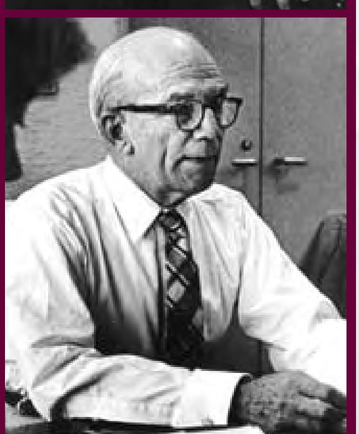
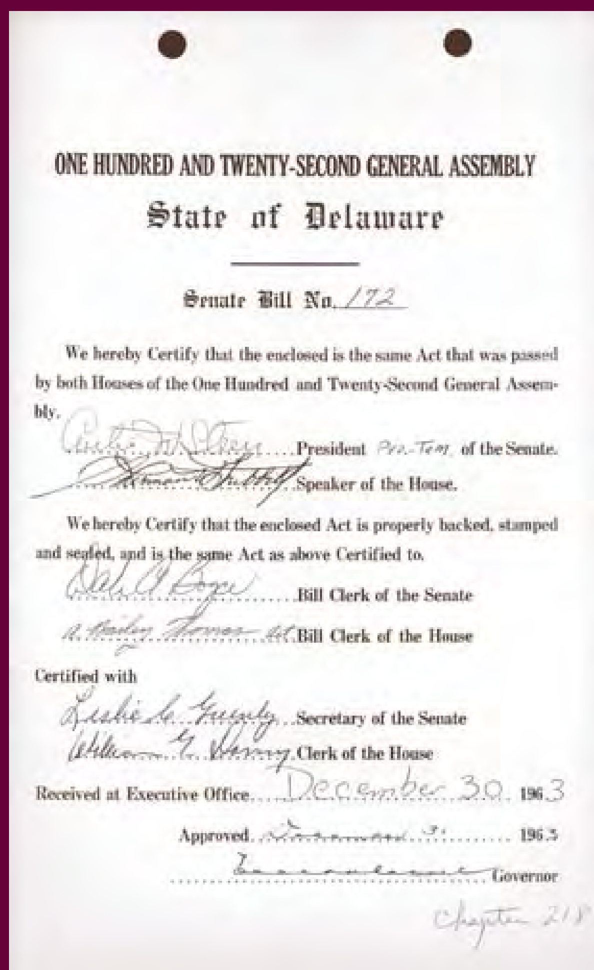
INSIDE: Revisiting the First State's Landmark Achievement Through the Eyes of the Drafters

Delaware Lawyer

A PUBLICATION OF THE DELAWARE BAR FOUNDATION
VOLUME 26 ◆ NUMBER 1
$3.00 ◆ SPRING 2008





ONE HUNDRED AND TWENTY-SECOND GENERAL ASSEMBLY

State of Delaware

Senate Bill No. 172

We hereby Certify that the enclosed is the same Act that was passed by both Houses of the One Hundred and Twenty-Second General Assembly.

.......President Pro-Tem of the Senate.

.......Speaker of the House.

We hereby Certify that the enclosed Act is properly backed, stamped and sealed, and is the same Act as above Certified to.

.......Bill Clerk of the Senate

.......Bill Clerk of the House

Certified with

.......Secretary of the Senate

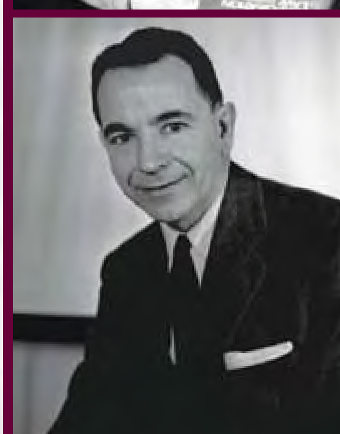
.......Clerk of the House

Received at Executive Office....December 30.. 1963

Approved.......31........ 1963

.......Governor

Chapter 218



Folk at 40: The Past and Future of the Delaware General Corporation Law

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ON THE COVER: Senate Bill 172 appropriated funds to begin the DGCL revision. Pictured clockwise from bottom left are Richard F. Corroon, Henry M. Canby, Professor Ernest L. Folk III and S. Samuel Arsht.

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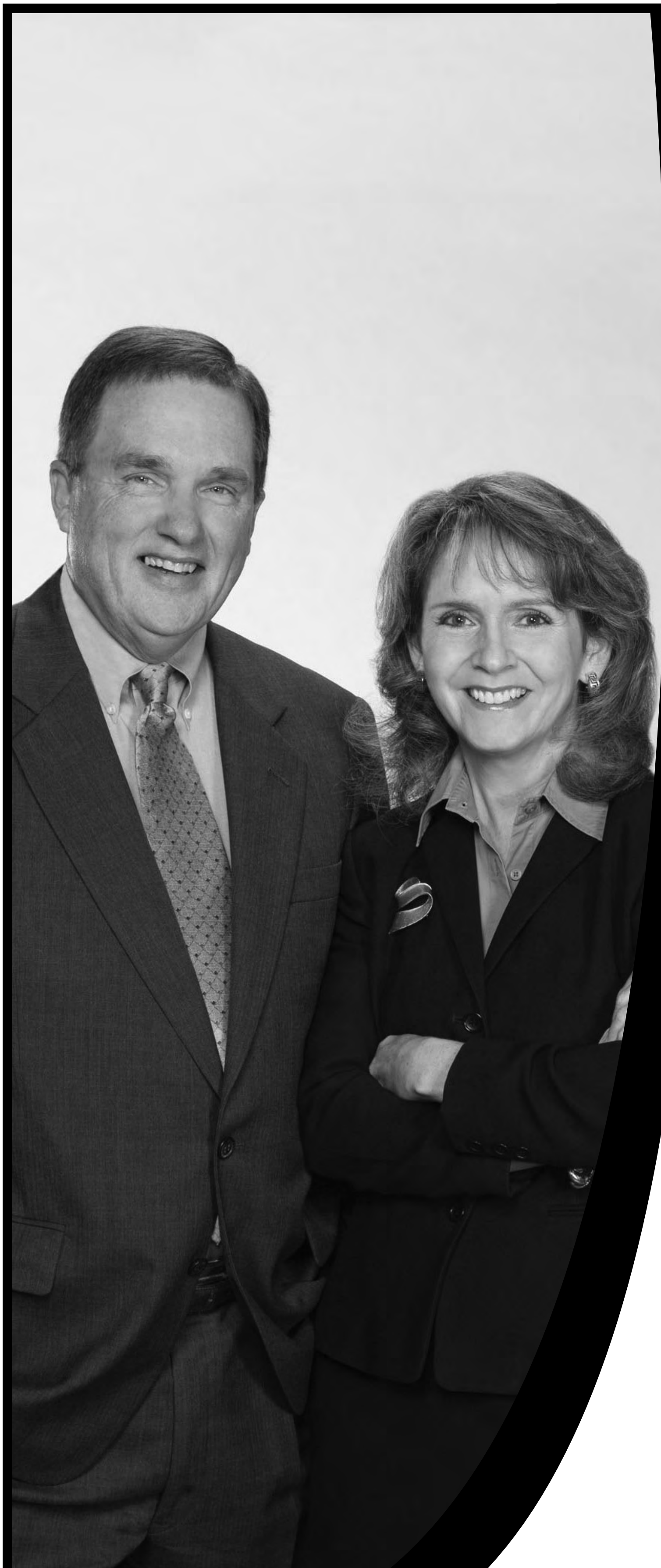

Delaware Lawyer

A publication of the Delaware Bar Foundation
Volume 26, Number 1

DELAWARE LAWYER
is produced for the Delaware Bar Foundation by:

Media Two, Inc.
1014 W. 36th St. / Baltimore, MD 21211

Editorial Coordinator / Peter L. Kerzel

Art Director / Samantha Carol Smith

Subscription orders and address changes should be directed to:
Chris Calloway 302-656-1809

Requests for advertising information should be directed to:
Howard B. Hyatt 1-800-466-8721

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Jacqueline Paradee Mette

As the new executive director for the Delaware Bar Foundation, I approached the *Delaware Lawyer* Board of Editors, asking that the Foundation have a voice in its magazine. Fortunately, they agreed to this column. I thought I would begin with the nuts and bolts of Interest on Lawyers' Trust Accounts (IOLTA).

