

DELAWARE'S *VANTAGEPOINT*: THE EMPIRE STRIKES BACK IN THE POST-POST-ENRON ERA

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INTRODUCTION

In the immediate wake of Enron's collapse and other corporate scandals, widespread calls for greater regulation of corporate decisionmaking produced limited but meaningful federal reform, including the Sarbanes-Oxley Act (SOX) of 2002,¹ and enhanced regulatory oversight of corporate

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¹ Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.). See generally Douglas M. Branson, *Enron—When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform?*, 48 VILL. L. REV. 989 (2003).

disclosure and governance.² These efforts were supplemented by aggressive state-level enforcement of corporate legal norms, most notably by New York's then-attorney general, Elliot Spitzer.³ During this post-Enron period, Delaware—the nation's leading producer of “substantive” corporate law—generated no statutory or administrative reforms addressing these abuses directly.⁴ Yet while avoiding radical departures from its preestablished common law norms, the Delaware courts did seem to review the conduct of corporate management with uncharacteristic scrutiny.⁵

But American corporate law now has entered the “post-post-Enron era.” Industry groups such as the U.S. Chamber of Commerce and the Paulson Committee are pushing back against post-Enron reforms and enforcement, seeking to curtail the most burdensome aspects of the regulations underlying SOX, impose limits on private securities litigation, and prevent what they see as overly aggressive state securities enforcement.⁶ While the U.S. Securities and Exchange Commission (SEC) continues to pursue some new initiatives, it has now shown a willingness to draw back in various ways.⁷ Even New York officials are suggesting some

² See, e.g., Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 93–94 (2005); Mark J. Loewenstein, *The Quiet Transformation of Corporate Law*, 57 SMU L. REV. 353, 365–70 (2004); Robert B. Thompson, *Delaware, The Feds, and the Stock Exchange: Challenges to the First State as First in Corporate Law*, 29 DEL. J. CORP. L. 779, 790–800 (2004). In addition, federal prosecutors stepped up investigatory and enforcement efforts with regard to corporate wrongdoing. See, e.g., Michael E. Horowitz & April Oliver, *Foreword: The State of Federal Prosecution*, 43 AM. CRIM. L. REV. 1033 (2006).

³ See, e.g., Robert W. Hamilton, *The Crisis in Corporate Governance: 2002 Style*, 40 HOUS. L. REV. 1, 44–45 (2003); H.D. Vinod, *Conflict of Interest Economics and Investment Analyst Biases*, 70 BROOK. L. REV. 53, 59 n.21 (2004). Some states have passed laws that mirror aspects of SOX and potentially extend greater protections. See, e.g., Deborah Solomon, *Zealous States Shake Up Legal Status Quo*, WALL ST. J., Aug. 28, 2003, at A4.

⁴ See, e.g., Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1768–69 (2006) (stating that Delaware's only post-Enron substantive statutory reforms addressed certain stockholder inspection rights and extended personal jurisdiction to top corporate officers); Thompson, *supra* note 2, at 779–80. Indeed, no Delaware agency engages in such ongoing oversight. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1604 (2005) (“Delaware has no regulatory agency that either examines compliance with corporate law or enforces its corporate law through fines, injunctions, or cease-and-desist orders; the state does not enforce corporate norms through criminal proceedings; and even though the Attorney General has some civil enforcement powers with respect to for-profit corporations, these powers are virtually never exercised.”).

⁵ See *infra* Part I.B (citing cases and commentary).

⁶ See generally COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006) [hereinafter COMM. CAPITAL REPORT]; Stephen Labaton, *Businesses Seek New Protection on Legal Front*, N.Y. TIMES, Oct. 29, 2006, at 1 (discussing new deregulation initiatives by the U.S. Chamber of Commerce, the Business Roundtable, and the Paulson Committee). The Paulson Committee is shorthand for the Committee on Capital Markets Regulation, which Treasury Secretary Henry Paulson formed in September 2006.

⁷ Stephen Labaton, *S.E.C. Seeks to Curtail Investor Suits*, N.Y. TIMES, Feb. 13, 2007, at C1; Press Release, Securities and Exchange Commission, Further Relief from the Section 404 Requirements for

(de)regulatory reform to preserve the competitiveness of American financial markets.⁸ And populist calls for greater federalization of corporate law have abated.⁹

With the threat of federalization subsiding, Delaware also has responded. For instance, the Delaware Supreme Court seems to have returned to its highly deferential approach to reviewing corporate decisionmaking. The most well-publicized example is its 2006 decision in *In re Walt Disney Co. Derivative Litigation*, in which the court affirmed a judgment in favor of Disney directors and officers on claims of breach of fiduciary duty and waste, claims arising from their initial approval and ultimate payout of a \$130 million severance package to an executive terminated after only fourteen months of service.¹⁰

In this Article, I argue that another recent Delaware Supreme Court decision, which has received much less attention, reveals far more about the court's "state of mind" in this new era. That 2005 case, *VantagePoint Venture Partners 1996 v. Examen, Inc.*, held that Delaware law on shareholder voting applies to a dispute between shareholders in a closely held firm with substantial ties to California, despite a California statute providing that California law governs in this circumstance.¹¹ The court's reaffirmation of the "internal affairs doctrine"—a choice-of-law rule that mandates application of the law of the state of incorporation to disputes among directors, officers, and shareholders¹²—is no surprise. What is telling is that the court declared its result a *constitutional* mandate (under the Due Process Clause

Smaller Companies and Newly Public Companies (Dec. 15, 2006), available at <http://sec.gov/news/press/2006/2006-210.htm>; Press Release, Securities and Exchange Commission, SEC Votes to Propose Interpretive Guidance for Management to Improve Sarbanes-Oxley 404 Implementation (Dec. 13, 2006), available at <http://sec.gov/news/press/2006/2006-206.htm>. Federal prosecutors likewise have backed away from some of their most aggressive prosecutorial tactics. See Memorandum from Paul J. McNulty, Deputy Attorney Gen., to Heads of Dep't Components, U.S. Attorneys (Dec. 15, 2006), available at http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf.

⁸ See, e.g., MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP 7–8, 77–78 (2007) [hereinafter BLOOMBERG & SCHUMER REPORT] (arguing for legal reforms that will reduce regulation, complexity, and litigation); Aaron Lucchetti, *Why Spitzer is Backing Study that Endorses Less Regulation*, WALL ST. J., Jan. 23, 2007, at C3.

⁹ There continue to be such calls in the academic literature and by activists, however. See, e.g., Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793 (2006). But one detects little political will to act on such calls.

¹⁰ 906 A.2d 27, 75 (Del. 2006); see also *Stone v. Ritter*, 911 A.2d 362, 372–73 (Del. 2006) (affirming dismissal of a board oversight claim and recognizing the very high bar plaintiffs must overcome to establish such claims and, more generally, claims based on lack of good faith).

¹¹ 871 A.2d 1108, 1116–18 (Del. 2005).

¹² See, e.g., *McDermott Inc. v. Lewis*, 531 A.2d 206, 215 (Del. 1987); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

and dormant commerce clause), and hence, pronounced that other states are barred from regulating the internal affairs of Delaware firms.¹³

VantagePoint not only removes any doubt that the Delaware Supreme Court structures its decisions to further Delaware's chartering market interests, but it also exposes Delaware's new strategies for furthering those interests. I contend that this decision, in this small but dominant state, is designed to do no less than chart the future course of American (and perhaps global) business entity law. In *VantagePoint*, the Empire has, indeed, struck back.

Despite their wide-ranging views on the causes and efficiency of Delaware's domination in the market for charters of public corporations, scholars tend to agree that Delaware's legal decisionmakers act consciously to maintain the state's market share and the resulting benefits for the state.¹⁴ These decisionmakers include Delaware's influential corporate bar, its legislature and agency officials, and, perhaps most importantly given its central role in developing the state's corporate law, its judiciary.¹⁵

A recent strand of scholarship posits that, to maintain its primacy, Delaware not only produces corporate legal norms—typically permissive ones—attractive to incorporators of firms, but also makes doctrinal adjustments to address looming threats to Delaware's domination.¹⁶ The threat on which these scholars focus is a vertical one; that is, greater federalization of substantive corporate law through legislation, creeping preemption by the SEC, or federal courts.¹⁷ Accordingly, Delaware decisionmakers will alter their behavior to the extent necessary to protect the state's chartering busi-

¹³ See *VantagePoint*, 871 A.2d at 1113. The Delaware Supreme Court had made a similar claim before, although in less bold terms and in a context in which it found it was obliged to apply foreign law to a foreign corporation. See *McDermott*, 531 A.2d at 211–13, 219. *VantagePoint*, however, was the first time that Delaware stated explicitly that other states cannot impose their own corporate law on the internal affairs of Delaware firms.

¹⁴ See generally *infra* Part I. Delaware benefits enormously from its domination in the chartering market for publicly traded firms. See *infra* Part I.A.

¹⁵ See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1074–88 (2000); Hamermesh, *supra* note 4, at 1752–62 (discussing the roles of the bar, legislature, and judiciary); Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 644–45 (2004) (discussing how the Delaware judiciary is uniquely well-situated to respond to threats); Kahan & Rock, *supra* note 4, at 1583 (arguing that the Delaware judiciary not only addresses most corporate law disputes in the first instance, but also plays a paramount role because Delaware has no command-and-control regulatory apparatus and the Delaware legislature rarely intervenes).

¹⁶ For example, according to Professor Mark Roe, because Delaware enjoys unique advantages over other states in the chartering market, the principal threat to Delaware's primacy comes not from other states but from the federal government. See generally Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 594–96 (2003) [hereinafter Roe, *Competition*]; see also Jones, *supra* note 15, at 644–45, 654–55; Kahan & Rock, *supra* note 4, at 1609–10.

¹⁷ See, e.g., Jones, *supra* note 15, at 644–45, 654–55; Kahan & Rock, *supra* note 4, at 1609–10; Roe, *Competition*, *supra* note 16, at 591–93; see also Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2493–97 (2005) [hereinafter Roe, *Politics*].

ness from a federal takeover.¹⁸ This view of Delaware's strategic decision-making is consistent with the subtle-but-noticeable shift in the Delaware courts' behavior in the post-Enron period.¹⁹

But now that times have changed again, Delaware need not be as concerned about the risk of federalization. While cases like *Disney* suggest that the Delaware Supreme Court is responding to this shift in the prevailing winds, *VantagePoint* reveals that the court recognized this shift by mid-2005 and chose to move decisively to confront Delaware's new challenges and opportunities in a post-post-Enron world.²⁰

The seemingly mundane shareholder voting dispute in *VantagePoint* struck a nerve. The court's constitutional assertions were unnecessary, short on genuine analysis, and based on dubious premises.²¹ In both its tone and its boldness, this is an unusual decision for the Delaware Supreme Court, a court known for its cautious, contextual approach to developing corporate legal norms.²²

The court's aggressive stance in *VantagePoint* and the early effects of the decision highlight two often overlooked aspects of the current structure of American entity law. First, in addition to federalization, Delaware faces another potential threat to its primacy, or at least the benefits it derives from its domination. This threat involves other states seeking to impose their corporate law mandates on Delaware firms. Despite the competitive advantages Delaware enjoys in the chartering market, should other states choose not to adhere to the internal affairs doctrine or to narrow its scope substantially, the value of chartering in Delaware would decline, potentially reducing chartering in the state or lowering the price Delaware can charge for that privilege. Thus, when the threat of greater federalization subsides, it makes sense for Delaware to seek to shore up this vulnerability vis-à-vis other states.

Second, *VantagePoint* comes at a time of fundamental and perhaps permanent change in the chartering markets and, correspondingly, Delaware's opportunities in these markets. Although Delaware remains dominant in the market for incorporations of publicly traded firms, this market is not producing the benefits for Delaware it once did. Corporate franchise tax revenues have remained flat since the beginning of the decade, and Delaware officials predict that these revenues will increase at only a modest

¹⁸ See *infra* note 58 and accompanying text.

¹⁹ See *infra* Part I.B.

²⁰ There were complaints and suggestions of a pushback against SOX and its regulations well before the *VantagePoint* decision was handed down in May 2005. See, e.g., Dan Roberts & Adrian Michaels, *Sarbanes and Oxley Under Fire in U.S.*, FIN. TIMES, June 14, 2004, at 26.

²¹ I am not alone in concluding that the constitutional assertions in the *VantagePoint* decision are unpersuasive. See, e.g., Larry E. Ribstein & Erin A. O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. (forthcoming) (manuscript at 54), available at <http://ssrn.com/abstract=956919>.

²² See *infra* Parts II.A & III.

rate for the foreseeable future.²³ In contrast, chartering of closely held firms—limited liability companies (LLCs) in particular—has exploded. Despite the de minimis yearly taxes Delaware imposes on such firms, the revenues they produce for the state have increased exponentially in recent years and are anticipated to grow significantly in the future.²⁴ In other words, necessity is pushing Delaware to “follow the market” by greatly expanding its chartering business beyond its mainstay in the publicly traded realm.

The commentary regarding Delaware’s horizontal and vertical “competition” focuses almost exclusively on incorporations in the publicly traded market. However, the *VantagePoint* decision, which addresses the internal affairs doctrine in the closely held context, suggests that the Delaware Supreme Court is very much aware of the changing market conditions. The court’s unusually aggressive, preemptive strike on internal affairs issues further suggests that the court is both seeking to protect its domination in the publicly traded market and positioning Delaware to take full advantage of the burgeoning market in closely held firms. Such a diversification strategy makes sense for another reason: going forward, federal preemption remains a genuine possibility, but it is likely to be limited to publicly traded firms. This would leave regulation of—and competition for—closely held firms to the states. Thus, *VantagePoint* reflects in a very direct way Delaware’s fears and ambitions in the post-post-Enron world.

The quandary for Delaware is that the constitutional assertions in *VantagePoint* cannot achieve all that the state desires because the decision binds only Delaware courts. The Delaware Supreme Court certainly could not have envisioned that *VantagePoint*’s reasoning alone would persuade many courts in other jurisdictions that their regulation of Delaware firms is unconstitutional, given its doctrinal weaknesses and Delaware’s obvious self-interest in making the internal affairs norm a national mandate.

So what then was the *VantagePoint* court really up to? I argue that the *VantagePoint* decision was not designed to persuade other jurisdictions and courts by normal judicial means—namely, well-reasoned constitutional analysis. It is instead a signal: one intended to deter other states, such as California and New York, from seeking to regulate the affairs of Delaware entities, or, in the alternative, to create the very conditions which might convince federal actors to prevent other states from doing so. Put another way, the Delaware Supreme Court has offered up *VantagePoint* both as a harbinger of potential “ongoing interstate conflict” over regulation that might implicate corporate internal affairs, and as a template for how federal actors might prevent such conflict. The use of *VantagePoint* in pending corporate choice-of-law litigation around the country, and the fact that Delaware’s natural allies—including the U.S. Chamber of Commerce—

²³ See *infra* Part III.A.

²⁴ See *infra* Part III.A.

have signed on, suggest that this campaign against such interstate conflict has already begun in earnest.²⁵

VantagePoint, therefore, marks the beginning of Delaware's post-post-Enron efforts to entrench whatever internal affairs law it creates, not just for Delaware, but also for the United States. It reveals a strategy for solidifying permanently Delaware's advantages vis-à-vis other states and extending Delaware's market share in both the publicly traded and closely held chartering markets. Ironically, this strategy reflects a reality for Delaware with regard to the internal affairs doctrine that is contrary to the one that guided Delaware's post-Enron behavior: rather than constituting the greatest threat to Delaware's primacy, federal actors may be the only ones who can save it.

Part I of this Article discusses Delaware's domination in the market for charters of publicly traded firms and the corresponding benefits, its competitive advantages vis-à-vis other states, and the federal threats to its domination. A focus of this Part is the central role the Delaware judiciary plays in creating and enforcing Delaware's corporate legal norms and responding to threats and changing circumstances. Part II analyzes the *VantagePoint* decision, contextualizing it in terms of other Delaware Supreme Court decisions and demonstrating how it reflects Delaware's incentives. This Part ends with a discussion of why, at first blush, it is unclear how the *VantagePoint* decision might further Delaware's interests, given the opinion's subject matter (a dispute in a closely held firm) and doctrinal weaknesses. Part III then explores the strategy that may underlie the *VantagePoint* decision. Delaware needs to protect its existing dominance and expand its chartering business in the context of closely held firms; to succeed, it must ensure adherence to the internal affairs doctrine. The *VantagePoint* court sought to serve this end by deterring other states from regulating Delaware firms and prodding federal actors into preventing them from doing so. This Part concludes by offering evidence that a resulting campaign to impose a universal internal affairs norm is already underway and, if it remains below the radar, may well succeed. Thus, those interested in preserving the regulatory prerogatives of other states ought to take note.

I. DELAWARE'S DOMINATION, COMPETITION, AND DECISIONMAKING

A. Delaware's Primacy and Rewards

Delaware dominates the "market" for incorporations of publicly traded firms. About sixty percent of all publicly traded American corporations are chartered in Delaware,²⁶ and an overwhelming percentage—over eighty

²⁵ See *infra* Part III.D.2.

²⁶ See, e.g., Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391 (2003).

percent—of all out-of-state incorporations of such firms are in Delaware.²⁷ In other words, in the vast majority of cases, publicly traded firms are either incorporated in their state of origin or in Delaware, and Delaware appears to be capturing an even greater percentage of firms that have recently gone public.²⁸

Delaware benefits enormously from its primacy in this market. First, this chartering activity produces a substantial amount of direct revenue. In fiscal year 2006, Delaware netted \$512 million in corporate franchise taxes.²⁹ It also collected tens of millions of dollars in various filing and other fees.³⁰ Indeed, fees and total entity taxes—which include not just corporations, but other entities such as LLCs, limited partnerships (LPs), and business trusts—account for a quarter of Delaware’s annual revenue.³¹

Delaware’s approach to ongoing regulation of the many firms it attracts produces further benefits. Delaware has no agency or other executive apparatus that directly regulates corporate governance or securities.³² Instead, it has a unique business-centered court system—its Court of Chancery and Supreme Court (as a reviewing court)—that, through its decisions in corporate law cases, provides much of the state’s regulatory oversight of its firms. Hence, the Delaware courts are the primary source of both the substance and enforcement of Delaware corporate law.³³ By developing standards through a careful, contextual approach, rather than via broad pronouncements of unbending general rules, the courts assure further litigation over corporate legal norms and their application.³⁴ The combination of upstream chartering activity and significant downstream corporate and business litigation supports a large incorporation and corporate law industry (composed of lawyers, registered agents, and others) in this otherwise tiny state.³⁵

²⁷ See *id.* at 395 (tabulating information indicating that of the 4393 firms chartered out-of-state, 3744 were chartered in Delaware).

²⁸ See *id.* at 391.

