to maintain its own corporate law. On the other hand, the risks associated with pursuing a modest legislative intervention are uncertain.

CONCLUSION

A legislative approach to addressing the out-of-Delaware trend represents a possible answer to the issue of forum shopping in shareholder litigation. From the point of view of shareholders and society as a whole, finding a balance that both permits shareholders to pursue claims in an orderly manner and reduces incentives for litigants to pursue litigation only for its settlement value is a valuable goal. Reducing incentives for plaintiffs to bring litigation outside the state of incorporation, and thus effectively limiting intracorporate litigation to a single forum, will improve efficiency in the adjudication of disputes while ensuring that shareholders maintain access to a convenient forum. Additionally, from the perspective of Delaware policymakers, limiting incentives for plaintiffs to pursue out-of-Delaware shareholder litigation is valuable in order to preserve its ability to update and maintain its corporate law. On the other hand, reliance on forum selection provisions in corporate charters may pose some risks of unintended consequences for Delaware policymakers if widespread adoption of such provisions generates a backlash against Delaware for overreaching. Consequently, if policymakers and firms pursue adoption of a legislative approach to resolving this question, they must do so with care.

Part of a careful approach includes additional empirical research into the value of forum selection provisions. While such provisions appear on their face to be value enhancing, the answer to the question of their real value to firms is an empirical one. Presently, the sample size of firms with such provisions in place at IPO is small in both relative and absolute terms. As firms continue to adopt the provision, it will soon become possible to undertake an investigation of the value of such provisions at the IPO stage. If, as one can hypothesize, forum selection provisions are valuable, then this information can help

²⁵² *Id.*

inform policymakers as they decide whether to pursue a legislative option to address the out-of-Delaware trend.

Should the data warrant a legislative option, the careful approach suggests avoiding a default rule limiting the adjudication of intracorporate disputes to a forum within the state of incorporation. Though parties can contract around default rules, the work of behavioral economists explains that once in place, default rules become quasi-immutable, thus making possible deviations difficult to accomplish. Similarly, waiting for incorporators to adopt such provisions in the absence of a default rule is equally unlikely to result in an optimal outcome. Rather, the stickiness of default rules and inertia in the contracting process suggests that an alternative, more flexible, approach to corporate contracting is required.²⁵³ Opt-in menus are, therefore, a valuable mechanism for overcoming contractual inertia and assisting contracting parties reach more optimal results. A menu, rather than a default rule can facilitate innovation and encourage flexibility in corporate contracting in ways that default rules cannot.

Menus can play an important role in improving Delaware's corporate law. Increased reliance on menus over default rules improves flexibility in corporate contracting as incorporators are able to reduce the cognitive barriers to adopting innovative terms.²⁵⁴ If the adoption of an opt-in menu results in relatively widespread use of the exclusive forum provision, that experience can inform the adoption of other opt-in menus in other contexts of corporate law. Ultimately, a flexible corporate law that promotes drafting of corporate charters that more closely reflects the optimal preferences of both shareholders and the firm will be more efficient and more durable over time.

APPENDIX A: SAMPLE LANGUAGE FOR PROPOSED §102(B)(8) OF THE
DELAWARE CODE

§ 102. Contents of certificate of incorporation.

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters: . . .

²⁵³ See Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 385 (2007) (investigating the question of sticky default rules and the development of "Teflon rules" in corporate law).

²⁵⁴ Listokin endorses opt-in menus as supportive of additional flexibility in corporate contracting. See Listokin, *supra* note 188, at 308.

(8) a provision providing that the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for: (i) any derivative action or proceeding brought on behalf of the Corporation; (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders; (iii) any action asserting a claim arising pursuant to any provision of the DGCL; or (iv) any action asserting a claim governed by the internal affairs doctrine. The Board of Directors or stockholders entitled to cast at least ten percent of the votes, which all stockholders are entitled to cast at an annual meeting, may in their discretion waive applicability of this provision.

APPENDIX B: FIRMS WITH EXCLUSIVE FORUM PROVISIONS

As of December 2010

Firm Name	Date of Offering
Netsuite Inc.	11/29/2007
Financial Engines, Inc.	12/09/2009
Meru Networks Inc.	03/12/2010
Primerica, Inc.	03/29/2010
Inphi Corp.	06/16/2010
LPL Investment Holdings Inc.	06/18/2010
Gordmans Stores, Inc.	08/03/2010
Charter Communications, Inc.	08/20/2010
TMS International Corp.	08/25/2010
US Concrete Inc.	08/31/2010
Chemtura Corp.	09/03/2010
FXCM Inc.	09/03/2010
Liberty Mutual Agency Corp.	09/13/2010
Life Technologies Corp.	10/18/2010
Aurora Diagnostics	10/25/2010
Booz Allen Hamilton Holding Corp.	11/04/2010
General Growth Properties Howard Hughes Corp.	11/12/2010
Spirit Airlines, Inc.	11/19/2010
Neophotonics, Inc.	11/22/2010
Harrahs Entertainment (S-1 withdrawn)	11/22/2010
Fluidigm Corp.	12/03/10
Motricity, Inc.	12/23/2010