The Foundation was incorporated in 1981 with a mission to improve the administration of justice in Delaware. In 1983, the Supreme Court of Delaware bestowed upon the Foundation the responsibility of overseeing IOLTA. IOLTA isn't the most exciting topic for lawyers, but it is important. Lawyers know they need to keep their client funds separate from their operating accounts and that IOLTA accounts are opened to pool relatively small client funds.[1] Most lawyers know that the interest on these lawyer trusts accounts is transferred to the Foundation.[2] For a review of IOLTA information, consider visiting the Foundation's Web site at www.delawarebarfoundation.org.

What lawyers may not know is whether the bank with which they do business is the best place for their IOLTA account. Small-balance IOLTA accounts may trigger fee assessments for small balances, and these fees are charged against the Foundation. If you know your account will hold a small balance regularly (typically below $2,500), triggering a balance fee, ask your bank to waive the fee. If your bank charges overdraft and wire transfer fees, consider asking the bank to waive those fees as well. A phone call could save the Foundation funds which would be better spent serving the needs of those who cannot otherwise afford legal counsel.

Finally, unlike many states that require banks, either by court rule or state regulation, to offer IOLTA rates comparable to other accounts at the bank, Delaware has chosen, to date, not to do so. Banks, therefore, have more discretion in Delaware regarding the rates offered. Therefore, it is important for all lawyers in Delaware to know the rate offered on their IOLTA account. A good rate will be at least 1.60 percent.

Jacqueline Paradee Mette

Jacqueline Paradee Mette

FOOTNOTES

1. *See* Del. Lawyers' Rules of Prof'l Conduct R. 1.15.

2. A letter from the lawyer to the bank, directing it to open the lawyer's account as an IOLTA account, with interest remitted to the Foundation, triggers this process. *Id.* The lawyer must also send a copy of this letter to the Foundation so that the Foundation can monitor the bank's transmission of interest. A form letter is available on the Foundation's website, www.delawarebarfoundation.org.

Leo E. Strine Jr.

The editorial board of *Delaware Lawyer* honored me with the charge of putting together an issue of the magazine addressing corporate law. What immediately came to my mind was the thought, "Folk at 40," an idea inspired by Professor Ernest L. Folk III's key role in helping the Delaware Corporation Law Revision Committee craft a comprehensive revision to the General Corporation Law of the State of Delaware (DGCL), a revision that was enacted into law in 1967.

Fortunately for me, the board of editors told me that I would have help from an extremely gifted, diligent, and conscientious young corporate lawyer, Blake Rohrbacher. I then got greedy myself and enlisted Delaware's strategic reservoir of knowledge regarding our corporate law and its history, Professor Larry Hamermesh, to help Blake and me figure out how to proceed.

Although we recognized that one of the most important legacies of the Delaware Corporation Law Revision Committee was the Council of the Corporation Law Section and the General Assembly's joint commitment to annually reviewing and keeping current the DGCL, the three of us also believed that, after 40 years, it would be useful to have a distinguished group of corporate law commentators, from practice and academia, take a forest-eye view of the statute, in light of the major economic and corporate developments since the Summer of Love.

We also thought that it was high time to bring together the three distinguished lawyers who, as young members of the Bar, served as the key staff to the Revision Committee, and to capture their memories of a tremendously important achievement in the history of our state.

This issue begins with a roundtable discussion of their recollections and finishes with 14 pieces by some of the leading corporate law commentators in our nation, for whose contributions we are immensely grateful. The conceit used as the charge for the commentators' submissions precedes their work.

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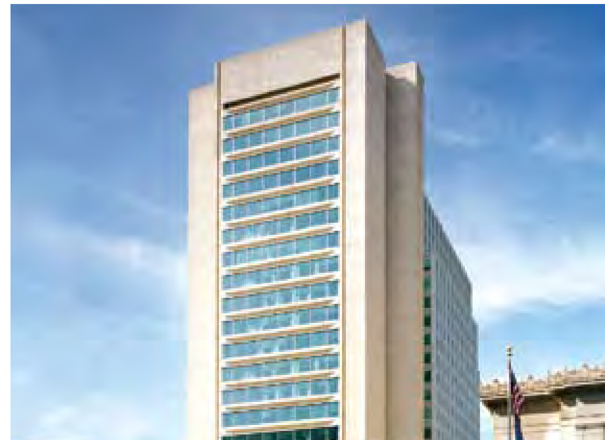
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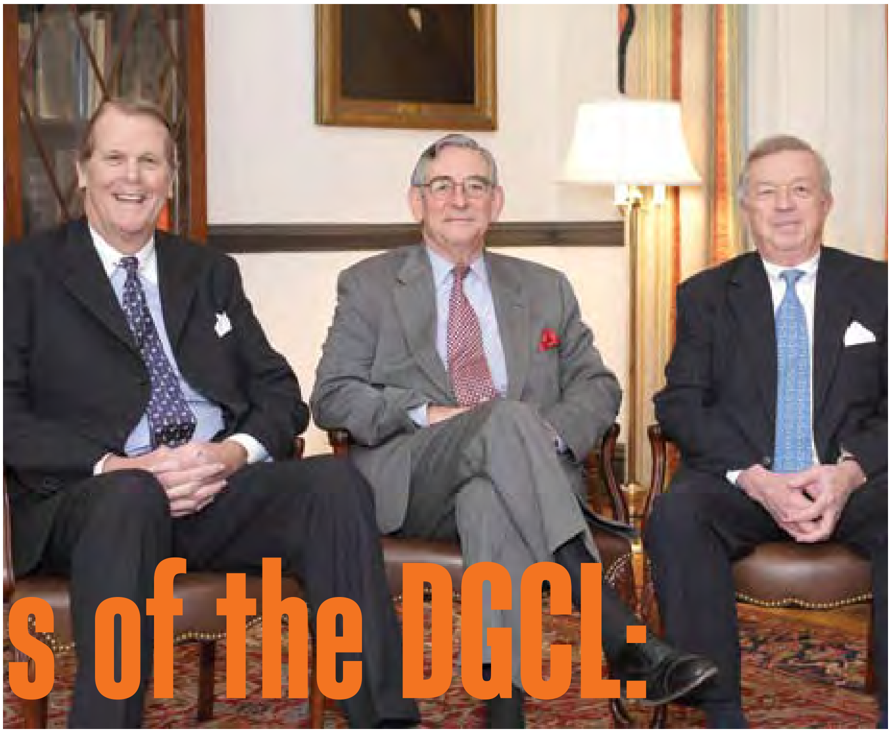
From left to right:
Charles F. Richards Jr.,
the Hon. Walter K. Stapleton
and Charles S. Crompton Jr.

Photo by Luigi Ciuffetelli



Dogsbodies of the DGCL:

Revisiting Roles in the Landmark Achievement

The process was an inclusive one that resulted in a great deal of attention being given to the final product.

On Jan. 7, 2008, Judge Walter K. Stapleton, Charles S. Crompton Jr. and Charles F. Richards Jr. sat down to discuss their work as the key staff and secretaries to the Delaware Corporation Law Revision Committee, and in particular to its drafting subcommittee, in the latter half of the 1960s. The meeting was moderated by J. Travis Laster and Frederick H. Alexander. Also in attendance were Vice Chancellor Leo E. Strine Jr., Professor Lawrence A. Hamermesh and Blake Rohrbacher. The meeting was transcribed by Kurt Fetzer of Wilcox & Fetzer as a service to the Bar, for which the editors of *Delaware Lawyer* and the Delaware Bar Foundation are grateful.

LASTER: Why did the 1967 revision happen?

STAPLETON: Competition from other states. The statistic I remember from 1968 was that 40 percent of Delaware's budget came from the Corporation department. That's something the legislature regarded as the goose laying the golden egg.

RICHARDS: Also, Delaware's position of prominence had begun to slip. I don't think there were defects in the corporation law or criticism about a particular section of the law. It was more the idea that, if the whole thing were reviewed and reinvigorated (which was not something that other states had done), maybe that would help. It ultimately turned out to be successful — far beyond the conception of the members of the Commission.