²⁹ See DEL. DEP’T OF STATE, DIV. OF CORPS., 2006 ANNUAL REPORT 2 (2006), available at http://corp.delaware.gov/2006%20Annual%20Report%20with%20Signature%20_2_.pdf [hereinafter 2006 ANNUAL REPORT].

³⁰ See *id.*; see also DEL. ECON. & FIN. ADVISORY COUNCIL, REVENUE FORECAST tbl.2 (June 2006), available at http://finance.delaware.gov/defac/min_0606.pdf [hereinafter JUNE 2006 DEFAC WORKSHEET].

³¹ See JUNE 2006 DEFAC WORKSHEET, *supra* note 30, at tbl.2.

³² See, e.g., Roe, *Politics*, *supra* note 17, at 2501.

³³ See, e.g., Kahan & Rock, *supra* note 4, at 1591–1604 (describing the functions of the Delaware courts and explaining how judge-made law governs core issues such as fiduciary duties, and how judicial glosses on the Delaware Code also render statutory application largely a matter of judicial interpretation).

³⁴ For a discussion of why Delaware’s common law approach to creating and enforcing corporate legal norms may be appealing to incorporators, see *infra* Part I.C.

³⁵ See, e.g., Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 687–99 (2002) [hereinafter Kahan & Kamar, *Myth*] (discussing the benefits Dela-

B. Identifying Delaware's Competition

The conventional explanation for Delaware's predominance is that it has won the state-versus-state competition for corporate charters because its corporate law is preferable to that produced in other jurisdictions.³⁶ Of course, whether Delaware's largely permissive brand of corporate law is superior—for shareholders and not just management—has been the subject of the decades-old race-to-the-bottom versus race-to-the-top debate.³⁷ Although some scholars still adhere to the view that there is this robust competition among states for corporate charters for publicly traded firms,³⁸ recent scholarship has challenged the assumption that the market for corporate charters is a truly competitive one. In this view, Delaware has both incentives and advantages that preclude or limit genuine competition in this chartering market.

First, given its size and domestic economy, Delaware possesses incentives to vie for charters that larger states do not. On a per capita basis, Delaware produces substantial revenues from its chartering business.³⁹ These revenues are so substantial, in fact, that there is a question whether other states are even trying to compete at all.⁴⁰ Although it is true that other state legislatures generally have followed Delaware's lead on corporate law

ware and the Delaware bar enjoy from Delaware's domination); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1232–36, 1246–48 (2001) [hereinafter Kahan & Kamar, *Price*] (same).

³⁶ See, e.g., ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 15–16 (1993).

³⁷ Compare Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (arguing that state competition leads to rules biased towards managerial interests), and William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (arguing that state competition results in a “race to the bottom”), with Daniel R. Fischel, *The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 915–16 (1982) (challenging Cary's analysis), and Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 280–81 (1985) (arguing that state competition results in a race to the top). Both sides have marshaled empirical evidence for their claims as to whether chartering in Delaware enhances firm value. Compare Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001) (yes), with Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1820–21 (2002) (no), and Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004) (no).

³⁸ See, e.g., Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?* (Yale Law Sch. Ctr. for Law, Econ. & Pub. Pol'y, Working Paper No. 307, 2005), available at <http://ssrn.com/abstract=693484> (arguing that the current state of corporate law is still best explained by robust competition); see also Ribstein & O'Hara, *supra* note 21, at 36–39 (contending the push by domestic constituencies for corporate law norms to retain charters may create genuine competition with Delaware).

³⁹ See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 583 (2002) (calculating that, in 2001, Delaware's tax revenues equated to an annual gain of \$3000 for a family of four); Kahan & Kamar, *Myth*, *supra* note 35, at 687–99.

⁴⁰ See generally Bebchuk & Hamdani, *supra* note 39. This is particularly true for larger states. See *id.* at 584.

matters by moving, over time, towards a more permissive regime akin to Delaware's, this may be more attributable to successful local interest group lobbying than to a strategic attempt to attract out-of-state incorporations.⁴¹

Even if states attempt to compete head-to-head with Delaware for corporate charters, Delaware enjoys a number of unique historical and systemic advantages that impose barriers to entry and otherwise limit horizontal competition.⁴² As an initial matter, while other states' statutes have largely tracked Delaware's permissive approach, they cannot easily duplicate Delaware's robust body of corporate decisional law.⁴³ Despite its ambiguity, which some suggest is itself a strength,⁴⁴ this body of case law offers a level of reliability that is lacking elsewhere because of both its detail and—at least with regard to the governing framework and normative approach—its predictability.⁴⁵

In addition, the Delaware Court of Chancery is a business-centered court system that offers various advantages from the perspective of corporate principals, including chancellor expertise on corporate law matters, speedy resolution of disputes, and no juries.⁴⁶ The Delaware Supreme

⁴¹ See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1221–22 n.74. *But see* Romano, *supra* note 38, at 16–18 (suggesting that local attorneys' lobbying efforts for laws attractive to incorporators creates competition); see also Ribstein & O'Hara, *supra* note 21, at 21–23 (discussing the role of local lawyers in pressing for state law to retain corporate charters). Even if other states modify their corporate statutes to attract or retain incorporations, they are unlikely to take more costly steps to compete, such as developing an expert court system akin to Delaware's. See Kahan & Kamar, *Price*, *supra* note 35, at 1213 n.35.

⁴² See, e.g., Bebchuk & Hamdani, *supra* note 39 (arguing that Delaware enjoys unique historical and structural advantages in the market for corporate law and questioning whether other states have the incentives to compete); Kahan & Kamar, *Myth*, *supra* note 35 (arguing that, for systemic reasons, states other than Delaware would not derive the same benefits from competing for corporate charters and therefore make only half-hearted attempts to do so).

⁴³ See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1212 (“Because many corporate disputes arise under Delaware law, Delaware’s case law is more developed than the case law of other states.”).

⁴⁴ See, e.g., Fisch, *supra* note 15, at 1081–85; Kahan & Rock, *supra* note 4, at 1598 (“[Its flexibility] permits Delaware law to respond to new problems or revise the way it deals with old problems without openly admitting the judges have made new law or changed old law.”).

⁴⁵ See Thompson, *supra* note 2, at 784 (“No other state can match Delaware in terms of reliability of its law and quick resolution of corporate disputes through the courts.”); Kahan & Kamar, *Price*, *supra* note 35, at 1214 (“In sum, . . . Delaware law is predictable and clear in comparison to the laws of other states”); cf. Kahan & Rock, *supra* note 4, at 1598 (describing how Delaware’s judge-made law is flexible and highly fact-intensive but is also presented as a stable, clear, and uncontroversial set of standards). Moreover, it is unlikely that a state would be able to overcome this competitive disadvantage by enacting a reception statute adopting Delaware case law. Such a maneuver would, at best, allow the other state to “draw even” with Delaware. And Delaware would still be better positioned with regard to perceived predictability because there would be no guarantee that the state’s courts would interpret and adapt Delaware law the way Delaware would, or that the state legislature would not change course downstream, given the particulars of that state’s judicial and political landscape. Cf. Ribstein & O’Hara, *supra* note 21, at 36–37 (discussing how Delaware’s would-be competitors would have to provide assurances regarding further lawmaking and adjudication).

⁴⁶ See Bebchuk & Hamdani, *supra* note 39, at 588–89; Kahan & Kamar, *Myth*, *supra* note 35, at 725–26.

Court is likewise known for its efficiency and expertise in corporate law matters.⁴⁷ Although other states could attempt to replicate some of these features, it would be difficult for them to ensure that their corporate courts would operate as expertly and independently, or that these courts would be subject to review only by equally hospitable appellate courts.⁴⁸ It would also take time to overcome the reputational advantages Delaware's courts now enjoy in the market. Indeed, the Delaware courts are a perennial favorite for business groups, including the U.S. Chamber of Commerce—something other branches of the Delaware government frequently tout.⁴⁹

Delaware enjoys other advantages. Its small size allows for the efficient coordination of principal actors. Its size and political environment also facilitate, when necessary, genuine legislative attention to corporate matters.⁵⁰ Delaware's corporate law decisionmakers—its influential corporate bar, legislature, agencies, and courts—respond quickly to corporate law issues and developments.⁵¹ Perhaps even more importantly, this political climate typically fosters legislative non-interference with the corporate and entity law produced by Delaware's courts.⁵²

Scholars have noted other forces that drive entry into Delaware on the front end and inhibit exit thereafter. Delaware benefits from various “network advantages”—its widely known legal norms and practices provide familiarity and clarity which may add value and impose barriers to competition.⁵³ Also, because public firms incorporated in Delaware face difficulty if they wish to exit the state (exit through reincorporation would require board approval), other states are unlikely to attract away such charters once

⁴⁷ See, e.g., Kahan & Rock, *supra* note 4, at 1602 (noting that Delaware Supreme Court justices are often drawn from the Chancery Court); *A Senior Corporate Practitioner Looks at the Leadership Role of the Delaware Judiciary*, METRO. CORP. COUNS., INC. (Mountainside, N.J.), Nov. 2004, at 45 [hereinafter *Leadership Role*] (containing an interview with A. Gilchrist Sparks III, in which he discusses the corporate law expertise of two chief justices of the Delaware Supreme Court).

⁴⁸ Cf. Ribstein & O'Hara, *supra* note 21, at 36 (discussing Delaware's “legal infrastructure” advantages).

⁴⁹ See DEL. DEP'T OF STATE, DIV. OF CORPS., 2005 ANNUAL REPORT 3–4 (2005), available at <http://www.corp.delaware.gov/2005%20doc%20ar.pdf> [hereinafter 2005 ANNUAL REPORT].

⁵⁰ See Hamermesh, *supra* note 4, at 1752–59, 1778–83 (discussing the interaction between and responsiveness of the Delaware corporate bar and the legislature).

⁵¹ See Roe, *Competition*, *supra* note 16, at 594 (discussing the coordination between the bar and legal decisionmakers and the ability of these decisionmakers to respond quickly to trends and issues); Kahan & Rock, *supra* note 4, at 1599–1601 (discussing the unique coordination between the Delaware bar and legislature on corporate law matters); see also Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 473 (1987) (discussing the influence of Delaware's corporate bar); *Leadership Role*, *supra* note 47, at 45 (discussing the bar's participation in selection of Delaware jurists and coordination with the Delaware legislature on corporate law matters).

⁵² See Kahan & Rock, *supra* note 4, at 1592–94; see also Thompson, *supra* note 2, at 783 (discussing the central role of Delaware's judiciary).

⁵³ See Bebchuk & Hamdani, *supra* note 39, at 586–88; Kahan & Kamar, *Price*, *supra* note 35, at 1227; Ribstein & O'Hara, *supra* note 21, at 35, 38–39.

an entity has made the initial decision to incorporate in Delaware.⁵⁴ In fact, according to some commentators, Delaware's hospitable conditions enable it to charge monopoly-like prices to large chartering firms⁵⁵ as long as it maintains legal norms sufficiently deferential to management, the prime movers in chartering decisionmaking.⁵⁶ The best other states can do may be to seek to retain the charters of locally based firms by, for example, adopting Delaware's brand of statutory law.⁵⁷

Building on the scholarship regarding Delaware's advantages and uniqueness, a new strand of commentary recognizes that Delaware's legal actors make doctrinal adjustments not only to continue to attract capital, but also to stave off perceived threats to the state's domination.⁵⁸ Professor Mark Roe contends that the principal threat to Delaware's primacy—and hence, its main “competition”—comes not from other states, but from the federal government.⁵⁹ Thus, when Delaware constrains managerial prerogatives, it does so with an eye towards staving off federalization through po-

⁵⁴ See Bebchuk & Hamdani, *supra* note 39, at 592 (arguing that, because management exercises veto power over reincorporations, other states are unlikely to be able to attract away firms currently chartered in Delaware, at least to the extent that their law is less favorable to management than Delaware's).

⁵⁵ See *id.* at 582–83; Kahan & Kamar, *Price*, *supra* note 35, at 1217; *cf.* Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 131–34 (2004) (arguing that although Delaware is able to charge more than other states, it must remain sensitive to price and quality). Delaware's corporate franchise fee ranges from \$35 to \$165,000 annually. The tax is calculated using the lesser of a multiplier based on the number of authorized shares or an assumed par value capital method. Del. Dep't of State, Div of Corps., How to Calculate Franchise Taxes, <http://www.state.de.us/corp/frtaxcalc.shtml>. Under either method, publicly traded firms will pay non-dominant taxes, while small, closely held firms may pay as little as \$35. See generally Kahan & Kamar, *Price*, *supra* note 35, at 1217–25 (discussing Delaware's franchise tax structure).

⁵⁶ See Oren Bar-Gill, Michal Barzuza & Lucian Bebchuk, *The Market for Corporate Control*, 162 J. INST. & THEORETICAL ECON. 134, 136–37 (2006); Bebchuk & Hamdani, *supra* note 39, at 600.

⁵⁷ Some contend that anti-takeover provisions also enhance retention rates. Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 132–42 (2001); Bebchuk & Cohen, *supra* note 26, at 412–14; Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1801 (2002). But see Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 341 (2006) (finding no such effect). Even those contending that robust competition exists appear to concede that that competition is largely between Delaware and home states. But they argue that such home-state steps to retain charters are, or may be, enough to create genuine competition with Delaware. See, e.g., Romano, *supra* note 38, at 15–16; Ribstein & O'Hara, *supra* note 21, at 37–38.

⁵⁸ See generally Jones, *supra* note 15, at 643–63; Roe, *Competition*, *supra* note 16, at 594; see also Bebchuk & Hamdani, *supra* note 39, at 603–04 (discussing how federal law may be the primary threat to Delaware's interests).

⁵⁹ Roe, *Competition*, *supra* note 16.

tential congressional legislation or through creeping preemption by the SEC or federal courts.⁶⁰

To support this thesis, Roe and others have noted that Delaware constrains management when there are calls for greater federal intervention into substantive corporate law for publicly traded firms. Roe discusses, for example, the changes in Delaware law that coincided with bursts of federal pressure in the corporate area, most recently in the early 1980s and post-Enron.⁶¹ Other commentators have also noted the Delaware judiciary's increased scrutiny of managerial decisionmaking during the post-Enron period,⁶² citing various Delaware decisions to support their claims.⁶³ Moreover, Delaware jurists made a point, in their speeches and writings in the post-Enron period, to emphasize Delaware's efforts to address corporate governance concerns.⁶⁴

⁶⁰ See *id.* at 592, 598–607; see also Jones, *supra* note 15, at 635–39; cf. Hamermesh, *supra* note 4, at 1768 (contesting some of Roe's assertions while also recognizing that the threat of federal intervention may lead Delaware actors to refrain from pushing too many "populist buttons").

⁶¹ Roe, *Competition*, *supra* note 16, at 617–18, 643; see also Kahan & Rock, *supra* note 4, at 1589.

⁶² See, e.g., Jeffrey D. Hern, *Delaware Courts' Delicate Response to the Corporate Governance Scandals of 2001 and 2002: Heightening Judicial Scrutiny on Directors of Corporations*, 41 WILLAMETTE L. REV. 207, 215–24 (2005); Jones, *supra* note 15, at 644–62 (discussing various post-Enron decisions and statements by Delaware jurists); Kahan & Rock, *supra* note 4, at 1618 n.173; Loewenstein, *supra* note 2, at 371–72, 374–75; Roe, *Competition*, *supra* note 16, at 643 n.211; see also Thomas A. Roberts et al., *Director Liability Warnings From Delaware*, BUS. & SEC. LITIGATOR, Feb. 2003, at 1.

⁶³ See, e.g., *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 918 (Del. 2003) (finding that a voting agreement among majority stockholders and other provisions in a merger agreement constituted defensive measures that were subject to enhanced judicial scrutiny, and, in the absence of an effective "fiduciary out" clause, such measures were invalid); *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003) (holding that the incumbent board of directors had the burden of demonstrating a compelling justification for expanding the size of its membership as a defensive measure, and the measure was not proportionate and reasonable in relation to the threat posed); *Telxon Corp. v. Meyerson*, 802 A.2d 257, 259 (Del. 2002) (reversing summary judgment in a shareholder derivative action relating to the corporation's acquisition of a company owned by the board chairman, because genuine issues of material fact existed regarding whether the corporation's board chair ever presented a development opportunity to the board); *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 118–19 (Del. 2002) (overturning a Court of Chancery decision limiting a shareholder's access to corporate books and records); *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 921 (Del. Ch. 2003) (finding that two special litigation committee members were not independent because of the relationships between defendant directors and the members' institution, Stanford University); see also Jones, *supra* note 15, at 654–62.

⁶⁴ See, e.g., William B. Chandler III & Leo E. Strine, Jr., *Views from the Bench: The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953 (2003) (stressing, in light of SOX, Delaware's role in fashioning corporate law norms that promote corporate responsibility and best practices in corporate government); Jones, *supra* note 15, at 654–55 (discussing Delaware jurists' comments); Roberts et al., *supra* note 62, at 1 ("Chief Justice Veasey's observations, together with recent actions by the Delaware Supreme Court, signal that court's—and almost certainly other courts'—heightened sensitivity and focus upon corporate governance issues and the increased exposure to liability directors face in the post-Enron and post-Sarbanes-Oxley Act of 2002 world."); see also *What's Wrong with Executive Compensation: A Roundtable Moderated by Charles Elson*, HARV. BUS. REV., Jan. 2003, at 68, 77 (quoting Chief Justice Nor-

Those who posit that Delaware may react largely to federal rather than state threats to its dominance disagree about the nature of the interaction between Delaware and the federal government and, in light of the potential threat, the amount of autonomy Delaware retains. For example, Professor Roe believes that Delaware corporate law ultimately either mimics the preferences of federal lawmakers or risks being preempted.⁶⁵ From this perspective, and despite its advantages vis-à-vis other states, Delaware operates with limited autonomy and must act to constrain managerial prerogatives enough to satisfy federal authorities and stave off a federal takeover.⁶⁶ Professors Marcel Kahan and Edward Rock also recognize this federal threat to Delaware, but they argue that it is significant only when there are populist calls for greater federal intervention.⁶⁷ Delaware therefore may alter its behavior to protect its chartering business in times like the post-Enron period, albeit typically within the confines of the common law process.⁶⁸

Not all scholars agree with the contention that the federal threat is Delaware's principal concern or even a motivating one.⁶⁹ And others accept these claims only in part.⁷⁰ Nevertheless, trepidation regarding the threat of federalization is, at minimum, consistent with the behavior of Delaware's judicial decisionmakers in the post-Enron period. The yet unresolved question is whether these accounts have predictive value now that Enron's collapse is becoming a more distant memory.

C. Delaware's Decisionmakers

Whether taking the traditional view that robust state-to-state competition for corporate charters exists, arguing that Delaware's primacy is the result of unique advantages, or recognizing that Delaware's "primary competition" is the federal government, commentators on Delaware's domination seemingly agree on one thing: Delaware is not simply a gratuitous or unconscious beneficiary of the chartering market for publicly traded

man Veasey as saying, "If we don't fix it, Congress will, but I hope they've gone as far as they're going to have to go").

⁶⁵ See generally Roe, *Competition*, *supra* note 16, at 592, 598–607.

⁶⁶ See *id.*

⁶⁷ Kahan & Rock, *supra* note 4, at 1588–89. Kahan and Rock also contend, however, that some federal intervention is not against Delaware's interests because it addresses areas that Delaware cannot effectively regulate and thereby reduces the potential for scandal and corresponding populist backlash. See *id.* at 1590. Hence, the relationship between Delaware and the federal government is (or can be) symbiotic.

⁶⁸ See *id.*

⁶⁹ See, e.g., Romano, *supra* note 38, at 27–40.

⁷⁰ For example, in a recent article offering an insider's view of how Delaware's corporate law decisionmakers operate, Professor Lawrence Hamermesh acknowledges that Delaware actors are conscious of the potential for a backlash, but he contends that, among other things, certain norms—including conservatism and stability, deference to common law development, and a preference for private ordering—also heavily influence and constrain these actors' behavior. See Hamermesh, *supra* note 4, at 1768–87.

firms. On the contrary, Delaware's legal decisionmakers—the corporate bar, legislature, administrative agencies, and courts—acting individually or in concert, are highly sensitive to Delaware's success in, and benefits from, that market.⁷¹ Indeed, this sensitivity is hailed by race-to-the-top theorists as one of the reasons Delaware is winning the chartering race,⁷² is noted as one of Delaware's unique traits by those who question the existence of robust competition,⁷³ and is inherently tied to the notion that Delaware actors respond to federal threats to the state's primacy.⁷⁴

One not familiar with this literature might find such behavior on the part of Delaware's political actors unremarkable; after all, local interest groups (such as Delaware's corporate bar) and elected officials naturally would act to preserve Delaware's domination and the resulting economic and tax benefits.⁷⁵ Perhaps more surprising to the outside observer, however, is the notion that the Delaware Court of Chancery and Supreme Court also are keenly aware of, and respond to, chartering market preferences and threats to Delaware's primacy.⁷⁶

Delaware itself acknowledges that its courts are highly sensitive to the preferences of the chartering market. Indeed, this is one of Delaware's selling points. For example, in the Delaware Division of Corporation's 2005 Annual Report, the Secretary of State observed: "Delaware cannot remain the Corporate Capital of the United States by resting on its laurels. And so collectively, our *three branches* of government and the private sector are constantly working to promote and enhance the corporate services provided by the state."⁷⁷ After then discussing the fact that Delaware's courts were once again named the best in the nation in a U.S. Chamber of Commerce

⁷¹ E.g., Kahan & Kamar, *Myth*, *supra* note 35, at 739; Kahan & Rock, *supra* note 4, at 1590; Roe, *Competition*, *supra* note 16, at 604–05; cf. Hamermesh, *supra* note 4, at 1765 (questioning some of the claims by others about Delaware's motivations and responses, but recognizing that Delaware actors are keenly aware of market forces and will adjust Delaware law to keep pace). An influential 2003 article by Chancellors Chandler and Strine makes clear the sensitivity of Delaware jurists (like themselves) to the federal-state balance in the production of corporate law. See generally Chandler & Strine, *supra* note 64, at 953–63, 1004–05.

⁷² See, e.g., Romano, *supra* note 38, at 10–11.

⁷³ See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1213.

⁷⁴ See, e.g., Kahan & Rock, *supra* note 4, at 1590; Roe, *Competition*, *supra* note 16, at 604.

⁷⁵ Cf. Roe, *Politics*, *supra* note 17, at 2500–02 (discussing Delaware's internal political dynamics and the resulting pressures to maintain a corporate legal regime that continues to produce robust franchise tax revenues).

⁷⁶ See, e.g., Kahan & Rock, *supra* note 4, at 1592–94 (suggesting that the breadth of judge-made corporate law in Delaware cannot be just a matter of historical accident, particularly because Delaware's economic well-being depends on franchise revenues).

⁷⁷ 2005 ANNUAL REPORT, *supra* note 49, at 3 (emphasis added). The 2006 Annual Report strikes a similar chord: "Our many successes did not happen by accident but through years of strategic collaboration among our Courts, the Delaware State Bar Association, the State's legal services community, and our State's elected leaders." 2006 ANNUAL REPORT, *supra* note 29, at 4. It also describes the involvement of members of the Delaware judiciary in the state's global outreach and marketing efforts. See *id.* at 2–3.

survey of corporate counsel and litigators, the report's last paragraph begins with the following statement: "As noted by Chief Justice Myron Steele, the Chamber of Commerce survey and our long-term success demonstrate[] that '*we are at heart a customer service organization.*'"⁷⁸ Such a statement by the Chief Justice, and the inter-branch coordination to attract business it is intended to exemplify, would seem bizarre in any state other than Delaware.

Of course, Delaware actors do not say how this sensitivity affects judicial decisionmaking on substantive corporate matters.⁷⁹ Yet the judiciary's central role in the production and enforcement of Delaware's corporate legal norms depends upon its sensitivity to such forces. Indeed, Delaware's political actors undoubtedly would step in if the courts did not further the state's interests.⁸⁰

Consider, for example, Delaware's response to the recent scandals and the federal legislative and regulatory activity surrounding SOX.⁸¹ On the one hand, the Delaware legislature and executive seemed to not respond at all. The legislature enacted few new laws in the wake of Enron, none of which addressed alleged abuses directly.⁸² Likewise, Delaware's executive agencies took no action.⁸³ In other words, despite heightened popular criticism of corporate legal norms and the threat of a federal takeover of at least some of state corporate law, Delaware's political branches did next to nothing.

Yet while the Delaware Supreme Court and Court of Chancery offered no radical departures from preestablished common law norms, many commentators have noted the courts' heightened scrutiny of managerial decisionmaking post-Enron.⁸⁴ This type of muted-but-notable post-Enron response from Delaware makes sense in light of the state's interests. By engaging in greater judicial scrutiny of managers in times of threatened federalization, the Delaware courts can alleviate political dissatisfaction but

⁷⁸ 2005 ANNUAL REPORT, *supra* note 49, at 4 (emphasis added); *see also* 2006 ANNUAL REPORT, *supra* note 29, at 4 (containing the same quote from Chief Justice Steele).

⁷⁹ The U.S. Chamber of Commerce comes close to this, stating that Delaware has the best legal environment because of its courts' fairness and impartiality and "reasonable treatment of punitive damages." *See* 2005 ANNUAL REPORT, *supra* note 49, at 4.

⁸⁰ *Cf.* Kahan & Rock, *supra* note 4, at 1592–96 (recognizing the great "tolerance" the Delaware legislature has for the primacy of judge-made law in the state and contending that the courts' role cannot be merely an accident of history given the economic incentives Delaware has to maintain its chartering business). The Delaware legislature has stepped in to "correct" what it perceives as a troublesome development in the Delaware courts, although rarely. *Id.* at 1596 (describing the legislature's quick enactment of section 102(b)(7) as a response to the "shocking" decision in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)).

⁸¹ *See supra* notes 4–5 and accompanying text.

⁸² *See supra* note 4.

⁸³ Indeed, no Delaware agency engages in such ongoing oversight. *See, e.g.,* Kahan & Rock, *supra* note 4, at 1604.

⁸⁴ *See supra* notes 62–63 and accompanying text.

leave open the opportunity to soften their approach later.⁸⁵ In addition, as long as Delaware continues to maintain attractive legal norms, it need not respond to the federal threat as if it were acting alone. Delaware's decisionmakers must know that the state's natural allies—the U.S. Chamber of Commerce and other business groups—are likely to combat such a threat or otherwise pursue a legal agenda consistent with Delaware's interests.⁸⁶

In conclusion, what is particularly noteworthy about Delaware's post-Enron response to threats to its primacy is that it was an exclusively judicial one. The Delaware courts therefore are not only the state's primary corporate law creators and enforcers, but also arguably the primary responders to threats to Delaware's dominance in the chartering market.

II. DELAWARE IN THE POST-POST-ENRON ERA: FROM *DISNEY* TO *VANTAGEPOINT* (AND VICE VERSA)

While the foregoing account is consistent with the Delaware courts' behavior up to and including the post-Enron period, times have changed again. SOX is on the books, but this new regime has left Delaware's primacy and substantive law largely unscathed. For some time now, there has been little political will for Congress to further federalize corporate law. Powerful interest groups have lined up against the most onerous portions of SOX and federal securities law—most notably private enforcement under Rule 10b-5.⁸⁷ Although Delaware and the SEC have continued to engage in a bit of tug-o-war over certain matters, including shareholder voting issues, most of the federal pressure on Delaware has subsided.

In a post-Enron article, Professor Renee Jones suggested that if the “threat [to Delaware] recede[d], Delaware [would] revert to its more lax jurisprudence.”⁸⁸ Other accounts were less explicit, but some retrenchment during a period in which the federal pressure is off is consistent with both Roe's hypothesis regarding the Delaware-Washington dynamic⁸⁹ and Kahan and Rock's conception of the federal threat.⁹⁰ Indeed, if Delaware is truly sensitive to the on-again, off-again threat of federalization, one might ex-

⁸⁵ See Bebchuk & Hamdani, *supra* note 39, at 603; *cf.* Kahan & Rock, *supra* note 4, at 1583–87 (noting that change can only occur if highly dissatisfied actors see a political benefit, and stating that Delaware must keep relevant interest groups, including corporate managers and promoters, satisfied).

⁸⁶ See, e.g., Kahan & Rock, *supra* note 4, at 1586–87 (discussing interest groups likely to oppose federalization and reasons those groups might oppose federal regulation even if mildly dissatisfied with Delaware rules). For a discussion of the “special treatment” Delaware has been able to achieve in recent legal reform efforts at the federal level, see *infra* Part III.D.3.

⁸⁷ See *supra* note 6 and accompanying text.

⁸⁸ Jones, *supra* note 15, at 663.

⁸⁹ See Roe, *Competition*, *supra* note 16, at 642–43 (discussing Delaware's space to act during times when there has been weaker federal pressure).

⁹⁰ See Kahan & Rock, *supra* note 4, at 1576 (arguing that Delaware's relationship with the federal government typically is symbiotic, and that the federal threat is only genuine during times of populist movements for federalization).

pect to see changes in the Delaware courts' behavior reflecting these new times.

One can now point to *Disney* and other decisions as providing examples of such backsliding, marking Delaware's return to its traditional, permissive approach to corporate governance.⁹¹ Interestingly, the *Disney* court's decision came during a period in which executive compensation and compensation practices remained in the public spotlight and under intensified SEC and prosecutorial scrutiny.⁹² Thus, one could view *Disney* in particular as signaling genuine recognition on the part of the Delaware Supreme Court that, despite continued federal regulatory and judicial activity, Washington is not presently interested in undermining Delaware's chartering business.⁹³

Nevertheless, I suggest the *VantagePoint* decision is even more revealing than *Disney* with regard to the Delaware Supreme Court's "state of mind" in this period of waning federal interest in corporate law reform. Given the court's aggressive and unambiguously self-interested posture in the opinion, *VantagePoint* suggests that, by mid-2005, the court recognized not only that any federalization threat was waning, but also that there is another potential threat to Delaware's primacy. With the vertical threat to the state's domination subsiding, the Delaware court turned its attention to the horizontal one—not direct competition from other states, but regulatory "intrusions" by other states into the internal affairs of Delaware firms. This threat, which has largely been overlooked in recent commentary, implicates a meta-issue of far greater importance to Delaware than any particular substantive dispute.⁹⁴

A. *The VantagePoint Decision*

The *VantagePoint* case arose out of a shareholder dispute within Examen, Inc. over a proposed merger with Reed Elsevier, Inc. Examen was a closely held Delaware corporation, headquartered in Sacramento, Califor-

⁹¹ See *supra* note 10 and accompanying text.

⁹² The SEC has since decided to take a softer approach to regulating such compensation, although Congress continues to show some interest in new legislation. See, e.g., David S. Hilzenrath, *New SEC Pay Rule To Benefit Executives*, WASH. POST, Dec. 28, 2006, at D1.

⁹³ Obviously, not all contemporaneous decisions in Delaware were resolved in favor of management or evince such a recognition. However, the *Disney* case was more closely watched than others during this period, and earlier opinions in the case favorable to shareholders were cited as evidence of Delaware's heightened sensitivity to governance concerns. See, e.g., Loewenstein, *supra* note 2, at 371–72; Roe, *Competition*, *supra* note 16, at 643 n.211.

⁹⁴ I say largely overlooked because a few other commentators have recently focused on the three-way dynamic affecting Delaware firms: Delaware law, federal regulation and the threat of federalization, and attempts by other states to regulate internal or insider affairs. See generally Donald C. Langevoort, *Federalism in Corporate/Securities Law: Reflections On Delaware, California, and State Regulation of Insider Trading*, 40 U.S.F. L. REV. 879 (2006); Ribstein & O'Hara, *supra* note 21, at 57–61.

nia, with regional offices in California, Connecticut, Illinois, Massachusetts, and Texas.⁹⁵ It had 8,626,826 outstanding shares of common stock and 1,090,589 outstanding shares of "Series A Preferred Stock."⁹⁶ The preferred stock was convertible to 1,670,782 shares of common stock.⁹⁷ Following consummation of a merger between Examen and Reed Elsevier on April 5, 2005, Examen, also a Delaware corporation, became the surviving entity.⁹⁸

VantagePoint Venture Capital Partners 1996, a Delaware limited partnership, is, as its name suggests, a venture capital firm. Prior to the merger, it owned 909,091 shares, or eighty-three percent of Examen's outstanding Series A Preferred Stock.⁹⁹ It owned no shares of common stock.¹⁰⁰

On February 17, 2005, Examen and Reed Elsevier executed a merger agreement that would expire on April 15, 2005, if the merger had not yet closed.¹⁰¹ Pursuant to Examen's certificate of incorporation (and the certificate of designations for the Series A Preferred Stock), adoption of the merger agreement required an affirmative majority vote, with all stockholders voting as a single class.¹⁰² Holders of the preferred stock voted on an as-converted basis, as if they had redeemed their preferred stock for common stock.¹⁰³ Thus, under this single-class voting structure, VantagePoint possessed a small fraction of the total voting power and could not block the merger on its own. If the stockholders had voted by class, however, VantagePoint (controlling over eighty-three percent of the Series A Preferred Stock) would have been able to block the merger single-handedly.¹⁰⁴ Both Examen and VantagePoint agreed that the single class voting structure set forth in Examen's certificate was permissible under Delaware law.¹⁰⁵

On March 3, 2005, Examen filed a complaint in the Delaware Court of Chancery against VantagePoint, seeking a declaratory judgment that, pursuant to Delaware law and Examen's certificate, VantagePoint was not entitled to a class vote of the Series A Preferred Stock on a proposed merger between Examen and a subsidiary of Reed Elsevier.¹⁰⁶ On March 8, 2005, VantagePoint filed an action in the California Superior Court seeking a declaration that Examen was a "quasi-California corporation" pursuant to sec-

⁹⁵ Examen, Inc. v. VantagePoint Venture Partners 1996, 873 A.2d 318, 320 (Del. Ch. 2005), *aff'd*, 871 A.2d 1108 (Del. 2005).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *VantagePoint*, 871 A.2d at 1111.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Examen, Inc.*, 873 A.2d at 321 n.6, 323; *VantagePoint*, 871 A.2d at 1111.

¹⁰³ *VantagePoint*, 871 A.2d at 1111.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 1109.

tion 2115 of the California Corporations Code¹⁰⁷ and thus was subject to California's statutory requirement that the principal terms of a merger be approved by a majority of the outstanding shares of each class.¹⁰⁸

Section 2115, known as California's "quasi-foreign" or "pseudo-foreign" corporations act, provides that a foreign corporation's articles of incorporation are deemed amended to comply with substantial portions of California's corporations law if certain criteria are met.¹⁰⁹ To qualify under the statute, a corporation must have the following business and ownership contacts with California: (1) the average of the property, payroll, and sales factors as defined in the California Revenue and Taxation Code must be more than fifty percent during the firm's latest full income year; and (2) more than one-half of the firm's outstanding voting securities must be held by persons having addresses in California.¹¹⁰ If a corporation qualifies under this provision, California corporate laws apply, "to the exclusion of the law of the jurisdiction in which [the company] is incorporated."¹¹¹ Publicly traded corporations are expressly excluded from the statute's coverage.¹¹²

After the Delaware Court of Chancery agreed to have an expedited hearing of Examen's motion for judgment on the pleadings, the California Superior Court stayed its action pending the ruling.¹¹³ On March 29, 2005, the Court of Chancery granted Examen's motion,¹¹⁴ holding that the case was governed by the internal affairs doctrine as set forth by the Delaware Supreme Court in *McDermott v. Lewis*.¹¹⁵ Specifically, the court determined that section 2115's class-vote requirement conflicts with Delaware law, which, together with Examen's certificate of incorporation, mandates that the merger be authorized by a majority of all Examen stockholders, voting as a single class.¹¹⁶ The court concluded that, because it could not enforce both Delaware and California law, Delaware law governed. The court held that the issue was solely choice of law, and, therefore, that it need not determine the constitutionality of section 2115.¹¹⁷

¹⁰⁷ CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006).

¹⁰⁸ *VantagePoint*, 871 A.2d at 1109–10 (citing CAL. CORP. CODE § 1201(a)).

¹⁰⁹ See CAL. CORP. CODE § 2115(a), (b).

¹¹⁰ *Id.* § 2115(a).

¹¹¹ *Id.* § 2115(b).

¹¹² *Id.* § 2115(c).

¹¹³ *VantagePoint*, 871 A.2d at 1110.

¹¹⁴ See *Examen, Inc. v. VantagePoint Venture Partners 1996*, 873 A.2d 318, 325 (Del. Ch. 2005), *aff'd*, 871 A.2d 1108 (Del. 2005).

¹¹⁵ *VantagePoint*, 871 A.2d at 1110 (citing *McDermott Inc. v. Lewis*, 531 A.2d 206 (Del. 1987)). In *McDermott*, the court had suggested that the internal affairs doctrine has a constitutional dimension in holding that Delaware courts are obliged to apply foreign law to foreign corporations. See *McDermott*, 531 A.2d at 209–17.

¹¹⁶ See *Examen, Inc.*, 873 A.2d at 325.

¹¹⁷ *Id.* at 323.