CROMPTON: That's right. Secretary of State Elisha Dukes, a very savvy politician, was aware of the fact that, if we could keep (and possibly increase) our revenue from this source, it would be a good idea. He was the driving force behind the effort. He said, "Let's get a real blue ribbon group together that will put us in a position that nobody else can match."

ALEXANDER: To a great extent, the 1967 changes were about streamlining things. Was the effort as much about making the statute user friendly as it was about introducing revolutionary concepts?

STAPLETON: I think so. In fact, there was a hesitancy to make substantive changes. The idea was that we had a good thing going here. If we were going to make a change, we had to be able to justify it. It was not about change for change's sake.

CROMPTON: The overriding philosophy was to keep things constitutionally broad in language and enabling, rather than codifying things or stating specifically what had to be done. There was a conscious effort on the part of the Commission — and certainly on behalf of the drafting subcommittee — not to make substantial changes without really being sure those changes would have merit. At the same time, we wanted to keep things as broad and flexible as possible. Flexibility was really a watchword.

RICHARDS: The process was an inclusive one that resulted in a great deal of attention being given to the final product. Input was sought from the national corporate bar, who gave specific suggestions as to changes we should make. It showed that we were not just some little group meeting in Dover and fixing up the law. Delaware was open to the best ideas of the corporate bar. The very process of soliciting their views made members of the national corporate bar aware of what we were doing and probably also served as an advertisement.

LASTER: How were you invited to participate in this?

Walter K. Stapleton, 1963

CROMPTON: "Invite" isn't the right word. I got tapped on the shoulder and was told, "We're doing this." I had been admitted three years then, and it was exciting — we were sitting around with former Chief Justice Southerland and a few of his friends and working on the Delaware Corporation Law. It was wonderful in that sense and challenging intellectually. It was also a lot of work, partly because of the technology — manual typewriters, carbon copies and the beginning of Xerox copying.

RICHARDS: We three were all appointed at the same time: April 1965. The first meeting any of us attended was April 20, 1965, the 15th meeting of the Commission. The meetings had been going on for a long time, and the Commission realized that they faced the burden of taking their policy decisions and actually writing a statute. That's when we got anointed, appointed or drafted.

I don't think the Commission envisioned the process that later occurred. When the Commission designated the drafting subcommittee, Messrs. Arsht, Canby and Corroon decided that we really couldn't just take the minutes of the things that had been decided. We had to go through every section of the statute and see, for example, whether a change we made in Section 169 would have an unexpected effect someplace else.

So we met on Saturday mornings for a year. The meetings were at 8 o'clock on Saturday mornings. In those days, we young fellows liked to go out on Friday nights. Canby and his buddies, they just wanted to get back in time for lunch or play golf in the afternoon; we had a little different agenda.

LASTER: Where did you meet?

CROMPTON: In Walt's office, because they were in the Hotel du Pont then.

STAPLETON: Where our conference room was located, there was a door into the Hotel. You could call from our conference room and get room service. That came in handy.

I was thrilled when Sam Arsht talked to me about this. For a lawyer at that stage in the game, professionally, it was really something very special. If I had known how hard we were going to have to work the next two years, maybe I wouldn't have been quite as thrilled. The meetings were long, and Canby, Corroon and Arsht were very serious about the project, though I don't remember it being contentious at all.

CROMPTON: No.

STAPLETON: But they certainly were diligent and careful.

CROMPTON: And forceful in their views on almost everything.

RICHARDS: They were tenacious as well. There were doctrinal arguments; one would be arguing, "This is what the law is," and the other one would say, "No, you're wrong; this is what it is." They would talk back and forth about these cases. In terms of an education in the corporation law, by the time we were finished, we had gone over every section of the statute line by line, not once or twice, but three or four times.

Ultimately, we were each assigned to write up an initial draft of part of the statute. The policy decisions were being made by others, of course, but at one point the three of us had drafted the entire corporation law. I had Sections 101 to 171, Charlie had Sections 172 to 260 and Walt had Section 261 to the end.

I'll tell you one anecdote. Everybody on the subcommittee had agreed that they would not stand up in court later and argue, "I meant this when I wrote so-and-so." I think that was generally kept to a minimum, but I remember I was having one argument with Sam Arsht on the other side. We were talking about Section 162, when he got up and said, "This is what we meant." I thought to myself, he doesn't know what he's talking about — I drafted those very words. But I didn't have the guts to say it. [Laughter]

STAPLETON: Charlie is right; it was quite a learning experience. And it wasn't just Sam Arsht and Henry Canby and Dick Corroon; it was also Professor Folk. He had gone through the statute section by section, he told you what other states were doing, and he commented on the Delaware Corporation Law. For people at our stage of the game, it was an invaluable education in the corporation law.

RICHARDS: He had all the caselaw in there. When you look at his work product and think of how much time went into it, remember that we paid $5,000 for that.

CROMPTON: They originally hired him in March 1964, hoping to have it ready to introduce to the General Assembly in September.

ALEXANDER: How significant was Folk's continuing role?

Secretary of State Elisha C. Dukes, 1965

STAPLETON: I would say his major contribution was what we started with.

CROMPTON: I don't think he ever came to a meeting of the Commission after he sent in his report. What he provided, as Walt and Charlie said, was an invaluable understanding into what other people were doing and where we stood. But his policy decisions were rejected as often as they were accepted.

LASTER: Did you all have vigorous policy debates during the Saturday morning meetings with Canby, Arsht and Corroon?

CROMPTON: My recollection is yes. I was reticent at first to put my word in, but it didn't take me long to warm up to the group and say, "You know, I think that's stupid."

RICHARDS: I don't remember you ever saying that. [Laughter]

CROMPTON: Well, maybe you said it. One of you two, probably. [Laughter] We debated serious philosophical and policy issues. We also debated minute things like commas. I remember long discussions about "are we going to call them shareholders or stockholders?" Is it going to be hyphenated, two words or single words? That went on for three or four meetings.

LASTER: I think it still does. [Laughter]

RICHARDS: The legal secretaries were obliged to defend our drafts. Though, of course, it wasn't our thinking. We didn't regard our job as saying what we thought the statute ought to look like. We were trying to faithfully record the Commission's decisions. When people would say, "You don't have this right," we had to be able to answer, "Well, look at the 37th meeting of the Commission; here's this, and here's that."

HAMERMESH: How did you publish your draft to the rest of the world?

CROMPTON: The Commission started out with a wide request for comments or suggestions.

RICHARDS: Canby or I would send things to lawyers at other firms, saying, "Here, we've come up with this section. What do you think about this?" They would write back with their suggestions. Some of their ideas were incorporated; some were not.

ALEXANDER: Was it only law firms or did you also go to corporations?

RICHARDS: Yes, we sent things to clients, too.

STRINE: Now, I take it Irv Morris interacted with the national plaintiffs' bar?

CROMPTON: I'm sure he did.

RICHARDS: He wrote several long scholarly pieces to the Commission in support of his views.

LASTER: What do you recall being some of the more vigorous debates?

CROMPTON: Sequestration, indemnification, cash-out mergers.

RICHARDS: Appraisals.

LASTER: Were there fault lines on the Commission between the plaintiffs' bar and the defense bar?

CROMPTON: Yes. The corporate agencies and the Secretary of State, Elisha Dukes, were very interested in repealing sequestration.[1] We had a lot of flak from people who didn't want it. I think that they were finally convinced that it wasn't something that created litigation per se; it just created litigation in Delaware, where any sensible businessman would want to be sued.

STAPLETON: I'm not sure they were persuaded, but they lost.

ALEXANDER: Did you have a continuing public relations battle on that front?

RICHARDS: The leading corporate practitioners said they didn't object to sequestration because there needed to be some forum for these issues to be resolved. They felt that it would be fine if this enabled Delaware to capture control over everybody because Delaware is a neutral, fair, informed forum.

STAPLETON: I agree with both Charlies' explanations of the winning argument on the sequestration issue. The biggest factor really was how folks viewed the Delaware court system.

STRINE: Did the Commission address the extent to which the federal securities laws and Rule 10b-5 would occupy the field?

CROMPTON: I don't remember that being a factor then.