VantagePoint then sought an expedited appeal and an injunction restraining the merger, pending the outcome. On April 5, 2005, the Delaware Supreme Court denied VantagePoint's request to enjoin the merger but granted its request for an expedited appeal.¹¹⁸ Thereafter, Examen and the Delaware subsidiary of Reed Elsevier consummated the merger.¹¹⁹

On May 5, 2005, the Delaware Supreme Court affirmed.¹²⁰ After determining that the merger did not render the case moot, the court turned to the choice-of-law issue, which it resolved by applying the internal affairs doctrine.¹²¹ First, the court summarized the doctrine's long-standing prominence and wide acceptance. It then discussed the virtues of the doctrine, including certainty, predictability, and protection of the expectations of parties with interests in the corporation.¹²²

The court's analysis could have ended with an application of the internal affairs doctrine to the underlying dispute and affirmance of the lower court's holding on the basis of Delaware's long-established adherence to the choice-of-law rule. Instead, the court went on to state that application of the internal affairs doctrine is mandated under the Due Process Clause and dormant commerce clause:

The internal affairs doctrine is not, however, only a conflicts of law principle. Pursuant to the Fourteenth Amendment Due Process Clause, directors and officers of corporations "have a significant right . . . to know what law will be applied to their actions," and "[s]tockholders . . . have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs." Under the Commerce Clause, a state "has no interest in regulating the internal affairs of foreign corporations." Therefore, this Court has held that an "application of the internal affairs doctrine is mandated by constitutional principles, except in the 'rarest situations,'" e.g., when "the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce."¹²³

¹¹⁸ See *VantagePoint*, 871 A.2d at 1110.

¹¹⁹ 871 A.2d at 1110.

¹²⁰ *Id.* at 1109.

¹²¹ *Id.* at 1110, 1112.

¹²² *Id.* at 1112–13.

¹²³ *Id.* at 1113 (footnotes omitted). Notably, the court did not even mention the Full Faith and Credit Clause, which it had discussed in *McDermott Inc. v. Lewis*, 531 A.2d 206, 218 (Del. 1987). This is understandable because the U.S. Supreme Court's most recent articulation of the limits that full faith and credit imposes on a forum's choice of law would not support the constitutional claims in this case. See *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 312–13 (1981) ("[F]or a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."); see also *Wilson v. La.-Pac. Res., Inc.*, 187 Cal. Rptr. 852, 857 (Ct. App. 1982) (applying *Allstate's* "less exacting standard" for determining whether the dictates of full faith and credit are satisfied by section 2115 and finding that the statute easily passes muster under this test).

The opinion includes a number of other statements about the constitutional status of the doctrine, interspersed with the policy bases for the internal affairs doctrine and the need for uniformity. The court's constitutional discussion was cursory and cited no direct authority for its constitutional claims. The court relied instead on prior Delaware cases, including *McDermott*, and selected quotes from three U.S. Supreme Court cases.¹²⁴ It also rejected a California Court of Appeals decision that had held section 2115 valid under the federal Constitution, contending that the decision predated one of the Supreme Court cases.¹²⁵ The court thus held that "Delaware's well-established choice of law rules and the federal [C]onstitution mandated that Examen's internal affairs, and in particular, VantagePoint's voting rights, be adjudicated exclusively in accordance with the law of its state of incorporation, in this case, the law of Delaware."¹²⁶

The posture of the case and the tones of both the lower and higher courts' opinions reveal not only great interest in the underlying conflict, but also an unusually aggressive approach to resolving the matter. First, although the Delaware Supreme Court had suggested in *McDermott* that the internal affairs doctrine has a constitutional dimension, it did so in far different circumstances. The principal holding in *McDermott* was that Delaware would not apply its own law to the internal affairs of a Panamanian corporation to protect its Delaware subsidiary, when the foreign parent had no substantial business activities in Delaware.¹²⁷ The *McDermott* court never addressed the question raised in *VantagePoint*—the constitutionality of *another* jurisdiction's regulation of a Delaware corporation under circumstances in which application of the foreign law was premised on majority business and ownership contacts with the foreign state. Thus, to the extent *McDermott*'s holding has a constitutional dimension, the *VantagePoint* court greatly expanded it, using it to constrain foreign legal actors rather than restrain its own actions. Furthermore, the entire tenor of the constitutional analysis in *McDermott* was more qualified and less conclusory,¹²⁸ and delivered in a tone signaling the court's recognition that its constitutional claims were tentative.¹²⁹

¹²⁴ See *VantagePoint*, 871 A.2d at 1113–17. The three U.S. Supreme Court cases are *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90 (1991), *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987), and *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

¹²⁵ See *VantagePoint*, 871 A.2d at 1116–17 (discussing *Wilson*, 187 Cal. Rptr. 852).

¹²⁶ *Id.* at 1116.

¹²⁷ See *McDermott*, 531 A.2d at 209.

¹²⁸ For example, the court said that Delaware's non-interference with the parent's internal affairs has "important federal constitutional underpinnings" and is one of "serious constitutional proportions," and it stated that *CTS* "seem[ed]" to support its interpretation of the *Edgar* decision. See *id.* at 209, 216, 217.

¹²⁹ Undoubtedly, the Supreme Court of Delaware recognized then, as it does now, that elevating the internal affairs doctrine to a constitutional mandate would be good for Delaware. But again, the *McDermott* opinion itself is less aggressive in substance and tone.

VantagePoint's approach was far from cautious or tentative. Although the case involved the validity of a California statute, there is scarcely anything in the opinion accommodating California's interest in the litigation or, more generally, reflecting notions of comity. In fact, there was no recognition that California had any interest at all in regulating the voting issues at hand.¹³⁰ In addition, after the Court of Chancery moved quickly to address Examen's motion, the Delaware Supreme Court granted expedited review while allowing the merger to be consummated and issued an expedited opinion only to *affirm* the lower court's opinion. Next, rather than simply affirming on choice-of-law grounds, the court went out of its way to find that California's choice-of-law regime is unconstitutional. Then, instead of limiting its reasoning to the circumstances in the case or to section 2115, or otherwise narrowing its reasoning, the court declared in the broadest terms that *any* "interference" in the internal affairs of a foreign firm violates the Constitution.¹³¹ Perhaps most remarkably, the court made these sweeping claims without genuine analysis of the constitutional doctrines and legal precedents on which it relied.¹³²

VantagePoint's tone, the sparseness of its legal reasoning, and the universality of its contentions are uncharacteristic for the Delaware Supreme Court. The court is known for a careful and contextual approach to corporate law matters. As many scholars have noted, Delaware courts typically avoid articulating unbending categorical rules in the corporate area, opting instead for contextual or standard-based approaches and lengthy, fact-intensive opinions.¹³³ To appreciate the contrast between *VantagePoint* and

¹³⁰ See *VantagePoint*, 871 A.2d at 1113 (suggesting that California has no interest in regulating the internal affairs of a Delaware firm).

¹³¹ The court easily could have limited even its constitutional claims. For example, because *VantagePoint* was a highly sophisticated investor chartered in Delaware, the court could have premised its dormant commerce clause claim on the fact that California does not have a strong interest in protecting *VantagePoint's* interests.

¹³² See *infra* Part II.C. Although the court's constitutional analysis in *McDermott* is no more convincing, it is less conclusory. For example, the *McDermott* court actually addressed the balancing test set forth in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), the modern approach to addressing whether state regulation runs afoul of dormant commerce clause restraints. See *McDermott*, 531 A.2d at 217.

¹³³ See, e.g., William T. Allen, *Ambiguity in Corporation Law*, 22 DEL. J. CORP. L. 894, 900 (1997) (discussing the "contextual" approach to decisionmaking and how he and other Delaware chancellors avoided broad pronouncements and general, bright-line principles in their judicial opinions); Fisch, *supra* note 15, at 1078; Kahan & Kamar, *Price*, *supra* note 35, at 1236–39; *Leadership Role*, *supra* note 47, at 45 (characterizing Delaware's jurisprudence as "lengthy, carefully drafted[,] and thoughtful opinions that not only analyze the facts and the law but do so in a way that permits the law to develop"). According to some scholars, this fact-intensive approach facilitates flexibility, allowing, for example, the court to avoid adhering to prior precedents by distinguishing them. See, e.g., Fisch, *supra* note 15, at 1078. This is not to say that the Delaware courts are unwilling to be "aggressive" in other ways. Professor Fisch argues, for example, that these courts view themselves as unusually free to address issues not directly implicated by the matter before them (i.e., to give guidance to corporate decisionmakers through dicta). See *id.* at 1078–80, 1088. And the Supreme Court's tone has been characterized as preachy or moralistic when addressing directors who have failed to meet the law's requirements. Kahan

the court's usual style, one might compare the court's treatment of the legal issues in this case with the court's careful and detailed examination of the issues, along with the qualified nature of its holdings, in *Disney*.¹³⁴ Again, this contrast cannot be explained simply because *VantagePoint* was heard on an expedited basis: if it was pressed for time, the court had multiple opportunities to affirm the Court of Chancery on narrower and less suspect grounds.¹³⁵

The Delaware courts' typical approach to decisionmaking described above helps to foster an image of judicial impartiality and avoid an appearance of bias towards particular policy preferences. This approach protects the court and Delaware in general from criticism and charges of illegitimacy.¹³⁶ Yet unlike the constitutional discussion in *McDermott*, which was cast as an exercise in Delaware's restraint, or the careful, contextual discussion in decisions like *Disney*, the *VantagePoint* decision is an unambiguous attempt to advance Delaware's interests.

All of this suggests that the Delaware Supreme Court viewed the stakes in this case as fundamentally different from the usual corporate law controversy, and therefore believed that a different approach was necessary to serve Delaware's interests. While Delaware's interests normally are served by the court's contextual and seemingly even-handed approach to substantive corporate law disputes, this dispute offered a unique opportunity for the court to address an entirely distinct concern of great importance to Dela-

& Rock, *supra* note 4, at 1599. But the universal and highly suspect contentions in *VantagePoint* are of a different character and are not just designed to give additional guidance on appropriate conduct to business decisionmakers.

¹³⁴ *Disney* not only is a very lengthy opinion, but also can be fairly characterized as offering qualified, fact-specific holdings at various points. See *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006); see also Kahan & Kamar, *Price*, *supra* note 35, at 1236–39 (providing other examples).

¹³⁵ *VantagePoint* is in one sense typical for the Delaware Supreme court: it was unanimous. See, e.g., Fisch, *supra* note 15, at 1078–79; David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127 *passim* (1997). But a court's propensity for reaching unanimous opinions normally cuts the other way; that is, it requires compromise, which tends to lead to moderation rather than overzealous reasoning.

¹³⁶ Bebchuk & Hamdani, *supra* note 39, at 604 (discussing how “apolitical” courts that are “professional, sophisticated, and respected” provide legitimacy for Delaware); Kahan & Rock, *supra* note 4, at 1612 (arguing Delaware jurists protect the state by deriving legitimacy through “neutral, nonpartisan, and technical ‘legal’ reasoning”); Roe, *Competition*, *supra* note 16, at 636–37 (“If Delaware players are uncertain what the Washington politics will be (or indeed what it is), it could be better to be fuzzy and immunize themselves from the harsh criticism they would get if they took a sharp, visible stand.”). One prominent member of the Delaware bar recently predicted that the federal-state balance will remain as is because Delaware has passed “any conceivable test for objective honesty.” *Leadership Role*, *supra* note 47, at 45. *VantagePoint*, however, departs from these various legitimacy enhancing characteristics. Moreover, in the past, Delaware jurists have shown sensitivity to claims of illegitimacy. See, e.g., William W. Bratton, *Delaware Law as Applied Public Choice Theory: Bill Cary and the Basic Course After Twenty-five Years*, 34 GA. L. REV. 447, 462 (2000) (“[Delaware judges] have an independent reputational incentive to protect the legitimacy of the system in a public policy sense.”).

ware—nationwide adherence to the internal affairs doctrine—necessitating a different tack.

B. *The Internal Affairs Doctrine*

The internal affairs norm plays a critical role in Delaware's domination, and correspondingly in the production of American corporate law. This norm operates to protect Delaware in two ways. The first, which is treated in much of the corporate federalism literature, describes the traditional reluctance of federal actors to regulate directly the internal affairs of corporations, leaving such regulation largely to the states.¹³⁷ Here the norm is simply a matter of policy preference; Congress clearly could, if it chose to, regulate such affairs directly.¹³⁸ Hence, as discussed above, recent literature is robust on the extent to which SOX, the SEC, and federal courts have strayed from this norm and on the appropriate balance between federal and state regulation of such affairs.¹³⁹

But the internal affairs norm also operates horizontally, in the form of the internal affairs doctrine. This choice-of-law rule dictates that the state of incorporation's law governs internal corporate disputes.¹⁴⁰ In the literature addressing the federal-state balance (or divide) in corporate law, continuing application of this doctrine by states other than Delaware is largely assumed, and, hence, its implications left unconsidered.

The internal affairs doctrine should not be so readily overlooked. Other states largely adhere to the doctrine, particularly in the publicly traded context.¹⁴¹ Nevertheless, as *VantagePoint* illustrates, there are exceptions.¹⁴² Moreover, the doctrine's scope—what constitutes corporate “internal affairs”—remains contested.¹⁴³ And at least to date, no federal law prevents other states from refusing to adhere to the doctrine.

¹³⁷ See, e.g., Roe, *Competition*, *supra* note 16, at 596–97.

¹³⁸ See, e.g., *id.* at 597.

¹³⁹ See, e.g., Jones, *supra* note 15 (discussing this debate over the proper allocation of authority between the federal government and Delaware); Kahan & Rock, *supra* note 4, at 1617–22.

¹⁴⁰ See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302. The internal affairs doctrine was not always “merely” a horizontal choice-of-law rule. In their early history, corporations were considered creatures of the states that created them, and, hence, the internal affairs doctrine was quasi-judicial. In the modern for-profit context, however, there is widespread agreement that the doctrine is a choice-of-law rule. For a discussion of the unique history of the corporate internal affairs doctrine, see Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006).

¹⁴¹ See, e.g., Note, *The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations for Its Continued Primacy*, 115 HARV. L. REV. 1480, 1480–81, 1497 (2002) (discussing the widespread adherence to the internal affairs doctrine and a few notable exceptions).

¹⁴² See *infra* Part III.B.

¹⁴³ See, e.g., *Friese v. Superior Court*, 36 Cal. Rptr. 3d 558 (Ct. App. 2005), *review denied*, No. S141028, 2006 Cal. LEXIS 3559 (Mar. 15, 2006), *cert. denied*, *Moore v. Friese*, 127 S. Ct. 138 (2006); *cf. Langevoort, supra* note 94, at 886–89 (discussing the differing conceptions of insider trading in Delaware and California and, relatedly, their differing views of their regulatory prerogatives); Ribstein

Despite the advantages Delaware enjoys in the market for corporate law, its primacy and the benefits it obtains as a result depend on widespread adherence to the internal affairs doctrine. Although scholars offer persuasive arguments that other states often cannot beat Delaware in head-to-head competition for corporate charters,¹⁴⁴ Delaware is vulnerable to the regulatory preferences of other states unless the internal affairs doctrine remains inviolable.

For example, Delaware's approach to the *Disney* dispute would matter far less if other states with an interest in regulating firms applied their own less deferential corporate law to internal disputes of Delaware firms. A forgotten aspect of the *Disney* litigation is that the first shareholder suits were filed in California. Unfortunately for the plaintiffs, their counsel filed parallel suits days later in Delaware, and that, combined with the internal affairs doctrine, was enough for the Court of Chancery to deny plaintiffs' request to stay the much speedier Delaware proceedings.¹⁴⁵

Now imagine that California courts, based on California's interest in a particular litigation or statute, were likely to apply California, rather than Delaware, corporate law to the dispute. The plaintiffs' strategy would have been different, and they would have avoided Delaware altogether by filing all suits in California. If a California court then applied its own law, not only might the governing legal framework and ultimate outcome in *Disney* have been different, but the legal constraints under which corporate decisionmakers operate—including those concerning executive compensation—might have changed dramatically.¹⁴⁶

More importantly from Delaware's perspective, even if this kind of refusal to apply its law to disputes within Delaware firms happened only occasionally, incorporation in Delaware would be less valuable to incorporators. Incorporation in a firm's state of primary business activity offers certain inherent "home field" advantages, including familiarity with the legal regime and its decisionmakers, potential local favoritism, lower

& O'Hara, *supra* note 21, at 30–32, 55 (discussing various limits on the internal affairs doctrine and noting that much corporate regulation falls outside of its reach).

¹⁴⁴ See *supra* Part I.B.

¹⁴⁵ See *In re Walt Disney Co. Derivative Litig.*, No. 15452, 1997 WL 118402 (Del. Ch. Mar. 13, 1997).

¹⁴⁶ I am not suggesting that California would have applied its own law in the *Disney* matter; because the case involved breach of fiduciary duty and waste claims in a publicly traded firm, California likely would have adhered to the internal affairs doctrine. See *infra* Part III.B. The point is that California could (or could try to) apply its own law, and, if it did, to consider the impact this would have. Note that in the *Friese* case, the California court found that an insider trading claim based on a California statute could be brought against insiders in a publicly traded Delaware corporation. See 36 Cal. Rptr. 3d at 571 (“[T]he history of [the insider trading statute] make[s] it clear that it is very much a part of California’s corporate securities regulation scheme and serves broad public interests rather than the more narrow interests of a corporation’s shareholders. . . . [I]t is not subject to the internal affairs doctrine . . .”). The court reached this conclusion by casting the claim as more akin to blue-sky regulation than fiduciary duty enforcement, see *id.* at 569–71, but that characterization is contestable.

transaction costs, and sometimes even direct protections for management, including anti-takeover measures.¹⁴⁷ As discussed above, corporate promoters or re-incorporators often choose Delaware because of its entity law, which is flexible, predictable, and permissive; its responsive regulatory and legislative environment; and its business-centered court system, which offers expertise and efficiency and has no juries.¹⁴⁸ Yet, as the *Disney* hypothetical above suggests, if other states could choose not to apply Delaware law to the internal affairs of Delaware firms, these benefits of chartering in Delaware would be uncertain at best. Delaware's law would not govern, and, depending on the posture of the case, Delaware's courts might be carved out of the litigation. This would dampen demand for Delaware charters, thereby reducing Delaware's ability to charge large premiums and threatening other benefits Delaware reaps from the existing regime. Thus, while Delaware may be well-protected against direct competition from other states, it remains vulnerable to other states' refusals to follow its dictates.

Once the threat of federalization subsided, Delaware succumbed to the temptation to eliminate this looming vulnerability vis-à-vis other states. The best way to achieve this would be to elevate the internal affairs doctrine to a constitutional mandate and thereby render other states powerless to act on their own choice-of-law preferences.

C. Delaware's VantagePoint Obscured

The foregoing discussion captures the character of the *VantagePoint* decision and Delaware's broader incentives with regard to the internal affairs doctrine. Yet it does not explain what the Delaware Supreme Court sought to achieve with the decision. Indeed, at first blush, the decision seems unlikely to further Delaware's interests, both because other jurisdictions may be disinclined to follow it and because the conflict it addresses is very much on the margins.