RICHARDS: I don't recall us discussing the Securities and Exchange Commission at all. There was some communication with the SEC as to what their view was about things, but I don't recall ever getting any input from them.

CROMPTON: They were very noncommittal.

LASTER: Were there any issues where Professor Folk had one view and the Delaware Bar had another?

CROMPTON: The only thing I can think of is his idea that we ought to have some uniformity, like the Model Act. He wanted us to adopt some of the generally accepted accounting terms and principles. Things like that that were contrary to what Delaware and the Commission wanted to do; we wanted to be unique.

Charles F. Richards Jr., 1963

RICHARDS: I recall that, with respect to some sections, he wanted to redraft them — in what maybe from the start would have been clearer language. If we didn't think the statute was problematic, and if nobody suggested important policy reasons to change it, we didn't change it. From time to time it was said, "Well, maybe that's better language, but we all know what this language means. There's not a problem with it, so let's not change it."

STRINE: One of the things that still I know is difficult for the Bar is situations where judges are perceived to have made an unwise decision. How did you deal with that?

RICHARDS: I don't recall that there were many occasions, as there have been since [laughter], when we focused on "this guy has it wrong and we've got to fix it." I don't recall fixing things in that sense, though we straightened out some things. I do remember that our firm used to give *Fechheimer Fishel*[2] opinions, and I was the firm's *Fechheimer Fishel* expert. And, damn, if we didn't clarify it so that all you had to do is read the statute. And

I said, "Well, gee, why did we do that?" [Laughter]

LASTER: Did you get research assignments from the three more senior guys?

RICHARDS: Not too much because Folk had most of the caselaw in his report and because these guys knew the caselaw. The body of caselaw was smaller then. Between the three of them, they had probably been in all the cases, or at least they had cited them many times. Certainly I would have been Henry Canby's dogsbody in looking something up, but those guys knew the law and would argue about it.

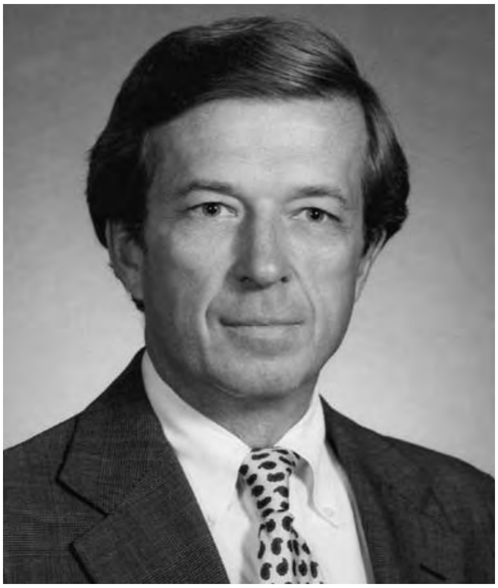
CROMPTON: They would argue about what the law should be or what should be done and what was practical, fair and popular.

LASTER: Was there anything that they thought should be done that was just too hot to handle?

CROMPTON: The biggest debate I remember is when Sam Arsht wanted to let corporations do away with annual shareholders' meetings. He was then representing Ford Motor Company and Henry Ford II was chairman. The company was doing very well, but Mr. Ford didn't want to be cross-examined by stockholders. And Sam said, "Well, why don't we just make it voluntary?" Dick Corroon and Henry Canby — and we three, too — said, "Come on, once a year, let the stockholders have their say."

RICHARDS: Sam was a little more willing to put forward suggestions. Canby and Corroon were more conservative. But my impression was that some of Sam's suggestions had come from somebody else, and that he wasn't heart and soul behind them. You know, he could go back and tell Henry Ford, "Well, I suggested that, but they shot it down." [Laughter]

LASTER: Other than the Saturday meetings, how much time did you



Charles S. Crompton Jr., early 1970s

spend on this project?

RICHARDS: We certainly had to spend a significant amount of time when we weren't at the meetings. But law practice for young people in those days wasn't as intense.

CROMPTON: The tyranny of the time sheet hadn't quite reached the peak as it has now.

ALEXANDER: Were your practices focused on the DGCL, or were they more generalized?

RICHARDS: Well, none of these firms had departments. I remember doing admiralty cases and zoning cases and everything in between.

LASTER: How about for Canby, Arsht and Corroon?

RICHARDS: Henry Canby was more of an office lawyer. I think he had gone to court earlier in his career, and he might go to court for one or two of his most significant clients. But he preferred to spend most of his time working on transactions in his office.

CROMPTON: Dick Corroon was almost entirely litigation then.

STAPLETON: Sam Arsht was right in between. He spent about 50 percent of his time doing planning and opinion work and 50 percent doing litigation.

STRINE: Your firms were the three largest firms in Delaware then. How big were they?

CROMPTON: When I started, I was the 12th lawyer at what was then Berl, Potter & Anderson.

RICHARDS: I was the 14th lawyer at Richards Layton. We only added at most one person a year, and not every year.

STAPLETON: I was the 10th lawyer at Morris Nichols in 1959. When I left to go to the District Court in 1970, I think there were 28 or 29.

ALEXANDER: With all the changes since 1967, is the time ripe for another major revision?

CROMPTON: I don't think it's needed. I would rather leave it to common law, case-by-case development.

RICHARDS: I agree with Charlie, principally because the corporate council reviews it annually. The statute has been kept up to date. Starting from the beginning and telling the world that we're going through it section by section would probably send an uncertain message to the national corporate bar.

LASTER: What is your best memory of the 1967 revision?

RICHARDS: I became good friends with Walt and Charlie, which might not have occurred otherwise. I also got to know Henry Canby in a way that I wouldn't have otherwise, and Sam Arsht and Dick Corroon. The latter two gentlemen always treated me very kindly afterward. It was the friendships and the associations that I remember the best.

STAPLETON: The relationships are the most memorable thing.

CROMPTON: I agree — the friendships that the experience has given me.◆

FOOTNOTES

1. Sequestration is a mode of serving process by attaching stock.

2. *In re Fechheimer Fishel Co.*, 212 F. 357 (2d Cir. 1914).

M E M O R A N D U M

TO: The Members of the Special Committee on the Future of the Delaware General Corporation Law

FROM: R. Gilman FrankWard McGold V, Chairman

DATE: Oct. 26, 2007

RE: Agenda-Setting Memorandum

I am pleased at your willingness to serve on the Special Committee established by S.J.R. 1967 to consider the overall structure, philosophy and drafting consistency of the Delaware General Corporation Law (DGCL). As you are aware, it has been approximately 40 years since the DGCL was thoroughly reviewed and revised.

Given the important developments in capital and trade markets, the huge increase in mergers and acquisitions activity, the creation of new forms of financial instruments, the prevalence of (increasingly active) institutional investors with a diversity of interests, a larger role for the federal government and the stock exchanges in corporate governance, and the rapidity of globalization of all aspects of economic activity (including the chartering of business entities and the listing of their shares), the General Assembly has asked us to consider whether any forest-level changes to the DGCL are advisable.

Delaware has long taken pride in the successful balance our corporation law has struck between the need for transactional and managerial efficiency, on the one hand, and the protection of investors, on the other. And, of course, the General Assembly and the Corporation Law Section of the Delaware State Bar Association have reviewed the DGCL on an annual basis with the goal of ensuring that amendments to maintain the competitiveness of the DGCL are promptly identified and adopted.

Nonetheless, in corporate law, as in any field of human endeavor, with the passage of time comes the danger that familiarity has dulled the mind to the need for more profound alterations. The purpose of the Special Committee is therefore akin to that faced by the Delaware Corporation Law Revision Committee in the 1960s, to see whether a thoroughgoing revision of the DGCL is in the public interest.

To help set our agenda, I am asking each member of the Special Committee to provide me with 500 to 750 words on the key subjects that the Committee should address. Your memorandum should identify big-picture topics of concern, possible directions for addressing those concerns and the economic and social factors supporting the importance of those concerns. I am not looking for detailed citations to authority. Nor, given our express charge from the General Assembly and the support of the Chief Justice for this Special Committee, should members of the Special Committee hesitate to recommend the adoption of legislative measures to address issues that are now largely a subject of judge-made common law.

Please forward your memorandum to me, our Special Committee's reporter, Professor Hamermesh, and our Committee's secretary, Blake Rohrbacher, on or before Jan. 14, 2008. Because of a diminishment in my eyesight due to age and hyperactive Web-surfing, please double-space your submission and put it in at least 12-point type.

Lucian A. Bebchuk

Shareholder Rights and the DGCL

Shareholders in publicly traded U.S. companies have much weaker rights than shareholders in the United Kingdom or other common-law countries.

The past and current designers of the Delaware General Corporation Law (DGCL) have much to celebrate. The DGCL directly governs the majority of publicly traded companies in the United States, and it has had considerable influence on the design of the other corporate codes of states that govern the remainder of U.S. public companies. The importance of the DGCL gives its designers correspondingly important responsibility. Because of the DGCL's dominant role, improving it can produce substantial benefits for investors and the economy.

One major area for potential improvement concerns shareholder rights. Shareholders in publicly traded U.S. companies have much weaker rights than shareholders in the United Kingdom or other common-law countries such as Canada and Australia. The United Kingdom provides an especially useful comparison point because, like the United States, it has a large, developed stock market dominated by companies with dispersed ownership. In its recent report, the bipartisan Committee on Capital Market Regulation stressed that the relative weakness of shareholder rights "creates an important potential competitive problem for the U.S." A reform of the DGCL could contribute substantially to closing the gap.

I have put forward detailed and comprehensive proposals for strengthening shareholder rights in three recent articles.[1] Here, I will briefly sketch the changes that would be worth making in connection with shareholders' critical power to replace directors.

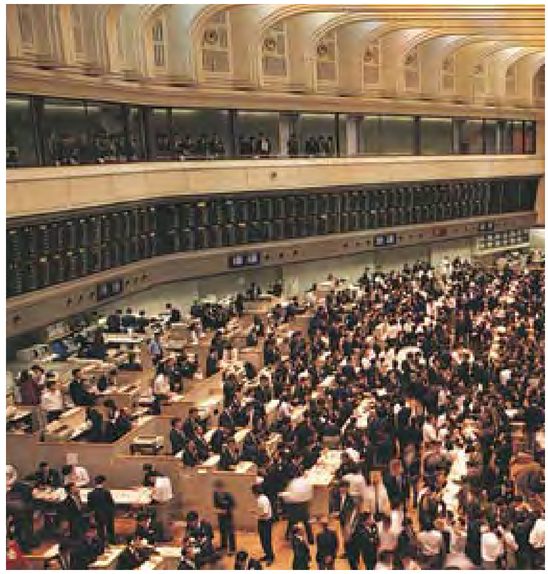
In *Blasius*, Chancellor Allen famously stated that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests." The shareholder franchise is a key mechanism for establishing board accountability under Delaware law. As I analyze in my academic work, however, the arrangements established by the DGCL are less hospitable for director replacement by shareholders than the arrangements in the United Kingdom and other common-law countries.

To begin, unlike corresponding laws in the United Kingdom, the DGCL makes possible corporate arrangements that do not ever provide shareholders with the ability to replace a majority of the directors in one vote. An empirical study I co-authored with Alma Cohen indicates that staggered boards, which the DGCL allows and many Delaware firms have, have a negative and economically meaningful correlation with firm value.

Second, the corporate law codes of the United Kingdom and other common-law countries grant shareholders with a sufficient stake the right to place director candidates on the corporate ballot. The DGCL fails to grant this right. It should be amended to provide such a right.

Third, facing a growing recognition that director elections should be governed by a majority voting standard, the DGCL was recently amended to facilitate the adoption of bylaws establishing such a standard. Although this is a beneficial change, the best approach would be for the DGCL to establish majority voting as the default arrangement.

Fourth, the DGCL should facilitate shareholder-adopted election bylaws. Directors should not have an excessive role in setting the rules of the game governing their own election. At a minimum, directors should not be allowed to repeal or amend shareholder-adopted election bylaws. The DGCL's recent amendments preclude the board from doing so with respect to shareholder-adopted bylaws establishing majority voting. The logic underlying this new provision clearly warrants extending it to other election bylaws established by shareholders.



Finally, the corporate codes of the United Kingdom and other common-law countries grant shareholders with a sufficient stake the power to place proposals for changes in corporate arrangements, such as those governing corporate elections, on the corporate ballot. The DGCL should also provide such a right. To be sure, shareholders of Delaware companies can amend company bylaws to grant shareholders rights to place candidates and proposals on the ballot. But the DGCL would do well to provide such rights as the default arrangement.

In his *Disney* decision, Chancellor Chandler emphasizes that the redress for management failures "must come from the markets, through the action of shareholders and the free flow of capital, and not from this court." For shareholders to be well-positioned to take the actions that are sometimes necessary for improving corporate value and performance, the DGCL should grant shareholders some of the rights that investors in other developed stock markets have. Strengthening shareholder rights in the DGCL is an important task that awaits the designers of this important code after they rightly celebrate this significant anniversary. ◆

FOOTNOTE

1. *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006); *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 676 (2007).

Charles M. Elson

Shareholder Election Reform and Delaware Corporate Regulation

Central to the philosophy of modern Delaware corporate law has been the concept of judicial restraint in the review of director decision-making. Wide discretion is granted to boards through the operation of the Business Judgment Rule. The theory is that shareholders through exercise of the electoral franchise provide the best mechanism for ensuring appropriate director discretion than the review by a third-party judicial body.

Of course, the linchpin to this approach is the availability of an open and fair election to provide the necessary outlet for shareholder will. Unfortunately, for a variety of reasons, in most public companies the shareholder election process functions as a mere formality to ratify the actions of a generally self-perpetuating board and management.

For the election to serve as the appropriate accountability vehicle intended by the Delaware scheme, it is important that from time to time there is the real potential that it function as a true contest over corporate policy and direction. To accomplish this, we need to level the playing field a bit between the incumbent board and the shareholders in the electoral process.

Traditionally in a proxy contest, the expenses of the challenging party are solely borne by that party, while the board uses the corporate treasury to finance the presentation of its position. This has been an obvious impediment to fostering vibrant elections as all shareholders effectively subsidize the board's candidacy while the challenger is forced to personally bear the cost of a campaign.

If the challenge involves a legitimate debate on corporate direction and policy, there is no good reason why the shareholders of the corporation should fund the cost of promoting one viewpoint and not the other. This asymmetry is certainly problematic in that it acts to stifle thoughtful discussion and reexamination of corporate policy, which ultimately leads to lessened accountability by the incumbent board and management to shareholders. That is why reform is necessary.

The simplest solution is to provide some sort of reimbursement of reasonable expenses to challengers in non-control directorial election challenges.

The simplest solution to this problem is to provide some sort of reimbursement of reasonable expenses to challengers in non-control directorial election challenges. If one is successful in proposing and electing a director, then one's expenses should be reimbursed by the corporation. If an individual is unsuccessful, but loses only by a small percentage, then it is clear that the effort was over a legitimate issue and some portion of that individual's expenses should be reimbursed. Should the challenging candidate or candidates lose by a significant vote, then no corporate funds should be expended for the support of the effort.

Such a scheme would be initiated with shareholder consent, and the Delaware General Corporation Law (DGCL) should be amended to explicitly provide for the mandatory establishment of such a regime upon an appropriate shareholder vote. By removing an important financial impediment to more vibrant corporate elections, the election process would no longer be a simple formality but a real forum for informed debate and ultimate expression of shareholder will.

This would accomplish two important goals. First, it would assure the necessary vibrancy of the electoral process vital to the appropriate functioning of the corporate regime as contemplated under traditional Delaware corporate law. Second, the election itself, or merely the threat of a contested election, would encourage better directorial and management accountability to shareholders and ultimately more effective corporate performance.

The DGCL has proven to be an incredibly effective vehicle for the regulation of public corporations. This proposed measured change is necessary to ensure its continued utility and effectiveness. ◆

Mark A. Morton

Charting a New Course: Long-Term Value vs. Short-Term Reward

When Professor Ernest L. Folk III compiled his report of recommendations for changes to the Delaware General Corporation Law 40 years ago, the corporate world was dramatically different. Boards generally included directors with strong connections to (and knowledge of) their companies' businesses. Institutional investors had a fraction of the influence they garner today. The term "activist shareholders" had yet to enter the investment community's lexicon. Proxy contests were waged for the entire board (rather than the "short slates" common today).