I. An Unpersuasive Piece of Judgecraft.—The *VantagePoint* court declared that the internal affairs doctrine is a constitutional mandate.¹⁴⁹ Yet beyond the *VantagePoint* litigation itself, Delaware's view of the U.S. Constitution binds no one but Delaware. Unless the decision is likely to persuade other jurisdictions that foreign regulation of Delaware firms is unconstitutional, one's first reaction is that the opinion will not help Delaware. While other jurisdictions could choose to follow Delaware's lead, they have two good reasons to reject *VantagePoint's* constitutional analysis.

¹⁴⁷ See, e.g., Bebchuk & Cohen, *supra* note 26, at 397–400 (discussing various factors, including the preferences of corporate counsel, that lead to home-state incorporation advantages, in particular for smaller firms); Bebchuk & Hamdani, *supra* note 39, at 572–74 (same).

¹⁴⁸ See *supra* Part I.B.

¹⁴⁹ *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116 (Del. 2005).

First, the decision is transparently self-interested. Indeed, as discussed previously, it is far more blatant than *McDermott*, the prior Delaware decision on which the court relied.¹⁵⁰

Second, its constitutional conclusions are a significant stretch, particularly in the context of closely held corporations. *VantagePoint*'s constitutional discussion is interwoven with claims about the efficiency of the internal affairs doctrine—that it promotes uniformity, predictability, and freedom of contract.¹⁵¹ Yet whatever one thinks of the efficiency of the doctrine, the portions of the opinion addressing the Due Process and Commerce Clauses directly are both cursory and dubious.¹⁵²

For example, the Due Process Clause analysis consists entirely of a statement that “directors and officers of corporations ‘have a significant right . . . to know what law’” will govern their conduct, and stockholders possess a similar right to know what the standards are for holding those managing the corporation accountable.¹⁵³ As support for this proposition, the court simply cites *McDermott*.¹⁵⁴ This claim is particularly unconvincing; it would be very odd, for instance, if officers and directors of corporations had a greater claim to certainty in application of the law than do other actors subject to common law and statutory mandates, including criminal laws.¹⁵⁵

While the court's dormant commerce clause claims are somewhat less vacuous, they are nevertheless largely void of reasoned analysis. In a nutshell, to support its Commerce Clause assertions, the *VantagePoint* court selectively quotes from three U.S. Supreme Court opinions for the proposition that a state has no constitutionally cognizable interest in regulating the internal affairs of a foreign firm.¹⁵⁶

These three opinions do not support this assertion.¹⁵⁷ Two of the cases—*CTS*¹⁵⁸ and *Kamen*¹⁵⁹—address matters far removed from the issues

¹⁵⁰ See *supra* notes 127–29 and accompanying text.

¹⁵¹ See *VantagePoint*, 871 A.2d at 1113.

¹⁵² As an initial matter, the constitutional discussion may be dicta because the court acknowledged that Delaware's recognition of the internal affairs doctrine as the operative choice-of-law rule would resolve the matter. See *id.* at 1116. However, it is unlikely that Delaware courts will treat it as such.

¹⁵³ *Id.* at 1113 (quoting *McDermott Inc. v. Lewis*, 531 A.2d 206, 216–17 (Del. 1987)).

¹⁵⁴ See *id.*

¹⁵⁵ For a general discussion of why the internal affairs doctrine is not mandated by the Due Process Clause, see *Wilson v. La.-Pac. Res., Inc.*, 187 Cal. Rptr. 852 (Ct. App. 1982), which upholds the validity of section 2115 under the Due Process Clause, see *id.* at 861–62.

¹⁵⁶ *VantagePoint*, 871 A.2d at 1115–17 (citing *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90 (1991); *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982)). The court also cites Delaware case law, most notably *McDermott*, 531 A.2d 206.

¹⁵⁷ See, e.g., Ribstein & O'Hara, *supra* note 21, at 53–54 (concluding that California has the better argument here because the Supreme Court “has never held that the Commerce Clause precludes a state from regulating the internal governance of a firm incorporated under another state's law”).

¹⁵⁸ 481 U.S. 69.

¹⁵⁹ 500 U.S. 90.

in *VantagePoint*. Indeed, although *VantagePoint* quotes most liberally from *CTS*, that case offers no support for the proposition that a state may not regulate the internal affairs of a firm chartered elsewhere.¹⁶⁰ In *CTS*, the Supreme Court upheld the control share acquisitions portion of the Indiana Business Corporation Law (an anti-takeover provision) under the Commerce Clause, in part because the law applied only to corporations incorporated in Indiana.¹⁶¹ In other words, the Court simply reaffirmed the authority of the state of incorporation to regulate; it had no occasion to address the extent to which states other than the state of incorporation have a constitutionally cognizable interest in regulating.¹⁶² In *Kamen*, the Court addressed whether federal courts ought to impose a universal demand requirement under the Investment Company Act. Although the Court discussed the merits of the internal affairs norm, it did so only in the context of filling gaps in federal law.¹⁶³ *Kamen* never suggested the doctrine is a constitutional imperative.

Providing slightly more relevant authority is *Edgar v. MITE Corp.*,¹⁶⁴ in which the Court found that an application of an Illinois anti-takeover provision to a tender offer involving a publicly traded foreign firm ran afoul of the dormant commerce clause. There is some language in the opinion that, stripped of its context, would appear to back *VantagePoint*'s claim.¹⁶⁵

¹⁶⁰ See Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporate Law*, 75 CAL. L. REV. 29, 34–35 (1987) (“[T]he constitutional ‘Delawarization’ of state corporation law[] is not what *CTS* intends or effects.”); Arthur R. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes after CTS Corp.*, 29 WM. & MARY L. REV. 699, 764–65 (1988) (arguing that although the Supreme Court historically has deferred to the law of the state of incorporation, that does not mean that the Court has established a Commerce Clause mandate that the law of the state of incorporation always be applied); Nat Stern, *Circumventing Lax Fiduciary Standards: The Possibility of Shareholder Multistate Class Actions for Directors’ Breach of the Duty of Due Care*, 72 NEB. L. REV. 1, 50–52 (1993) (“[The *CTS* Court’s] comments do not reflect an intent to confer constitutional status on a strict internal affairs doctrine.”).

¹⁶¹ 481 U.S. at 88–89.

¹⁶² The *VantagePoint* court is unconvincing in its reliance on *CTS* to suggest that California courts would no longer follow the California Court of Appeals’ decision in *Wilson v. Louisiana-Pacific Resources, Inc.*, 187 Cal. Rptr. 852, 859–60 (Ct. App. 1982). Similarly, the court is incorrect in its claim that a post-*Wilson* California decision, *State Farm Mutual Automobile Insurance Co. v. Superior Court*, 8 Cal. Rptr. 3d 56 (Ct. App. 2003), further indicates that California is now likely to recognize the constitutional imperatives of the internal affairs doctrine because the court relied on *CTS* and *McDermott*. *State Farm* simply relied on these two decisions for the proposition that the internal affairs doctrine is the prevailing choice-of-law rule. In fact, the court acknowledged that California need not adhere, and has not always adhered, to the doctrine. *Id.* at 64–69. *State Farm* even noted section 2115 as one exception to the doctrine but simply found that the internal affairs doctrine governed in the particular matter before the court. *See id.* at 69.

¹⁶³ See *Kamen*, 500 U.S. at 105–06.

¹⁶⁴ 457 U.S. 624 (1982).

¹⁶⁵ See *id.* at 645–46 (“Illinois has no interest in regulating the internal affairs of foreign corporations.”).

Yet upon closer examination, *Edgar* provides no such support.¹⁶⁶ As an initial matter, the entire constitutional discussion in *Edgar* may be dicta because a plurality had already found the anti-takeover provision to be preempted under the Williams Act.¹⁶⁷ Regardless, the constitutional discussion of the internal affairs doctrine certainly is dicta because the Court made clear that the regulation at issue did not involve corporate internal affairs.¹⁶⁸

Moreover, the particular Illinois provision purported to regulate broadly securities transactions between nonresidents outside the state even in the absence of a meaningful relationship to Illinois's regulatory interests.¹⁶⁹ A plurality found that such a direct regulation of interstate transactions entirely outside of the regulating state is unconstitutional regardless of the alleged regulatory purpose.¹⁷⁰ A majority then concluded that the Illinois provision failed under the dormant commerce clause balancing test set forth in *Pike v. Bruce Church, Inc.*, which prohibits states from discriminating against interstate commerce and provides that the burden imposed on that commerce must not be excessive in relation to the local interests served by the regulation.¹⁷¹ The Court found that the Illinois statute's regulation of nationwide securities transactions imposed a burden on interstate commerce that far exceeded the alleged regulatory purposes of the statute, which the court found to be dubious.¹⁷²

Critically, however, the *Edgar* Court acknowledged that states have a legitimate interest in protecting domestic shareholders.¹⁷³ It simply doubted that the Illinois statute was designed to further this purpose and concluded that the regime went well beyond serving such an end.¹⁷⁴

¹⁶⁶ P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 41 (“[*Edgar*] should not be read as constitutionalizing the *lex incorporationis*.”).

¹⁶⁷ *Edgar*, 457 U.S. at 630–40.

¹⁶⁸ *See id.* at 645 (“Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.”). In fact, none of these cases involve internal affairs—*Edgar* and *CTS* address tender offers, and *Kamen* involves a question of federal law.

¹⁶⁹ *See id.* at 644–45. The Court found that the regulation of these out-of-state transactions was not related to the alleged interest the statutory scheme was designed to serve—the protection of Illinois securities holders. *See id.* at 644–46.

¹⁷⁰ *Id.* at 640–43.

¹⁷¹ *Id.* at 643 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)).

¹⁷² *Id.* at 644–46.

¹⁷³ *Id.* at 644.

¹⁷⁴ In upholding the validity of section 2115 under the dormant commerce clause, the California Court of Appeal distinguished *Edgar* as follows:

The high threshold requirements of section 2115 distinguish this case from *Edgar v. MITE Corp.* . . . The Illinois statute applied to target companies of which shareholders located in Illinois owned [ten] percent of the stock subject to the offer, *or* for which any two of the following three conditions are met: the corporation has its principal executive office in Illinois, is organized under the laws of Illinois, or has at least [ten] percent of its stated capital and paid-in surplus represented within the state. Obviously, several states could apply such statutes to a company; such is not the case with section 2115. The court noted that the Illinois law on its face would apply even if not a single one of a company's shareholders were a resident of Illinois. “Thus the Act could be applied

Edgar therefore falls far short of supporting *VantagePoint's* claims of an absolute or categorical prohibition on regulating the internal affairs of foreign firms.¹⁷⁵ Moreover, in fashioning a categorical rule, the *VantagePoint* court ignored the *Pike* balancing test—the modern, contextual approach to evaluating whether state regulation runs afoul of the dormant commerce clause.¹⁷⁶ Perhaps this was due to the court's conclusion that California has no interest whatsoever in regulating Delaware firms,¹⁷⁷ but, for the reasons set forth above, this blanket refusal to consider California's interests evidences serious overreaching. As it turns out, the California statute at issue in *VantagePoint* is a particularly strong contender for surviving scrutiny under *Pike* because the statute does not discriminate against interstate commerce—it subjects foreign corporations to the *same* mandates as domestic firms—and is narrowly tailored, applying only to closely held firms with a substantial operational and ownership presence in California.¹⁷⁸

Edgar suggests there are some types of foreign internal affairs regulation that, although intended to protect domestic shareholders or further other legitimate regulatory interests, would impose an excessive burden on

to regulate a tender offer which would not affect a single Illinois shareholder." The court found it apparent that the statute "is a direct restraint on interstate commerce and that it has a sweeping extraterritorial effect." Such regulation by other states would stifle securities transactions. We find the higher degree of contact with the state which the California statute requires, the significantly decreased if not eliminated possibility of conflicting regulation, and the minimal burden on commerce present here provide a principled distinction between this case and [*Edgar*].

Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 860 n.6 (Ct. App. 1982) (citations omitted).

¹⁷⁵ *VantagePoint's* categorical prohibition is even contrary to the Restatement's articulation of the underlying choice-of-law rule. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302(2) ("The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied.").

¹⁷⁶ See *Pike*, 397 U.S. at 142 ("Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." (citation omitted)).

¹⁷⁷ See *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005).

¹⁷⁸ See, e.g., *Wilson*, 187 Cal. Rptr. at 858–61 (rejecting Commerce Clause and Due Process challenges to section 2115 and discussing how the statute is tailored to match California's legitimate regulatory interests); Jason S. Haller, Comment, *The Constitutionality of Outreach Statutes Under the Dormant Commerce Clause*, 37 SETON HALL L. REV. 597, 619–23 (2007) (discussing the constitutionality of section 2115); Christian Kersting, *Corporate Choice of Law: A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOKLYN J. INT'L L. 1, 31–36 (2002) (discussing constitutionality of outreach statutes in general); P. John Kozyris, *Some Observations on State Regulation of Multistate Takeovers—Controlling Choice of Law Through the Commerce Clause*, 14 DEL. J. CORP. L. 499, 519–20 (1989) (discussing pseudo-foreign corporation statutes). The *VantagePoint* court suggests that California should and perhaps would change its view in light of *CTS*, see *VantagePoint*, 871 A.2d at 1116–17, which was decided thereafter, and cites another recent California decision calling into question *Wilson's* holding. See *id.* at 1117–18 (citing *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 8 Cal. Rptr. 3d 56, 56 (Ct. App. 2003)). In light of the foregoing, this contention is not a strong one.

interstate commerce. California's carefully limited statute, however, is an unlikely candidate. And, of course, *VantagePoint's* categorical claims go even further, suggesting that a state could not regulate the internal affairs of a foreign firm whose operations and owners reside *entirely* within its borders.¹⁷⁹

Furthermore, the *VantagePoint* court's framing of the inquiry is deeply problematic. Without support, the court assumes at the outset that the analysis begins with the state of incorporation, characterizing any attempt at regulation by jurisdictions other than that state as an intrusion or outside interference.¹⁸⁰ Yet nothing in the dormant commerce clause cases suggests that the parties' choice of incorporating jurisdiction—the parties' initial choice of law—establishes the presumptive baseline or otherwise affects the analysis of the constitutionality of another state's attempt to regulate.

In addition, the court's conclusion suggests that the dormant commerce clause establishes a categorical rule that only one state is privileged to regulate certain corporate relationships.¹⁸¹ Yet no dormant commerce clause precedent supports this winner-take-all approach to horizontal regulatory conflicts where more than one state may have significant interests in regulating.¹⁸² Such a categorical rule would necessarily create a carve-out, raising much broader questions about the applicability of the *Pike* balancing test in other areas. Moreover, the court's conclusion that the state with regulatory privileges is always the state of incorporation disregards entirely the regulatory interests of all other states and overemphasizes the relative interests of the incorporating jurisdiction. If this proposition were accepted, it would effectively elevate the parties' initial choice of law to a constitutional imperative.

Finally, such an elevation of the parties' choice of law has enormous implications beyond corporate internal affairs. As an initial matter, because what constitutes corporate internal affairs is contested,¹⁸³ such a constitutional rule would call into question the ability of other states to regulate as-

¹⁷⁹ See *VantagePoint*, 871 A.2d at 1113 (“Under the Commerce Clause, a state ‘has no interest in regulating the internal affairs of foreign corporations.’ Therefore, this Court has held that an ‘application of the internal affairs doctrine is mandated by constitutional principles, except in the ‘rarest situations,’ e.g., when ‘the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce.’” (citations omitted)).

¹⁸⁰ See *id.* at 1112.

¹⁸¹ See *id.* at 1116 (“[W]e hold Delaware’s well-established choice of law rules and the federal constitution mandate that Examen’s internal affairs, and in particular, *VantagePoint's* voting rights, be adjudicated exclusively in accordance with the law of its state of incorporation . . .”).

¹⁸² Cf. Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Bottom/Top*, 23 YALE L. & POL’Y REV. 381, 413 (2005) (describing as “deeply implausible” the notion that federalism principles require other states to allow Delaware to regulate activities entirely outside of its borders). Again, *CTS* does not support this proposition—the decision simply affirms that the state of incorporation has an interest in regulating the affairs of the entity.

¹⁸³ *Id.* at 421–30; Jed Rubinfeld, *State Takeover Legislation and the Commerce Clause: The “Foreign” Corporations Problem*, 36 CLEV. ST. L. REV. 355, 376–82 (1988).

pects of the relationships between managers, shareholders, and the firm, including state blue-sky requirements and common law tort duties. Delaware and certain corporate constituencies would greatly prefer such a regime. In fact, one motive underlying the court's decision in *VantagePoint* may be to expand the frontiers of the internal affairs doctrine to capture corporate legal norms that do not currently fall within its reach. But such an expansion is entirely inconsistent with Commerce Clause precedent and the traditional division of regulatory authority.¹⁸⁴

Even more dramatically, constitutionalizing the parties' choice of law could have effects well beyond the business entity context, suggesting a constitutional bar whenever there are multiple contracting parties who transact with one another across state lines or have agreed to be governed by the law of a state other than the state within which they have consummated their agreement.¹⁸⁵ *VantagePoint*'s grant of constitutional status to party choice of law in such circumstances would bind courts to enforce contractual provisions that, although acceptable under another state's law, are repugnant to their own public policies. This would create, in effect, a *Lochner*-like prohibition on state interference with contract, placing many contractual relations subject to choice-of-law clauses beyond reach of all states except the one chosen through private ordering.

2. *A Dispute of Seemingly Little Consequence.*—In addition to *VantagePoint*'s unpersuasive legal reasoning, at first blush the particular internal affairs dispute it addresses seems of little consequence to Delaware. Although California, New York,¹⁸⁶ and a few other states impose limits on the internal affairs doctrine in the closely held context,¹⁸⁷ few states have imposed significant limitations on the doctrine in disputes within publicly traded firms. There are important outstanding issues in terms of the scope of the doctrine—what constitutes “corporate internal affairs”—even in the publicly traded sphere.¹⁸⁸ But for those matters that fall squarely within its reach, including the kind of voting structure at issue in *VantagePoint*, the doctrine is virtually unchallenged. And at least until now, few commentators have attempted to articulate a workable and preferable alternative

¹⁸⁴ See, e.g., *Edgar v. MITE Corp.*, 457 U.S. 624, 641 (1982) (discussing and citing decisions upholding state blue-sky regulations against Commerce Clause challenges).

¹⁸⁵ Cf. Ribstein & O'Hara, *supra* note 21, at 5–6 (arguing that because the corporation is a set of contracts between various constituencies, treating corporate choice of law—via the internal affairs doctrine—differently than choice-of-law inquiries with regard to other contractual arrangements is suspect); Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 386–90 (2003).

¹⁸⁶ See N.Y. BUS. CORP. LAW §§ 1317–20 (McKinney 2003).

¹⁸⁷ See *infra* notes 226–31 and accompanying text.

¹⁸⁸ See *supra* note 143 and accompanying text. These issues can be very important. They include, for example, whether and when state securities laws, shareholder standing requirements, or derivative suit requirements constitute “internal affairs.”

choice-of-law regime for disputes between and among shareholders and managers in publicly traded firms.¹⁸⁹

Again, it is the market for these firms that Delaware has traditionally dominated. Delaware does not dominate the market for closely held firms and in fact captures only a small percentage of such charters.¹⁹⁰ Moreover, given Delaware's entity taxation scheme, publicly traded firms have traditionally produced the vast majority of Delaware's chartering revenues despite their small number relative to the number of closely held firms.¹⁹¹ Because of their structure, publicly traded firms also have produced a sizable portion of the litigation in Delaware's courts.¹⁹² As Professors Larry Ribstein and Erin O'Hara have noted, to the extent that there is a litigated dispute involving the internal affairs of a closely held firm, it tends to be a terminal one.¹⁹³ Thus, while Delaware has a strong preference for application of its own law even in the closely held context, the *VantagePoint* court's motive for going well beyond what it needed to do to affirm the lower court's opinion in this case is, at minimum, obscure.

III. DELAWARE'S *VANTAGEPOINT* REVEALED: NEW AMBITIONS, NEW THREATS, AND A NEW STRATEGY

Given the dubious nature of its reasoning and the circumstances of the case, from afar the *VantagePoint* decision seems unlikely to achieve anything. But why then did the Delaware Supreme Court go out of its way to make its broad-reaching assertions?

¹⁸⁹ A few commentators have proposed horizontal choice-of-law alternatives to the internal affairs norm. See, e.g., Greenwood, *supra* note 182, at 409–30 (arguing that there should be no internal affairs exception, and that standard conflict of laws principles ought to apply to disputes involving corporate actors); Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51 (2005) (arguing that choice should be expanded so that parties may choose applicable state law different than the state of incorporation in their articles of incorporation). The “real seat” approach to choice of corporate law—which has a long history in Continental Europe and would favor the law of the jurisdiction where the corporation is headquartered—has not gained many adherents in the American context. One concern is the significant risk that such a regime would be subject to capture by management and, hence, produce inefficiencies such as robust anti-takeover provisions—a concern that was lurking in the background when the Supreme Court decided *Edgar*. Scholars have made compelling arguments, however, that the internal affairs doctrine should not govern even in the publicly traded context when states address relationships between shareholders, managers, the firm, and other stakeholders, such as employees or creditors. See, e.g., KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* 107–24 (2007); Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135 (2004).

¹⁹⁰ Kahan & Kamar, *Price*, *supra* note 35, at 1227.

¹⁹¹ *Id.* at 1224–25. Data collected by Kahan and Kamar shows that a substantial percentage of franchise tax revenues is derived from a small number of large publicly traded firms (that is, firms that pay substantial taxes because they have a significant number of outstanding shares and high assumed par value capital). See *id.* at 1251.

¹⁹² *Id.* at 1227–28.

¹⁹³ Ribstein & O'Hara, *supra* note 21, at 40.

This court is not known for being sloppy or overzealous in its reasoning.¹⁹⁴ Furthermore, it has strong incentives to adhere to judicial decision-making norms—careful reasoning, accurate use of precedent, and avoidance of unnecessarily broad pronouncements—in order to legitimize its decisions and further Delaware's chartering market interests. Unwanted negative attention and reputational harm would reflect badly not only upon the court, but also upon Delaware's chartering enterprise.¹⁹⁵ It therefore seems unlikely that the court would risk being accused of precisely what I am suggesting in this Article—that, in *VantagePoint*, the Delaware Supreme Court acted more like an agent serving Delaware's pecuniary interests than a judicial body—unless it had a very good reason for doing so.¹⁹⁶ Thus, something of importance and urgency must have driven the court to behave the way it did. A closer examination of Delaware's incentives reveals the impetus for *VantagePoint*'s claim that the internal affairs doctrine is a constitutional mandate.

A. The Changing Market for Entity Charters

To explain *VantagePoint*, we must first understand Delaware's ambitions and fears in the post-post-Enron era. Delaware intends to maintain its dominance in the publicly traded context. Reflecting broader market trends and the potential downstream threat of federalization, however, it also must expand its chartering business to other markets.

Although charters for publicly traded firms have traditionally produced far greater benefits for Delaware than closely held firms,¹⁹⁷ Delaware is becoming more dependent on attracting smaller, closely held firms. Figure 1 shows that Delaware's corporate franchise tax collections have been flat in recent years. As a percentage of the state's overall revenue, the franchise tax declined from 19.3% in fiscal year 1996 to 16.6% in 2006.¹⁹⁸

¹⁹⁴ On the contrary, Delaware courts enjoy a reputation for their expertise in corporate law matters and the quality of their legal reasoning. *See, e.g.*, Fisch, *supra* note 15, at 1077–78; Kahan & Rock, *supra* note 4, at 1613.

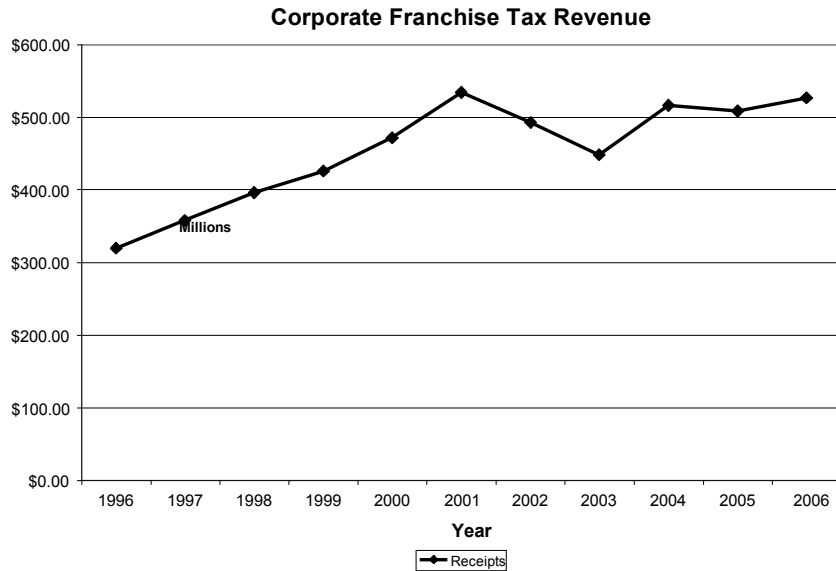
¹⁹⁵ *See supra* note 136 and accompanying text.

¹⁹⁶ Indeed, Kahan and Rock argue that Delaware has strong incentives to *avoid* interjurisdictional conflicts that might lead to further questions about its legitimacy and a backlash from other states. Although they were referring specifically to Delaware's seeking to expand the reach of its law beyond corporate internal affairs, they noted that Delaware has “a lot to lose” if it is perceived as too aggressive. Kahan & Rock, *supra* note 4, at 1616.

¹⁹⁷ *See supra* note 191.

¹⁹⁸ *See* DEL. DEP'T OF FIN., 2006 FISCAL NOTEBOOK 26 (2006), available at http://finance.delaware.gov/publications/fiscal_notebook_06/front/1_2.shtml [hereinafter 2006 FISCAL NOTEBOOK]. Indeed, franchise revenues have actually declined when adjusted for inflation. *See id.* at 96.

Figure 1¹⁹⁹



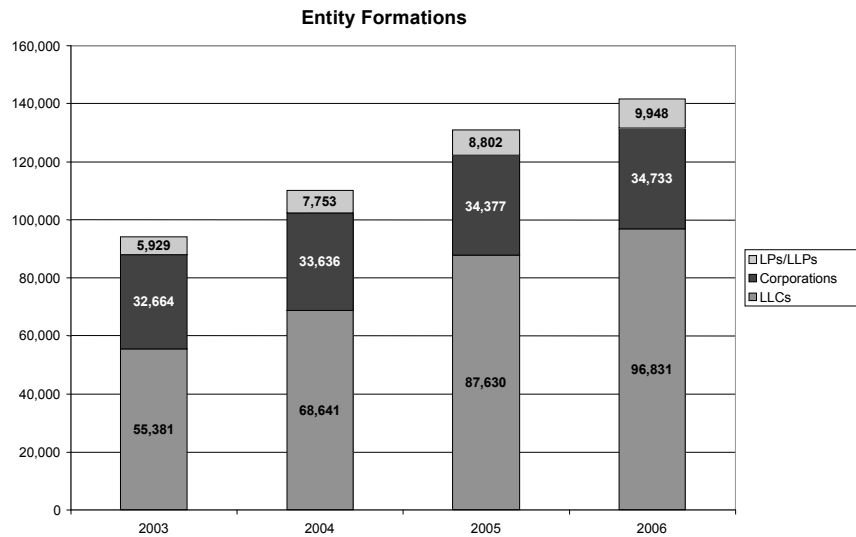
Revenues failed to rise substantially, even after a 2003 increase in franchise tax rates.²⁰⁰ And this occurred despite significant growth in corporate formations, which is reflected in Figure 2.²⁰¹ The decline and then stagnation in revenues, which occurred despite the tax increase and the rise in formations, suggest a proportionate increase in charters for smaller, closely held corporations, which can charter in Delaware and pay as little as \$35 in annual taxes.²⁰²

¹⁹⁹ See *id.* at 22–26. Net franchise tax revenue (post-refund) is even lower. For example, in fiscal year 2005, net franchise tax revenues were \$491 million. See JUNE 2006 DEFAC WORKSHEET, *supra* note 30, at tbl.1. In 2006, net revenues were \$512 million. See 2006 ANNUAL REPORT, *supra* note 29, at 2; DEL. ECON. & FIN. ADVISORY COUNCIL, REVENUE FORECAST, tbl.2 (Dec. 2006), available at <http://www.state.de.us/finance/publications/DEFAC.shtml> [hereinafter DECEMBER 2006 DEFAC WORKSHEET].

²⁰⁰ 2006 FISCAL NOTEBOOK, *supra* note 198, at 98 (the minimum tax was increased from \$30 to \$35, and the ceiling was raised from \$150,000 to \$165,000).

²⁰¹ See 2006 ANNUAL REPORT, *supra* note 29, at 1.

²⁰² 2006 FISCAL NOTEBOOK, *supra* note 198, at 95.

Figure 2²⁰³

The trend in Delaware with regard to corporate chartering is consistent with broader market trends. Given the structure of Delaware's franchise tax, which taxes on a per share or assumed par value capital basis up to a ceiling of \$165,000, new incorporations and reincorporations of publicly traded firms are an important source of tax revenue growth.²⁰⁴ Yet the number of American initial public offerings (IPOs) for corporations plummeted after the market decline in 2000, and, despite a later rebound, they remain well below their peak.²⁰⁵ Moreover, there are some indications that more public firms may be going private,²⁰⁶ perhaps stripping away existing franchise tax revenues for Delaware. The causes and permanence of these broader trends are in dispute; what is not in dispute is that Delaware recently witnessed decline and then relative stagnation in state franchise tax

²⁰³ 2006 ANNUAL REPORT, *supra* note 29, at 1; 2005 ANNUAL REPORT, *supra* note 49, at 1.

²⁰⁴ See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1251 (showing that a substantial percentage of franchise tax revenues was collected from a relatively small number of large, publicly traded firms); Patrick Jackson, *State's Budget Growth on Track to Decelerate*, NEWS J. (Del.), Dec. 19, 2006, at 1A (stating that a decline in projected franchise tax revenues for 2007 is "fueled by a slowdown in initial public stock offerings for new companies").

²⁰⁵ See, e.g., Jay R. Ritter, *Some Factoids About the 2006 IPO Market* (Aug. 7, 2006), available at http://bear.cba.ufl.edu/ritter/work_papers/Some%20Factoids%20about%20the%202006%20IPO%20Market.pdf; see also COMM. CAPITAL REPORT, *supra* note 6, at 3–4, 29–34. There are some signs of recovery in terms of American IPOs, but the numbers have remained well below the 2000 figure, when they reached their peak. Posting of Robert Jackson to The Harvard Law School Corporate Governance Blog, <http://blogs.law.harvard.edu/corpgov> (Jan. 19, 2007, 17:08 EST).

²⁰⁶ See, e.g., COMM. CAPITAL REPORT, *supra* note 6, at 4, 34–35.

revenues, and it is projecting very modest growth of these revenues in the future.²⁰⁷

During the same period, LLC formations have exploded, both nationwide and, as reflected in Figure 2 above, in Delaware.²⁰⁸ To facilitate chartering by smaller entities, Delaware charges individual closely held firms—including corporations and LLCs—minimal annual taxes. At least until recently, however, this regime has resulted in de minimis tax revenue for Delaware when compared to that produced by publicly traded firms.²⁰⁹

In order to capitalize on the dramatically increasing volume of closely held charters, Delaware doubled its annual LLC/LP tax from \$100 to \$200 at the same time it increased its corporate franchise tax.²¹⁰ Unlike the increase in the franchise tax, which produced relatively little additional revenue,²¹¹ tax revenues from LLCs and LPs more than doubled in the year after the increase, as reflected in Figure 3 below.²¹² Thereafter, these revenues have risen steadily each year as the number of new LLC charters in Delaware has grown, indicating that many entity promoters have not been chased away by the increase in the annual LLC/LP tax. Indeed, although it still remains far behind the revenue generated by publicly traded firms, the revenue the state now generates from closely held entities—corporations, LLCs, LLPs, etc.—has gained notably.²¹³

²⁰⁷ See *supra* notes 199–202 and accompanying text (including Figure 1); see also DECEMBER 2006 DEFAC WORKSHEET, *supra* note 199 (projecting modest growth in franchise tax revenues).

²⁰⁸ See 2006 ANNUAL REPORT, *supra* note 29, at 1; 2005 ANNUAL REPORT, *supra* note 49, at 1. For data on LLC formations nationwide, see INT’L ASS’N OF COMMERCIAL ADM’RS, 2006 ANNUAL REPORT OF JURISDICTIONS, available at <http://www.iaca.org> [hereinafter IACA REPORT] (providing comparative data from fifty states for 2004 and 2005 filings).

²⁰⁹ For example, as recently as 2000, the state collected just \$13.6 million in LLC/LP company taxes, while collecting \$471 million in corporate franchise taxes. 2006 FISCAL NOTEBOOK, *supra* note 198, at 96, 120; see also Kahan & Kamar, *Price*, *supra* note 35, at 1251 (showing that a substantial percentage of Delaware’s franchise tax revenues from 1997 to 1999 were collected from a relatively small number of large, publicly traded firms).

²¹⁰ 2006 FISCAL NOTEBOOK, *supra* note 198, at 98, 121.

²¹¹ *Id.* at 96.

²¹² *Id.* at 120.

²¹³ For example, LLC/LP company taxes generate almost one-sixth of the revenue generated from the corporate franchise tax. See DECEMBER 2006 DEFAC WORKSHEET, *supra* note 199, at tbl.2. Again, the corporate franchise tax also includes taxes paid by closely held corporations, and the tax’s floor and ceiling were raised in 2003. See *supra* note 200.

Figure 3²¹⁴

This gain already matters to Delaware. For example, in the 2005 Annual Report for Delaware's Division of Corporations, the Secretary of State pointed out that the state's "small decline in corporate franchise tax collections was more than offset by the 24% increase in LLC tax collections and a 17% increase in filing fees collected."²¹⁵

While Delaware has projected that franchise tax revenues will increase at about the rate of inflation in the near-term, it has projected continued double-digit growth in LLC/LP annual tax revenues.²¹⁶ Both projections appear to assume no tax increase. But if, for example, Delaware again doubled its LLC/LP tax (to \$400 annually) or implemented some price discriminating variant that produced a mean annual tax obligation of \$400, and maintained close to the same growth in chartering volume, the revenues the LLC/LP entity taxes produce would begin to be substantial relative to those the state receives from charters of publicly traded firms.²¹⁷ Likewise, given the sheer volume of existing charters for closely held corporations and the continued growth in such charters, Delaware might also enjoy significant

²¹⁴ 2006 FISCAL NOTEBOOK, *supra* note 198, at 120.

²¹⁵ 2005 ANNUAL REPORT, *supra* note 49, at 2. In 2006, LLC/LP tax collections increased by 21%, again leading the division in growth. 2006 ANNUAL REPORT, *supra* note 29, at 2.

²¹⁶ See DECEMBER 2006 DEFAC WORKSHEET, *supra* note 199 (projecting almost 18% growth in LLC/LP tax collections in fiscal year 2007 and 12% growth in 2008 and 2009).

²¹⁷ For example, based on current projections and insubstantial falloff due to the hike, a doubling of the LLC/LP tax would yield almost \$200 million in fiscal year 2008. *See id.*

short-term revenue gains if it altered its franchise tax structure by, for example, increasing its base rate for corporations—from \$35 to \$100—and making upward adjustments for other corporations near the bottom of the tax scale.²¹⁸ Moreover, the burgeoning volume of Delaware charters for closely held entities will produce other benefits, including various fees, litigation, and work for Delaware's corporate bar.²¹⁹

Thus, it appears that, out of necessity, Delaware is relying, and will continue to rely much more, on attracting closely held firms than it once did. And, beyond sheer necessity, it has a further reason to focus on this market. After Enron, Delaware once again avoided a substantial or complete federal takeover of corporate law. If or when there is another wave of corporate governance scandals, populist sentiment for a federal takeover may return. This time, such a takeover may become a reality. Yet if such federalization occurs, it most likely would be limited to the publicly traded and other large firms on which Congress, the SEC, and the public historically have focused. This would leave regulation of privately held firms largely in the hands of the states. In a sense, Delaware's push to expand its share in the market for closely held firms is not only a needed revenue generator currently, but also a sensible diversification strategy in light of the risk of federal intervention in the future.

So how might Delaware take full advantage of the market for closely held firms, most notably LLCs? Despite the large number of closely held firms currently chartered in Delaware, this market remains largely untapped. Delaware already attracts a disproportionate share of such charters relative to its size and amount of domestic business activity. But unlike its dominance in the market for publicly traded firms, Delaware captures only a small fraction of the national corporate and LLC chartering markets.²²⁰

Assuming broader market conditions do not change significantly, to increase revenues Delaware must attract such new charters in even greater numbers, raise its entity taxes, or both. To accomplish this, it must offer enticements that justify the costs to firms of chartering outside of their states of operation. The benefits Delaware offers to closely held entity promoters are largely the same as those it offers to larger firms—its law,

²¹⁸ I suggest this might be short-term because current trends indicate that, going forward, more and more closely held entities are likely to be organized as LLCs.

²¹⁹ For example, Delaware's revenue from entity fees is projected to increase at a substantially higher rate than its franchise tax revenue. See DECEMBER 2006 DEFAC WORKSHEET, *supra* note 199. It is worth noting that the number of entities chartered in Delaware has grown by fifty percent in the last six years. 2006 ANNUAL REPORT, *supra* note 29, at 1.