Forty years later, the corporate world has been transformed. The delicate balance of power between boards of public companies and their shareholders has been dramatically altered. Significant legislative changes, including the Sarbanes-Oxley Act of 2000, have been adopted. Governance activists have pressed corporations (with appreciable success) to declassify staggered boards, eliminate poison pills, add "independent" directors and adopt a majority vote standard for elections. Activist shareholders are increasingly willing to run a proxy contest with a short slate, typically with the blessing of Institutional Governance Services, the leading proxy advisory service.

While some of these changes have advanced shareholder rights (for example, by creating greater transparency in financial reporting), they also have created new challenges for boards. Subject to another layer of regulatory burdens, directors now have even less time to focus on long-term strategic planning. When they do, fewer directors do so with the benefit of a meaningful connection to the company's business.

For many directors, an acquisition proposal offering a modest premium is far more attractive than the alternative: trying to execute a long-term strategic plan that offers both risk (in execution) and reward (through value creation). In addition, with the rise of activist shareholders, the advent of proxy advisory firms — and the increasing influence of each on institutional investors, who often are focused on generating short-term (that is, annual) returns for their funds — directors frequently are under pressure to abandon their long-term strategic plans in favor of transactions designed to immediately increase shareholder value.

Subject to another layer of regulatory burdens, directors now have even less time to focus on long-term strategic planning.

Traditionally, our corporation law has encouraged boards to embrace execution risk and strive for long-term value creation by affording directors the promise of limited exposure to personal liability. However, faced with the challenges described above (and the head winds they pose), some boards now appear less willing to set a course that is likely to lead to long-term value creation.

With challenges buffeting directors from every direction, a few changes to Delaware corporate law may seem like an unlikely panacea. However, in the author's view, the following changes, if adopted, would be a step in the right direction because they would afford directors greater latitude to pursue long-term strategies.

Make director terms three years long, eliminate staggered boards, and require a majority vote for director elections. Extending the directors' terms will foster the development of intra-board relationships that are critical to the board's success. In addition, three years is long enough both for a board to pursue meaningful long-term strategic plans and for shareholders to be able to fairly assess the board's progress. If all staggered boards were eliminated at the same time (for example, at the company's 2009 annual meeting), shareholders would have the opportunity to seek to replace the entire board before the first three-year term starts (thus offsetting any entrenchment concerns).[1]

Require a one-year holding period before a shareholder may nominate directors or propose any items for consideration at the shareholders' meeting.[2] Public company bylaws often include an "advance notice" provision requiring a shareholder who seeks to nominate a slate of directors or to propose a matter for consideration at the meeting to submit the slate or proposal to the company well in advance (generally 90 days) of the annual meeting. Such bylaw provisions already effectively impose a three-month holding period for shareholders who wish to nominate directors or propose business. A one-year holding period would give shareholders who have a long-term horizon greater influence over the nomination of directors and the business to be conducted at the annual meeting. At the same time, the holding period would make it less likely that an activist shareholder would be successful in using a proxy contest or shareholder proposal as leverage to get directors to focus on short-term valuation strategies.[3]

The foregoing changes are noteworthy for two reasons: they encourage boards to focus on long-term value creation, and they reward shareholders who have a long-term view. At the same time, the changes would allow shareholders to chart a new course for the company every three years if they are dissatisfied either with the company's direction or the board's performance. ◆

FOOTNOTES

1. Other changes to consider would include the vote required for contested elections, what happens if a board fails to receive majority approval (due to withholds), and whether directors may be removed without cause.

2. Shareholders also should be required to have a minimum ownership position (the author's suggestion is 5 percent) to qualify to nominate a slate or propose any business.

3. Since activist shareholders also use books and records requests as leverage, the author also would suggest adding certain minimum holding periods and ownership requirements to § 220.

R. Franklin Balotti, Donald A. Bussard and Thomas A. Uebler

The (Mis)Application of Section 144

The statutory tests of § 144 have been erroneously intertwined with longstanding common law principles and have eroded the plain meaning of unrelated statutory law.

Professor Ernest L. Folk III advocated the enactment of § 144 to validate self-dealing transactions involving directors and officers when those transactions comply with any one of three statutory safeguards.[1] Since its enactment in 1967, however, courts and litigants have created confusion by invoking § 144 in circumstances beyond its narrow scope. As a result, the statutory tests of § 144 have been erroneously intertwined with longstanding common law principles regarding director liability and have eroded the plain meaning of unrelated statutory law.

Gov. Charles Terry, Secretary of State Elisha C. Dukes and Gov. Elbert N. Carvel

Section 144 deals solely with the validity of self-dealing transactions. "A contract or transaction covered by the statute is not void or voidable solely because those approving a transaction have a conflict of interest . . . . *The validating effect does not go beyond removing the spectre of voidability* ..."[2] Section 144 was not intended to displace or otherwise affect Delaware courts' equitable standards for imposing liability upon directors for breach of fiduciary duty.[3] The Court of Chancery has recognized this limitation by stating that the "question of when an interested transaction might give rise to a claim for breach of fiduciary duty — i.e., to a claim in equity — was left to the common law of corporations to answer."[4]

Delaware courts, however, have not uniformly adopted this approach. Both the Court of Chancery and the Supreme Court have, erroneously in the view of the authors, cited compliance with § 144 as limiting or eliminating director liability.

By considering § 144 in director liability analyses, Delaware courts have erroneously expanded the role of § 144. First, a court should consider § 144 only when determining whether a transaction is void or voidable. Director liability analyses should be wholly unrelated to § 144. Second, the court's duty to determine the fairness of acts by fiduciaries is rooted in Delaware's common law, not § 144.[5]

While the common law entire fairness standard is substantially identical to that in § 144(a)(3),[6] the two tests serve distinct purposes. The question is whether it makes a difference if § 144 is permitted to affect director liability. Recent cases in the Court of Chancery show that it does matter.

In *Valeant Pharmaceuticals International v. Jerney*, the plaintiff corporation sought damages from its former director and president for breach of the duty of loyalty related to a self-dealing transaction.[7] In its analysis, the Court considered § 144 and determined that entire fairness was the appropriate standard of review because the transaction was neither approved under § 144(a)(1) nor ratified under (a)(2).[8] Under entire fairness scrutiny, the Court deemed the transaction voidable and found the defendant liable for breach of fiduciary duty.[9]

The Court's application of § 144 in *Valeant* seemed to be inextricably intertwined with its analysis of director liability. The Court went further, however, and eroded another section of the DGCL, § 141(e). Rejecting the argument that good faith reliance on the advice of experts under § 141(e) provides a defense to liability, and reaffirming that such reliance is merely one factor in the entire fairness calculation, the Court stated:

> To hold otherwise would replace this court's role in determining entire fairness under 8 *Del. C.* § 144 with that of various experts hired to give advice to the directors in connection with the challenged transaction, *creating a conflict between sections 141(e) and 144 of the Delaware General Corporation Law*.[10]

To the contrary, recognizing good faith reliance on the advice of experts as a defense to liability — as § 141(e) instructs — would not create a statutory conflict because § 144 has no role in determining director liability. By linking § 144 to § 141(e), the Court muddied the proper role and effect of both provisions and created further uncertainty for directors who rely in good faith on the advice of experts.

Unless a court must determine the validity of a self-dealing transaction before it considers a director's equitable conduct and potential liability, § 144 should not be considered when determining director liability. Until the General Assembly instructs otherwise, § 144 should be limited to the purpose expressed by Professor Folk 40 years ago — validation of self-dealing transactions. ◆

FOOTNOTES

1. Ernest L. Folk III, *Report to the Corporate Law Revision Committee* 67 (1965–1967).

2. Ernest L. Folk III, *The Delaware General Corporation Law: A Commentary and Analysis* 82 (1972) (emphasis added).

3. *See* Folk, *supra* note 1, at 74.

4. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 615 (Del. Ch. 2005).

5. *See Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 110 (Del. 1952).

6. *See Marciano v. Nakash*, 535 A.2d 400, 405 n.3 (Del. 1987). *But see Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1371 n.7 (Del. 1995).