²²⁰ In fact, Florida is the leader in LLC chartering, followed by Delaware, although neither state captures anywhere near a majority of such charters. See IACA REPORT, *supra* note 208; Ribstein & O'Hara, *supra* note 21, at 39–40.

regulatory environment, and court system—plus some potential, although not always realized, tax advantages.²²¹

Given Delaware's price-discriminating entity tax structure, the benefits of chartering in Delaware come at a far lower price for closely held entities. Yet at least from an *ex ante* perspective, these benefits are far less valuable, particularly to firms with smaller capitalization.²²² For example, stakeholders in smaller firms are unlikely to view access to the Delaware court system as highly valuable because internal affairs litigation is less likely than it is in publicly traded firms, and the inconvenience and expense of litigating such issues in Delaware might be viewed as prohibitive.²²³ And some of the advantages of the Delaware Court of Chancery—expertise, no jury—may be achieved by including an arbitration clause in the terms of organization documents. In fact, the potential risks associated with subjecting the firm to general jurisdiction in Delaware might be perceived as outweighing any potential benefit from access to Delaware's courts for internal affairs matters.²²⁴

Moreover, at least currently, the differences between Delaware's substantive laws and the laws of other states in the closely held entity context are less pronounced than in the publicly traded context because Delaware has not had the opportunity to develop as uniquely robust a body of judicial decisions for LLCs. Furthermore, although Delaware entity taxes for closely held entities are *de minimis* compared to franchise taxes for publicly traded firms, incorporating in Delaware would add costs that might deter some firms from chartering there. Chartering costs include paying the annual premium for chartering in one state and doing business in another, maintaining a registered agent in Delaware, and paying transaction costs associated with initial filing and subsequent changes. Finally, in addition to other perceived advantages of being a "home-field" entity, the lawyers and other business planners who assist promoters in chartering smaller firms may be less familiar or less comfortable with Delaware law than are those who incorporate or charter larger firms.²²⁵

Thus, it is perhaps that much more imperative to Delaware that other states consistently adhere to the internal affairs mandate in the closely held context. Without some assurance that a firm's state of principal business

²²¹ One example is the Delaware Series LLC, which in theory allows a principal and a series of subsidiary LLCs to be treated separately for liability purposes but as a single entity for tax purposes.

²²² See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1225–26; Ribstein & O'Hara, *supra* note 21, at 38–39; Romano, *supra* note 38, at 17–18; cf. Bebchuk & Cohen, *supra* note 26, at 401 (finding in their study of incorporations of publicly traded corporations that firms with greater capitalization were more likely to incorporate out of state).

²²³ See, e.g., Kahan & Kamar, *Price*, *supra* note 35, at 1226, 1231; Ribstein & O'Hara, *supra* note 21, at 40.

²²⁴ For example, if a small California firm has a dispute with a much larger lender or commercial partner, the latter might decide to apply pressure by bringing suit in Delaware.

²²⁵ See *supra* note 147 and accompanying text.

activity will follow Delaware law, there may be little or no perceived benefit to the firm for chartering in Delaware. At a minimum, some promoters, and perhaps more importantly, corporate counsel, may view the uncertainty of the benefits as not justifying the costs.

This leads back to *VantagePoint*—an interjurisdictional dispute over whether Delaware or California will govern the internal affairs of a closely held firm incorporated in Delaware but having substantial ties to California. California is an enormous market for entity charters.²²⁶ If California courts were to apply California law to disputes within closely held firms incorporated in Delaware but largely operating or owned in California, it would be a substantial setback for Delaware. Such an outcome would both reduce the value of chartering in Delaware and divert some litigation away from Delaware courts.²²⁷ That, however, is precisely what California's quasi-foreign corporation statute mandates for certain matters.²²⁸ New York's statutory provision is even broader,²²⁹ and, given its size and substantial business activity, that state is also a substantial source of entity charters.²³⁰ Moreover, application of the internal affairs doctrine in other states is not assured today or in the future.²³¹

There is no parallel “quasi-foreign” entity provision in California's or New York's LLC statutes. In fact, consistent with the Uniform Limited Liability Company Act, the LLC statutes in California, New York, and most other states contain provisions providing that, as a general matter, the state should apply the chartering state's internal organization law to a foreign LLC.²³² Yet, given the newness of LLCs, their “hybrid” nature, and their

²²⁶ See IACA Report, *supra* note 208.

²²⁷ This would be on top of another setback: the California Franchise Tax Board recently took the position that each entity comprising a “Delaware Series LLC” must be taxed as a separate entity, thereby eliminating one further benefit of chartering in Delaware. Debbie Newcomb, What is FTB's Position on Delaware Series LLCs? (Apr. 2006), http://www.assetprotectionbook.com/CalFTB_SeriesLLC_Apr06.pdf.

²²⁸ See CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006) (requiring application of California law when more than half of all business is conducted in California and more than half of outstanding voting securities are held of record by persons residing in California).

²²⁹ See N.Y. BUS. CORP. LAW §§ 1317–20 (McKinney 2003 & Supp. 2007) (carving out publicly traded firms but seemingly sweeping within the coverage of New York corporate law foreign firms doing business within the state). However, the application of these provisions and the extent to which they in fact mandate application of New York law remains unresolved. See, e.g., *Potter v. Arrington*, 810 N.Y.S.2d 312, 315–16 (Sup. Ct. 2006) (holding that section 1319 does not compel application of New York law, but rather is a statutory predicate allowing New York to follow its conflict rules in determining applicable law).

²³⁰ See IACA REPORT, *supra* note 208.

²³¹ See, e.g., *Beloit Liquidating Trust v. Grade*, 677 N.W.2d 298, 306–07 (Wis. 2004) (suggesting Wisconsin does not adhere to the internal affairs doctrine because of the language of WIS. STAT. § 180.1704); see Note, *supra* note 141, at 1480–81 (discussing other states).

²³² See CAL. CORP. CODE § 17450(a); N.Y. P'SHIP LAW § 801; UNIFORM LIMITED LIABILITY COMPANY ACT § 1001(a), 6A U.L.A. 285 (Supp. 2007); LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES § 13:3 (2004).

explosive growth, California, New York, and other states might seek to regulate the internal affairs of foreign LLCs in the future. Indeed, the quasi-foreign corporation statute in California was the product of a 1970s reform effort to address perceived laxity in foreign corporations law,²³³ and California has already carved out at least one narrow statutory exception to the LLC internal affairs rule.²³⁴ Moreover, the scope of the internal affairs doctrine in this context is neither clear nor easily demarcated. Thus, by defining narrowly what constitutes a matter of internal organization or affairs, courts have applied domestic law to internal disputes of foreign entities, and one can foresee other courts doing the same.²³⁵

B. The Threat in the Traditional Market

VantagePoint may also reflect a more general uneasiness on Delaware's part. In the post-post-Enron era, Delaware has reason to be concerned about new state-level threats of regulatory interference in the publicly traded context. Although states traditionally have shied away from direct regulation of the internal affairs of publicly traded foreign firms, the legal regime that Delaware and the federal government currently maintain does not always play well elsewhere.²³⁶ This should not be overstated: other states historically have followed Delaware's lead, and with regard to most issues, their corporate law is similar to that of Delaware. Nevertheless, in light of recent perceived abuses, legal decisionmakers in other states may want to apply greater pressure to corporate management for the benefit of domestic shareholders and for their own sake as securities market participants.²³⁷

²³³ See, e.g., Comment, *California's Statutory Attempt to Regulate Foreign Corporations: Will It Survive the Commerce Clause?*, 16 SAN DIEGO L. REV. 943, 944 (1979).

²³⁴ See CAL. CORP. CODE § 17,453 (providing for inspection rights for members of foreign LLCs when members with twenty-five percent or greater voting interest reside in California); *Burkle v. Burkle*, 46 Cal. Rptr. 3d 562, 564 (Ct. App. 2006) (holding that California law governs inspections covered under this section). The California Code also appears to apply its derivative suit procedures and requirements to both domestic and foreign LLCs. See CAL. CORP. CODE §§ 17,500–01.

²³⁵ See, e.g., *Ayers v. AG Processing, Inc.*, 345 F. Supp. 2d 1200 (D. Kan. 2004) (finding that intentional interference with a contract claim against a managing member of a foreign LLC, for alleged interference with the LLC operating agreement, is governed by domestic law). Other courts are likely to apply domestic tort law even when the claim addresses disputes among LLC members. Moreover, if the LLC is organized as a member-managed entity akin to a general partnership, a court might apply domestic rather than foreign law on member fiduciary duties because general partnerships have traditionally been subject to the law of the state of operations.

²³⁶ See, e.g., *Langevoort*, *supra* note 94, at 890–92 (suggesting that when there is controversy surrounding corporate governance, other states may become aggressive, but noting that state policymakers have good reasons not to push too far); *Roe, Politics*, *supra* note 17, at 2523–26 (discussing interest groups that may be influential with regard to corporate governance matters in other states—including labor and state pension funds—that lack influence in Delaware).

²³⁷ For example, other states may seek to protect pension funds from insider abuse. Obviously, there will be domestic interest group pressures cutting the other way. See, e.g., *Ribstein & O'Hara, supra* note 21, at 25, 37 (arguing that members of the local corporate bar will favor corporate rules that

There is some judicial pressure along these lines. In *Friese v. Superior Court*,²³⁸ the California Court of Appeals held that a Delaware issuer based in California could bring suit against certain firm managers under a California insider trading statute.²³⁹ In addition, the state attorneys general and other officials have recently shown heightened interest in enforcing related legal norms governing entities,²⁴⁰ including, most notably, the recent enforcement activity of former New York Attorney General Elliot Spitzer.²⁴¹

Other states have not yet sought to regulate directly what they perceive as the internal affairs of foreign public firms, but such regulation is a clear prospect, particularly in times of heightened populist concern about corporate actors. States may also apply regulatory pressure indirectly by narrowly defining what constitutes corporate internal affairs.²⁴² Indeed, the *Friese* court found that the insider trading cause of action was not governed by the internal affairs doctrine because the statute is more akin to a blue-sky regulation than a fiduciary duty provision.²⁴³ In other words, state courts and legislatures may cast more corporate regulation as relating to securities market integrity, thereby enhancing their regulatory role while continuing to profess adherence to the internal affairs doctrine. Moreover, one can imagine courts in other states engaged in a choice-of-law analysis concluding, correctly or incorrectly, that their more robust entity-law norms apply because they do not conflict directly with Delaware's.

Finally, left undeterred, such heightened oversight of corporate management by other states might cause greater downstream harm for Delaware if, for example, it shames or prods federal actors into action²⁴⁴ or leads to genuine interstate conflicts that increase the appeal of a uniform federal regime. Thus, while the California statute at issue in *VantagePoint* posed a threat to Delaware's ambitions in the market for charters of closely held firms, Delaware may also have perceived a potential but genuine threat to the fruits of its dominance in the publicly traded arena.

will attract or retain entity charters). Political currents and other pressures in states other than Delaware, however, may result in such regulatory efforts.

²³⁸ 36 Cal. Rptr. 3d 558 (Ct. App. 2005), *review denied*, No. S141028, 2006 Cal. LEXIS 3559 (Mar. 15, 2006), *cert. denied*, *Moores v. Friese*, 127 S. Ct. 138 (2006).

²³⁹ The court actually found that the cause of action was not governed by the internal affairs doctrine because the statute is more akin to a blue-sky regulation than a fiduciary duty claim. *See id.* at 569–71. Whether the statute in fact governs “internal affairs” is debatable, but this decision shows the potential for courts in other states to carve away at the internal affairs norm through interpretation.

²⁴⁰ *See* Christopher R. Lane, *Halting the March Towards Preemption: Resolving Conflicts Between State and Federal Regulators*, 39 NEW ENG. L. REV. 317, 330–40 (2005) (discussing state regulatory efforts).

²⁴¹ *See supra* note 3 and accompanying text.

²⁴² *Cf.* Ribstein & O'Hara, *supra* note 21, at 30–33 (discussing how, viewed broadly, much of the regulation of corporations at the state level is outside the internal affairs doctrine).

²⁴³ *Friese*, 36 Cal. Rptr. 3d at 569–71.

²⁴⁴ *See, e.g.*, Gretchen Morgenson & Patrick McGeehan, *Wall Street Firms Are Ready to Pay \$1 Billion in Fines*, N.Y. TIMES, Dec. 20, 2002, at A1.

C. Along Comes VantagePoint: The Perfect Case

The prior two sections show that Delaware has a growing interest in preventing other states from regulating the internal affairs of both closely held and publicly traded corporations. But it faces a practical problem: In many of the cases where foreign states impose or seek to impose their law on the internal affairs of Delaware firms, the Delaware courts have no ability to participate. For example, Delaware could not prevent a foreign state's attorney general from bringing an enforcement or regulatory action that implicates entity internal affairs. Similarly, private suits that raise issues of the application of foreign law to Delaware firms are typically brought and litigated in foreign states.²⁴⁵ The declaratory judgment action in *VantagePoint* therefore provided Delaware with a rare opportunity to address head-on whether a foreign jurisdiction may impose its law in a dispute within a Delaware firm.

For a number of other reasons, *VantagePoint* presented the Delaware Supreme Court with favorable circumstances to make a strong statement. First, the timing was right: sensing a subsiding federal threat and waning public attention on most corporate matters, the court could turn its attention to horizontal concerns and act without much risk of triggering a backlash.²⁴⁶ Also, the conflict presented in *VantagePoint*—separate-class voting under California law versus single-class voting under Delaware law—looks like the kind of direct conflict over organizational structure that is particularly troubling.²⁴⁷ Indeed, the efficiencies of the internal affairs doctrine are more apparent in this kind of dispute than in, for example, cases in which courts in the two jurisdictions would simply apply different rules governing litigation or different standards of scrutiny for corporate actors' conduct. Furthermore, *VantagePoint*—a sophisticated venture capital firm chartered in Delaware that agreed to the disputed voting structure when it bargained for a stake in Examen—is a particularly unsympathetic shareholder-plaintiff.²⁴⁸ Finally, because *VantagePoint* later filed a competing suit in California, the Delaware Supreme Court was able to cast its constitutional mandate as necessary to avoid races to the courthouse, prolonged interjurisdictional disputes, and the uncertainties associated with them. In light of all of this,

²⁴⁵ The two California cases highlighted in this Article—*Friese* and *Grosset v. Wenaas*, 35 Cal. Rptr. 3d 58 (Ct. App. 2005), *affirmed*, No. 139285, 2008 WL 383196 (Cal. Feb. 14, 2008)—are examples.

²⁴⁶ Indeed, the case has received some attention, but there has been no backlash and fairly muted criticism.

²⁴⁷ In a sense, the conflict was not that direct because California law (requiring single-class voting) was mandatory while Delaware law was merely permissive (allowing the parties to opt for voting by class but not requiring it). The two bodies of law clearly do mandate different voting regimes in this case, however, because Delaware law mandates following the terms of the incorporation documents.

²⁴⁸ The Chancery Court made certain that the case would not become more sympathetic to observers by refusing to allow discovery on the extent of Examen's connections with California, most importantly, the residence of Examen's shareholders.

VantagePoint offered a unique opportunity for the Delaware Supreme Court to stake out its constitutional position.

D. Delaware's VantagePoint Strategy: A Self-Fulfilling Prophecy

As discussed above, Delaware has strong incentives to seek universal adherence to a robust internal affairs doctrine, and *VantagePoint* provided a unique opportunity for Delaware to make its case. Yet merely proclaiming the efficiency of the internal affairs doctrine does not ensure other states will agree, particularly when, as in California, the statutory framework mandates otherwise. And, while constitutionalizing the doctrine would achieve its goal, Delaware cannot impose its own constitutional views on others.

Nevertheless, I contend that the Delaware Supreme Court designed its constitutional analysis in *VantagePoint* to further this goal indirectly. By making this constitutional claim, the Delaware Supreme Court hopes to deter other states from applying their own entity law to Delaware firms, or, alternatively, to convince federal decisionmakers to bar them from doing so. In other words, the court seeks to persuade not by reasoning, but by (1) creating the specter of ongoing interjurisdictional conflicts, distasteful to legal decisionmakers at all levels, and (2) offering up an easy, facially neutral solution.²⁴⁹

This contention may be off-putting to some not only because it is inconsistent with the conventional wisdom regarding the quality of the Delaware judiciary, but also because of reluctance to attribute such “nonjudicial” motives to the court. Such a tactic, however, is consistent with Delaware’s incentives and the judiciary’s chartering market sensitivity. It is also consistent with the court system’s central role within the Delaware decisionmaking structure. Delaware’s political branches could not act effectively in this particular area; those branches’ assertions regarding other states’ constitutional power to regulate would lack legitimacy and carry no weight with legal decisionmakers in other jurisdictions.²⁵⁰ Again, the *VantagePoint* decision itself is particularly revealing: among Delaware Supreme Court opinions in the corporate area, it is conspicuous in its boldness, the broad and categorical nature of its legal assertions, and the weakness of its doctrinal claims and analysis.

The question then is how such a strategy might work—or, rather, how the court might have thought it would work. There are three possibilities.

²⁴⁹ Thus, while I agree with Professors Kahan and Rock that Delaware often has an interest in minimizing various types of interjurisdictional conflicts, *see* Kahan & Rock, *supra* note 4, at 1615–17, here I argue that Delaware is seeking to entrench its internal affairs law by fostering—even instigating—interjurisdictional conflict.

²⁵⁰ *Cf.* Bebchuk & Hamdani, *supra* note 39, at 604 (stating that, as products of a political branch, legislative decisions in Delaware face legitimacy problems in other states).

1. *Deterring Other States.*—As an initial matter, while *VantagePoint*'s constitutional assertions are weak doctrinally, they may still deter other jurisdictions from imposing their own laws on Delaware firms. In part, this is because courts in other states often reflexively defer to Delaware and its courts on corporate law matters, and thus *VantagePoint* may be influential far beyond the inherent persuasiveness of its reasoning. This already has happened, ironically enough, in a California Court of Appeals decision. *Grosset v. Wenaas*²⁵¹ addressed whether California or Delaware law governs the issue of shareholder standing in a derivative suit after a merger has been consummated and the shareholder's stock has been repurchased. In holding that Delaware law applies and the shareholder therefore lacks standing, the court relied heavily on *VantagePoint*, including its constitutional analysis.²⁵² The California Supreme Court affirmed, although, in doing so, it expressly avoided resolving the choice-of-law issue.²⁵³ In any event, by simply raising the specter of a constitutional problem, *VantagePoint* might deter some courts and legislatures from reconsidering the internal affairs doctrine or, more broadly, from seeking to regulate in areas that might implicate internal affairs.