7. 921 A.2d 732 (Del. Ch. 2007).

8. *Id.* at 745-46.

9. *Id.* at 752.

10. *Id.* at 750-51 (emphasis added).

Bruce L. Silverstein

The Cash-Out Merger Turns 40

One of the most significant changes to the Delaware General Corporation Law (DGCL) implemented by the comprehensive 1967 Revision was an amendment that authorized cash merger acquisitions of Delaware corporations. Before 1967, a cash acquisition could be accomplished only through a tender offer followed by a short-form merger. This was cumbersome, required the endorsement of management as a practical matter and was infrequently accomplished. Today, cash acquisitions are commonplace, and tens of billions of dollars change hands annually in such transactions.

Although the DGCL is reviewed for changes on an annual basis, the development of the law governing the powers and duties of directors considering a cash-out merger and/or responding to a hostile acquisition effort has been left largely to the common law.

While various provisions of the DGCL are often identified as providing support for the development of the common law, the DGCL does not specifically address the myriad issues resolved in the landmark decisions in *Weinberger v. UOP, Inc.* (sustaining right of stockholders to sue for breach of fiduciary duty, outside context of statutory appraisal, following cash-out merger), *Unocal* (imposing "reasonableness" standard of review on target board's use of defensive mechanisms), *Revlon* (imposing "heightened scrutiny" on sale of company, and faulting board for considering effects of merger on constituencies other than stockholders), *Cavalier Oil* (dissenting stockholders are entitled to pro rata share of enterprise value, and not simply fair market value of minority shares), *Kahn v. Lynch* (imposing "entire fairness" review when controlling stockholder effects cash-out merger, even with use of special committee and majority-of-minority voting condition), *Omnicare* (prohibiting combination of "force the vote" requirement with lock up of a majority of vote), *Glassman v. Unocal Exploration* (eliminating fiduciary review in short-form mergers), and the *Aquila/Siliconix/Pure Resources* trilogy ("entire fairness" review does not apply where majority stockholder conducts a non-coercive tender offer followed by a short-form merger).

Many of these common-law developments have come to be taken for granted. This raises the obvious question of whether the time has come for a legislative review and codification of the rules developed in this arena.

Most of the foregoing issues have long been resolved by the Delaware Supreme Court. Thus, in the absence of the Supreme Court reversing itself (which does happen on occasion), the only recourse to changing many of the rules established by these cases is through amendment to the DGCL. Imagine how different the law (and the economy) might be if the DGCL imposed a different rule from that developed by the common law.

Suppose, for example, that the DGCL prohibited the board of a target corporation from interfering with the stockholders' ability to tender into a hostile tender offer. Or, suppose that the DGCL expressly imposed an "entire fairness" standard of review in a short-form merger, or provided for "business judgment rule" protection in the case of a cash-out merger by a controlling stockholder where there was a majority-of-the-minority voting condition.

Raising these questions is not meant to suggest any disagreement with the wisdom of the decisions reached. The factors that cause a court to reach a given decision, however, are not necessarily the same as the factors that animate legislation. The task of the courts is to seek to discern and honor the intent of the legislature. In so doing, courts are constrained by the record developed by the parties, are often limited to deciding isolated questions presented by active (and often expedited) litigation, and are prudentially motivated to honor the rule of *stare decisis.* Legislatures, on the other hand, are free to move the law in whatever direction they deem most beneficial — often with a broader perspective.

One might argue that the silence of the Delaware legislature constitutes an implicit endorsement of the rules of law developed by the Delaware courts in the various precedents noted herein. There is, however, no "legislative history" reflecting a conscious decision to defer to the common law on such matters.

As the 40th anniversary of the last comprehensive overview of the DGCL passes into history, it may be time to revisit these precedents through a legislative lens that is not constrained by the contours that shape the evolution of the common law. The result might well be to codify much of the common law developed by the courts. Even such a decision, however, would provide guidance for the continued development of the common law in the decades to come. ◆

J. Travis Laster

Goodbye to the Contemporaneous Ownership Requirement

Section 327 establishes the contemporaneous ownership requirement for stockholder derivative actions: If a stockholder plaintiff did not own stock at the time of the wrong, the stockholder lacks standing to sue.[1] This rule is an unnecessary barrier to meritorious derivative suits. Section 327 should be amended to require only that the plaintiff (i) hold stock at the time of the lawsuit and (ii) not voluntarily divest the stock during the lawsuit.

Section 327 fundamentally conflicts with the basic nature of a derivative action. Section 327 focuses on the stockholder asserting the claim. A derivative claim, however, belongs to the corporation, not the suing stockholder. Any recovery goes to the corporation, not the suing stockholder. From the corporation's standpoint, it does not matter when the stockholder bought stock. The corporation benefits regardless.

According to caselaw, § 327 was adopted to "prevent what has been considered an evil, namely, the purchasing of shares in order to maintain a derivative action designed to attack a transaction which occurred prior to the purchase of the stock."[2] But why is this an evil? Delaware law should not find anything amiss in the right to sue derivatively passing with the transfer of shares.

Delaware courts are able to grant defendants broad transactional releases precisely because the right to sue passes with transferred shares. "[W]hen a claim is asserted on behalf of a class of stockholders …, the class will ordinarily consist of those persons who held shares as of the date the transaction was announced and their transferees, successors and assigns."[3] This is because when a stockholder sells shares, "the claim relating to the … transaction passe[s] to his purchaser," who then "enjoy[s] the benefits of [it]."[4] The right to assert a derivative claim and receive the indirect corporate benefits when it is resolved likewise should pass to a successor stockholder.

Because all stockholders do not engage in monitoring, the vigorous efforts of some stockholders are essential to the health of the corporate system. As then-Chancellor William T. Allen observed in 1996, "it is likely that in a public corporation there will be less shareholder monitoring expenditures than would be optimum from the point of view of the shareholders as a collectivity."[5] But rather than helping address the agency problems inherent in the corporate form, the contemporaneous ownership rule exacerbates them. It renders finite the number of stockholders who can seek to remedy corporate wrongdoing, then shrinks that universe over time as stock trades.

The result is less protection against corporate wrongdoing than otherwise would exist, and a greater chance that wrongdoing will go undiscovered and unremedied. An institutional plaintiff who can effectively vindicate corporate rights should not be prevented from conferring benefits on the corporation via a derivative action simply because the wrong occurred before the institution purchased its shares.

Compared to the debatable evil of a pre-acquisition derivative claim, it would seem far more of an evil for fiduciaries to breach their duties and not be held accountable. Rather than focusing on when a stockholder acquired stock, Delaware law should focus on the merits of the claim being asserted. Section 327 does nothing to address this goal. It does not distinguish in any way between meritless or meritorious claims. Fortunately, Delaware law already provides defendants with means to dispose of meritless derivative claims. They can move to dismiss under Rules 12(b)(6) and 23.1, seek summary judgment or employ a special litigation committee. The contemporaneous ownership rule will not be missed.

Finally, the contemporaneous ownership requirement ignores the practical reality that plaintiffs' counsel, not their nominal stockholder clients, are the driving force behind derivative litigation. When a contemporaneous ownership issue arises, derivative counsel typically substitute a new derivative plaintiff. The rule only has substantive impact when a replacement plaintiff cannot be found. This, of course, is most likely to happen when a long time has passed since the challenged transaction took place — precisely the situation when defendants already enjoy protection from statutes of limitations and the doctrine of laches. The substantive impact of the contemporaneous ownership rule is thus generally minimal and largely random. Rather than dismissals based on the merits, the rule generates dismissals based on whether a substitute plaintiff can be found.

An incoherent rule with rare and largely random effects has no place in the Delaware General Corporation Law. Section 327 should be amended to eliminate the contemporaneous ownership requirement. The amended statute should state, "In any derivative suit instituted by a stockholder of a corporation, it shall be averred that the plaintiff is a stockholder of the corporation." ◆

FOOTNOTES

1. The rule is also set forth in Chancery Court Rule 23.1.

2. *Rosenthal v. Burry Biscuit Corp.*, 60 A.2d 106, 111 (Del. Ch. 1948); *accord Shaev v. Wyly*, 1998 WL 13858, at *4 (Del. Ch. Jan. 6, 1998) (following *Burry Biscuit* and declining to deny standing to sue derivatively where it would not serve the "sole aim of section 327").