Moreover, the posture of *VantagePoint*—a declaratory judgment action filed to avoid application of California law—combined with the outcome offers a not-so-subtle invitation to corporate actors to file preemptively in Delaware. The constitutional assertions in *VantagePoint* also authorize Delaware courts to be aggressive in future interjurisdictional conflicts. For example, the court may choose to issue anti-suit injunctions, refuse to defer as a matter of comity to proceedings in other states, and, to the extent consistent with full faith and credit, refuse to enforce foreign equitable judgments and remedies.²⁵⁴ This is not mere conjecture. Recall that in *Disney*, the Court of Chancery ruled that the case should proceed in Delaware, in part because of the internal affairs doctrine, in spite of the fact that the first suits were filed in California.²⁵⁵ Now that the Delaware Supreme Court has elevated the doctrine to a constitutional mandate, Delaware courts have an even greater (perceived) interest in retaining jurisdiction. This is particularly true during a period of sustained uncertainty over corporate regulatory prerogatives because the court has suggested that its willingness to defer to

²⁵¹ 35 Cal. Rptr. 3d 58 (Ct. App. 2005), *affirmed*, No. 139285, 2008 WL 383196 (Cal. Feb. 14, 2008).

²⁵² *Id.* at 68.

²⁵³ See *Grosset*, 2008 WL 383196 at *11. Both the context and choice-of-law issues presented in *Grosset* are quite different from those addressed in *VantagePoint*.

²⁵⁴ In another context, the Delaware Supreme Court recently emphasized that Delaware courts should resist giving up jurisdiction over corporate disputes. See *Berger v. Intelident Solutions, Inc.*, 906 A.2d 134 (Del. 2006) (reversing a forum non conveniens dismissal because, while Florida would be convenient and Florida law would govern, a Delaware trial was not an overwhelming burden).

²⁵⁵ See *In re Walt Disney Co. Derivative Litig.*, No. 15452, 1997 WL 118402 (Del. Ch. Mar. 13, 1997).

judicial proceedings in another state depends on how confident it is that the other forum will abide by the internal affairs doctrine.²⁵⁶ And, sure enough, the Chancery Court has recently become very aggressive in this regard: relying on the internal affairs doctrine and the purported need for Delaware courts to resolve uncertainties in Delaware law, the Chancery Court has recently refused to stay proceedings in a number of shareholder actions filed first in other jurisdictions.²⁵⁷

At the same time, courts in other states are often queasy about inter-jurisdictional disputes²⁵⁸ and, in the absence of strong countervailing incentives, may opt to back down. If they initially do not back down, and dueling litigation between Delaware and another state ensues, Delaware will usually win the race to judgment (and the preclusion prize that follows) given the unique structure of the Delaware Court of Chancery.²⁵⁹ Indeed, this happened in both *Disney* and *VantagePoint*. Thereafter, courts in other states may simply abandon as futile attempts to retain jurisdiction or control over such disputes.

2. *Federal Judicial Intervention.*—If Delaware’s preferences do not prevail by attrition and other states continue to apply their own law to Delaware firms, *VantagePoint* signals that Delaware will always resist such “interference.” Delaware has strong incentives *never* to back down, not only because it wants its law to apply without exception, but also because the risk of “prolonged interstate conflict” itself makes an ultimate victory for Delaware more likely. The appearance of a lingering interstate mess may render *VantagePoint*’s constitutional analysis self-fulfilling.

Despite the federalism-related virtue of local experimentation, federal jurists may be uncomfortable with prolonged interjurisdictional tussles. If faced with the prospect of ongoing interstate conflict between Delaware and, say, California, one can easily imagine a federal court favoring Delaware due to, for example, the state’s historical leadership in promulgating corporate legal norms, bias towards the perceived status quo, assumptions about the efficiency of the internal affairs doctrine, and Delaware’s own framing of the issue as foreign intrusion. Absent a constitutional mandate, however, the federal court could not constrain California’s horizontal choice-of-law decisionmaking, which is a matter of state substantive law.

²⁵⁶ See *Draper v. Gardner Defined Plan Trust*, 625 A.2d 859, 864–65, 869 (Del. 1993) (granting plaintiffs’ motion to voluntarily dismiss suit in favor of an action pending in California; the court predicted that California would apply Delaware law because it was constitutionally bound to do so).

²⁵⁷ See, e.g., *Brandin v. Deason*, C.A. No. 2123-VCL, 2007 WL 2088877 (Del. Ch., July 20, 2007); *In re Topps Co. S’holder’s Litig.*, 924 A.2d 951 (Del. Ch. 2007); *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007).

²⁵⁸ See, e.g., *Advanced Bionics Corp. v. Medtronic, Inc.*, 59 P.3d 231 (Cal. 2002) (expressing reluctance to issue anti-suit injunctions against proceedings in other states, despite the fact that strong domestic public policies were implicated).

²⁵⁹ See *supra* notes 46–49 and accompanying text (discussing the unique attributes of the Chancery Court).

Thus, if convinced that the situation is intolerable, the court might be willing to fashion or extend existing constitutional doctrine (under the Commerce Clause or otherwise) to resolve the perceived conflict, despite the troubling broader implications of such a ruling.²⁶⁰ And Delaware need not be directly involved: the parties opposing application of California law to the internal affairs of a Delaware corporation can now cite *VantagePoint* as both evidence of the “prolonged interstate conflict” and authority for the solution.

This is not far removed from reality; *VantagePoint* was already deployed in this way in the *Friese* case.²⁶¹ After the California Court of Appeals ruled that the issuer’s insider trading claims could go forward and the California Supreme Court denied review, the defendants petitioned for certiorari to the United States Supreme Court.²⁶² In their petition, they claimed that the insider trading statute necessarily addresses internal affairs and that, because the corporation is a Delaware firm, application of Delaware rather than California law is mandated under the dormant commerce clause and Due Process Clause.²⁶³ The petition cites *VantagePoint* not only as primary authority for its constitutional assertions, but as exemplifying the interstate conflict that has ensued and the need for Supreme Court intervention:

The decision below not only sweeps aside these fundamental constitutional principles; it brings the California courts into severe tension with the Delaware Supreme Court. That court recently invalidated an effort by California to interfere with the internal affairs of Delaware corporations. . . . Holding that “application of the internal affairs doctrine is mandated by constitutional principles,” *VantagePoint Venture Partners 1996 v. Examen, Inc.*, the Delaware Supreme Court invalidated [the] “quasi-California corporation” provision as applied to a Delaware corporation.

In this case, by contrast, the California courts have upheld a California law that intrudes at least as seriously into a Delaware corporation’s internal affairs. At issue here is California Corporations Code Section 25502.5. As authoritatively construed by the state courts below, this statute permits a Delaware corporation to sue its own officers and directors, subject to California shareholder demand and board voting rules, for breach of internal duty to the corporation—regardless of what Delaware law might provide. This Court’s intervention is warranted to resolve this deep conflict between the principles adopted by the California and Delaware state courts.²⁶⁴

²⁶⁰ For example, a court might be willing to fashion a categorical rule under the Commerce Clause, even though this approach is contrary to the modern case-by-case approach, or somehow recalibrate the *Pike* analysis to invalidate the foreign state’s regulation.

²⁶¹ *Friese v. Superior Court*, 36 Cal. Rptr. 3d 558 (Ct. App. 2005), review denied, No. S141028, 2006 Cal. LEXIS 3559 (Mar. 15, 2006), cert. denied, *Moore v. Friese*, 127 S. Ct. 138 (2006).

²⁶² Petition for Writ of Certiorari, *Friese*, 127 S. Ct. 138 (No. 05-1590).

²⁶³ See *id.* at 3–4.

²⁶⁴ *Id.* at 3–4 (internal citations omitted).

The U.S. Chamber of Commerce and other industry groups made similar arguments as amici curiae:

In sum, whereas Delaware holds as a matter of federal constitutional law that a corporation's internal affairs are governed "exclusively in accordance with the law of its state of incorporation," . . . California holds that it may regulate internal affairs of Delaware corporations. The conflict is real, pervasive[,] and entrenched. Only this Court can resolve it.²⁶⁵

Although the Supreme Court denied review in *Friese*, the case leaves *VantagePoint* untouched and shows that groups like the Chamber of Commerce are now engaged with this issue. These groups and future parties can use every new case in which application of the internal affairs doctrine is raised to bolster later claims that the interstate conflict is becoming messier (i.e., "*VantagePoint*, *Friese*, *Grosset*, and now . . .").

In reality, the types of regulation of Delaware entities at issue in cases like *Friese* and *Grosset* create little risk of disrupting interstate commerce or causing lingering uncertainty.²⁶⁶ Nevertheless, the specter of an ongoing interjurisdictional tug of war and the claims of inefficiencies alleged by industry groups might be enough to persuade a federal court to accept *VantagePoint*'s Commerce Clause "solution," at least in the absence of equal persistence by those who take the contrary view.

3. *Federal Legislative Intervention.*—If federal courts ultimately are unwilling to bite, Delaware or, more likely, interest groups, may turn to Congress for relief. In light of its popularity with powerful interest groups, Delaware enjoys a history of being privileged in federal legislation through exceptions or carve-outs for matters involving corporate internal affairs. As Professors Kahan and Rock note, when Congress otherwise tramples on states' prerogatives in matters touching on corporate law or governance, Delaware's allies ensure that its interests are protected.²⁶⁷ Two examples are the Class Action Fairness Act (CAFA) of 2005²⁶⁸ and the Securities Litigation Uniform Standards Act (SLUSA) of 1998.²⁶⁹ CAFA excludes

²⁶⁵ Brief for Technology Network as Amici Curiae Supporting Petitioners at 15, *Friese*, 127 S. Ct. 138 (No. 01-1015).

²⁶⁶ Neither the California insider trading regulation at issue in *Friese* nor the more liberal approach to standing at issue in *Grosset* creates legal obligations or rights that are irreconcilable (that is, unable to coexist) with Delaware's legal mandates. Moreover, corporate actors will not face lingering uncertainty: once they are aware that California imposes heightened duties under the regulation and that shareholder standing in California may be broader than that in Delaware, they can act accordingly. Thus, there is little merit to the claim that application of California law in these cases will create sustained uncertainty, substantially interfere with commerce, or place corporate actors in the untenable position of having to choose between mutually exclusive legal rules.

²⁶⁷ Kahan & Rock, *supra* note 4, at 1587–88.

²⁶⁸ Pub. L. No. 109-2, 119 Stat. 4 (2005) (codified at 28 U.S.C. § 1453).

²⁶⁹ Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified in scattered sections of 15 U.S.C.).

state corporate law class actions from its removal jurisdiction,²⁷⁰ and SLUSA contains a “Delaware carve-out” that exempts from its coverage misrepresentation claims based on the law of the state of incorporation.²⁷¹ Thus, not only have populist pushes for federalization of corporate law fallen short, even post-Enron, but where Congress has acted to federalize other matters, interest groups have succeeded in preventing states’ corporate law prerogatives from being affected as a matter of substance or procedure. Although Delaware is the primary beneficiary of these measures, they are often cast in facially neutral terms. Proposals contained in the Paulson Committee’s interim report offer the most recent evidence of the business community’s attempts to privilege the law and courts of Delaware, albeit in particularly subtle ways.²⁷²

With a history of widespread adherence to the internal affairs doctrine and the *VantagePoint* decision providing the frame, a record of “interjurisdictional conflict,” and powerful interest groups backing the measure, Congress may be persuaded to clean up any lingering interstate confusion by making the internal affairs doctrine a national choice-of-law rule, at least in the absence of populist calls for stricter federal regulation of corporations.²⁷³ *VantagePoint* and the internal affairs disputes now appearing in its wake of-

²⁷⁰ See 28 U.S.C. § 1453(d)(2)–(3) (exempting from CAFA’s removal provisions claims that “relate[] to the internal affairs or governance of a corporation or other form of business enterprise and arise[] under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized” and claims that relate to the rights, duties, and obligations arising from or created by any security).

²⁷¹ 15 U.S.C. § 77p(d)(1) (excluding from SLUSA’s preemptive scope actions “based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity)”; *id.* § 77bb(f)(3)(a) (same)).

²⁷² The Committee proposes an overhaul of various aspects of federal and state corporate law to improve the competitiveness of American financial markets. See generally COMM. CAPITAL REPORT, *supra* note 6, at 8–22. Many of the Committee’s proposals—reforming SOX, controlling private litigation under Rule 10b-5, and preventing certain aggressive state-level enforcement efforts—are part of the pushback likely to benefit Delaware. In addition, the Committee does not propose any changes to corporate civil litigation in state courts; for example, while suggesting that private securities claims be subject to arbitration, the Committee makes no such suggestion with regard to state corporate law claims. See *id.* at 109–11. Perhaps most interestingly, the Committee offers robust criticisms of state anti-takeover law, including Delaware’s, and suggests modest reform is needed. See generally *id.* at 93–104. Yet, rather than harming Delaware, mandated reform through preemption (or otherwise) of state anti-takeover provisions would actually benefit Delaware: anti-takeover provisions are a potentially powerful enticement other jurisdictions may use to keep home-grown publicly traded firms from incorporating in Delaware. See *supra* note 57.

²⁷³ In a recent article, Larry Ribstein and Erin O’Hara note this possibility. See Ribstein & O’Hara, *supra* note 21, at 58 (“Federal law theoretically could solve the problem of state non-application of the [internal affairs doctrine] not just by displacing these laws, but alternatively by providing for federal enforcement of contractual choice. A possible mechanism . . . could be through a law preempting state laws on corporate governance or securities *except* to the extent that it is subject to the [internal affairs doctrine].”). Others have discussed potential preemption of state-level regulatory efforts. See, e.g., Jill E. Fisch, *Institutional Competition to Regulate Competition: A Comment on Macey*, 55 CASE W. RES. L. REV. 617 (2005); Lane, *supra* note 240.

fer Delaware's allies an opportunity to cast this as a type of reasonable tort reform—perhaps akin to CAFA or SLUSA—to prevent rogue states or judges selected by forum-shopping plaintiffs' counsel or politically motivated attorneys general from causing widespread uncertainty and interstate conflict. And unlike many federal forays into new areas, such a reform could be presented as preserving the status quo—*preventing* regulatory interference with the choices of incorporators and *preserving* traditional allocation of corporate lawmaking authority.²⁷⁴ The U.S. Chamber of Commerce is already making these types of arguments in internal affairs litigation.²⁷⁵ Moreover, by seeking federal limits on and oversight of state regulators' enforcement activities, the Paulson Committee has signaled its desire to have federal authorities step in to prevent what it views as inefficient state-level enforcement of corporate norms.²⁷⁶

Obviously, the likelihood of federal legislation codifying the internal affairs doctrine depends on the prevailing political winds, which could change yet again. There is also genuine danger here for Delaware: It runs the risk of placing the internal affairs doctrine and, accordingly, Delaware's domination, front and center before the political branches of the federal government. What these branches can give in good times, they can also take away in bad ones (and then go further).²⁷⁷

But Delaware has its supporters on both sides of the political aisle,²⁷⁸ as does, at present, the more general post-post-Enron pushback against SOX and federal securities law.²⁷⁹ Moreover, while the internal affairs doctrine has its critics,²⁸⁰ most who criticize Delaware's domination advocate federal chartering and may be far less enthusiastic about regulatory intervention by other states.²⁸¹

Given everything else that is currently being debated as part of this pushback,²⁸² attempts to prop up Delaware's position through facially neutral federal legislation may go relatively unnoticed. Thus, those who are

²⁷⁴ See Ribstein & O'Hara, *supra* note 21, at 57–58 (contending that when a non-incorporating state seeks to regulate corporate governance, the risk of multiple-state regulation may justify federal intervention).

²⁷⁵ See *supra* note 265 and accompanying text.

²⁷⁶ See COMM. CAPITAL REPORT, *supra* note 6, at 9–10, 68–69.

²⁷⁷ Cf. Kahan & Rock, *supra* note 4, at 1588–89 (discussing the threat of a populist push to federalize corporate law in response to crises and the lurking danger of Delaware being viewed as politically illegitimate).

²⁷⁸ *Id.* at 1586 (discussing Delaware's political allies, which include members of both political parties).

²⁷⁹ See, e.g., BLOOMBERG & SCHUMER REPORT, *supra* note 8, at 77.

²⁸⁰ See, e.g., GREENFIELD, *supra* note 189, at 109–12; Greenwood, *supra* note 182, at 409–30.

²⁸¹ See, e.g., Bebchuk & Hamdani, *supra* note 9 (rejecting the argument that state law—and Delaware law in particular—is capable of producing adequate investor protections, and arguing that federalization of corporate law is the means to achieve more optimal corporate arrangements).

²⁸² See *supra* notes 6–8 and accompanying text (discussing the various proposals to amend SOX and roll back federal securities enforcement).

concerned about the implications of *VantagePoint* and efforts to entrench permanently Delaware law as the predominant law governing business entities need to monitor closely federal legislative activity and be prepared to take action to ensure this does not happen.

CONCLUSION: UNMASKED AMBITION AND A TWIST OF IRONY

For the Delaware Supreme Court, the *VantagePoint* decision is uncommonly conspicuous. Appearing to overreach for nonjudicial reasons is never good for a court. It seems particularly dangerous for a Delaware court addressing corporate matters, since any indicia of illegitimacy might harm Delaware's ability to protect itself against the looming threat of federalization. The court therefore must have had powerful incentives to be so aggressive.

While perhaps relieved that Congress again did not preempt state corporate law or fundamentally alter the nature of chartering in the post-Enron era, Delaware's decisionmakers now must confront new challenges. In this post-post-Enron era, the state faces the reality that its dominance in the publicly traded market will not produce the benefits it once did. Delaware must find ways to tap further the burgeoning market for charters of closely held entities, recognizing that its ability to realize benefits from these markets is dependent upon preventing foreign internal affairs regulation. Thus, in *VantagePoint*, the Delaware Supreme Court saw the opportunity to begin the campaign to entrench its law in both the publicly traded and closely held contexts.

The *VantagePoint* decision reveals something else: the Delaware court, cognizant of both the threat of federalization and the threat of foreign internal affairs regulation, recognizes that these two threats require different responses. While Delaware's strategy vis-à-vis the federal threat is occasional appeasement, its strategy vis-à-vis other states is exactly the opposite. This explains *VantagePoint*: warn of a potential interstate mess, refuse to recognize the regulatory prerogatives of other states, stand steadfast to deter others from entering, blame the undeterred for the impending conflicts, and offer up a federal remedy. Delaware's appeasement strategy has worked so far; whether its *VantagePoint* strategy will succeed remains to be seen.

Finally, all of this is rather ironic. Despite Delaware's decades old, on-again, off-again struggle to prevent a federal takeover of substantive corporate law, Delaware *wants and needs* a federal takeover of corporate choice of law. Delaware and allied interest groups may hope this irony is lost on those from whom they seek relief; others opposing such a regime should make sure that it is not.