3. *In re Prodigy Commc'ns Corp. S'holders Litig.*, 2002 WL 1767543, at *4 (Del. Ch. July 26, 2002).

4. *Id.*

5. *Bird v. Lida, Inc.*, 681 A.2d 399, 403 (Del. Ch. 1996).

Robert B. Thompson

Folk at 40: Filling the Shareholder Space

Delaware's statute retains unique advantages that define its place in corporate governance.

The current Delaware General Corporation Law (DGCL) is like the top rock bands originating in the Folk period — still packing them in but relying on aging lyrics. Looking to the future, the Folk statute may be no better positioned to survive the next 20 years than its musical contemporaries facing the certainty of the human life cycle. By focusing on the central mission of the Delaware statute, this comment suggests the steps Delaware should take, particularly in filling the empty spaces relating to officers and shareholders, to secure Delaware's continuing central role in corporate governance.

The Folk statute came into force at a time much different than today: Delaware ascendant; the SEC stirring after a decades-long retrenchment; the stock exchange a limited player in corporate governance; Bill Cary's critique not yet in print. Many key touchstones of the current corporate governance debate that have arisen to challenge Delaware's dominance — the Williams Act, multiple merger waves, technology, and the growth of governance intermediaries — were not then visible. Most importantly, the Securities & Exchange Commission has become a much larger presence in corporate governance and a challenge to Delaware's position as the prime regulator of corporate governance.

Even in this setting, Delaware's statute retains unique advantages that define its place in corporate governance. It alone establishes the essential legal framework that permits the creation of corporations and names the key governance players — directors, shareholders and officers. It alone establishes the legal magic by which mergers and other fundamental changes occur, a crucial element in the package that law offers to those organizing businesses. It makes possible an effective dispute resolution whereby group of expert jurists speedily resolve litigation brought by private parties.

Based on these characteristics, the Folk statute reflects a consistent mission statement as to corporate governance. First, it establishes a straightforward, predictable governance system whose central tenet is to trust directors. Second, this statutory governance system is designed to operate in tandem with a rich array of constraints on corporate actors. Directors can deploy various gatekeepers, contracts and market constraints to achieve the most effective combination (or can decide not to use them). Third, shareholder voting and judicial review via fiduciary duties provide a necessary check on the agency costs that can arise when directors control other people's money.

In the wake of Enron and other scandals, the federal government and the stock exchanges filled in some of the empty space created by the Delaware statute, particularly as to the roles of shareholders and officers. Delaware's statute says almost nothing about the role of officers, who have become the most important players in large corporations. Delaware has left wide-open spaces as to shareholders' ability to propose agenda items, to change bylaws and to nominate directors. Continued silence will invite an ever-broadening reach of federal regulation that will make Delaware's statutes, judges and lawyers increasingly less relevant in corporate governance.

At its inception, the DGCL mapped out, more thoroughly than anything done until then, the respective roles of corporate actors. To retain the core strengths of the Folk statute, the Delaware legislature needs to bring its statute current, given the new issues and new players which have emerged. Federal lawmakers ostensibly defer to state law as to the relative roles of shareholders and directors in corporations. Where state law has been silent, on such questions as shareholder nominations and agenda proposals, federal law has provided affirmative rules. Silence on these questions now operates to Delaware's disadvantage.

Delaware should define a role for shareholders that fits within the overall mission statement defined above and reflects the purpose of shareholder voting. Shareholders vote not because they are like citizens in our public polity, the only and ultimate claimants to the collective. Rather, most often voting is an error-correcting device, used when shareholders are best able to check the deficiencies that necessarily arise in the director decision-making system chosen by the DGCL.

Thus, shareholders should be able to replace directors, approve mergers, and cleanse self-dealing transactions. Similarly, they should be given a say on pay, likely through an enabling exception to § 141. Management compensation has been the hardest issue for Delaware's courts to review effectively; directors themselves end up caught in a compensation-consultant-fueled, Lake Wobegon world. Shareholder voting can provide an error-correcting decision-making role here as well.

Gov. Charles Terry

Similarly, Delaware needs to recognize that if it leaves the role of officers undefined, the federal government will fill the vacuum. Duties should be defined to draw on Delaware's existing structure and the dispute-resolution system that is Delaware's strength.

Delaware has won the race for corporate charters, and the state treasury seems safe for the moment. But preserving the distinctive place for Delaware's law, its judges, and its lawyers requires that its corporate statute provide a full specification of the roles of shareholders and officers, as well as directors, in ways that reflect the current reality of modern corporations. This doesn't necessarily require Delaware to fundamentally shift its current mission statement as to corporate law, but rather to more particularly define the role of shareholders and officers within that structure and to thereby define a state presence that the federal government cannot ignore without an express decision to federalize corporate law. ◆

Michael P. Dooley

Rethinking Appraisal

The case for taking a careful look at appraisal in mergers involving publicly held corporations[1] can't rest on the inherent importance of the remedy because it doesn't have much. Instead, the argument for rethinking appraisal is that such an exercise necessarily raises the fundamental issue of the extent to which a corporation statute should guide judicial review of at least some recurring transactions.

In this respect, the Model Business Corporation Act and the Delaware General Corporation Law (DGCL) represent polar alternatives, and appraisal is as good a place as any to begin thinking about the issue.

DGCL § 262 tells us lots about the mechanics of appraisal but provides little clue as to the fair value of what it is that is to be determined and, more important, why. The Model Act answers both questions.

With regard to the first question, "fair value" under the Model Act is established if the consideration paid falls within a range of values that would be paid for similar businesses in the context of the same type of transaction for which appraisal is sought. The prevailing view in Delaware is that the real-world fairness of the transaction is less important than the calculation of an amount sufficient to compensate a plaintiff for the loss of his proportional interest in the seller as a going concern. This has led to awards to plaintiffs of two to five times the amount accepted by a majority of the other shareholders, thereby turning the appraisal proceeding into a lottery of sorts.

Although hard to justify on any independent ground, the Delaware courts may have thought themselves constrained to use an imaginary "going concern" value because of an otherwise inexplicable provision in § 262 to deny the market-out exemption from appraisal for publicly held corporations where cash, rather than stock, is used as consideration. The theory for this distinction may be that the plaintiff who receives stock in the merged entity retains an interest in the "going concern" of the selling corporation, whereas "going concern" in the old entity is extinguished when cash is used.

The distinction is untenable because the old firm disappears in either case — management, assets and finances of the merged firm may be radically different from the profile of the old firm had it continued in business (which, of course, it hasn't). I hope it is uncontroversial to observe that the "going concern" value of any enterprise can be monetized only when it is sold as a whole and that, in the absence of such a transaction, no holder of (non-controlling) publicly traded shares can expect to sell her shares at a price higher than the one that prevails in the market.

Accordingly, the pre-transaction market price of the selling corporation provides a baseline from which the adequacy of the consideration offered in a merger can be judged by shareholders asked to approve it. If this were not the case, there would be no justification for the market out when stock is used as consideration, further demonstrating the illogic of distinguishing between stock and cash consideration (which obviously presents no valuation difficulty) for purposes of exempting the transaction from appraisal. Cash and shares are treated alike under the Model Act.

The Model Act approach to defining the "what" question of appraisal should eliminate the lottery-like aspect of Delaware appraisal and reduce the incentives to bring such an action in an arm's-length transaction. For transactions involving conflicts of interest, a modified appraisal remedy can play a very useful role, however.

Since appraisal is a non-fault proceeding, shareholders who are both dissatisfied and suspicious can obtain judicial review of the fairness of the transaction without incurring the initial information costs necessary to frame a complaint for damages. Once again, the Model Act approach is useful to consider: both the availability of the market out and the scope of remedies for a transaction subject to appraisal depend upon whether the transaction involves actors or circumstances falling within the definition of "interested transaction" in the Act.

The Model Act goes one step further, however, by specifying approval mechanisms that can be used to cleanse certain types of interested transaction. Those mechanisms also are worthy of consideration and demonstrate how a rethinking of appraisal can illuminate more fundamental issues of the appropriate balance between statutory rules and judicial review. ◆

FOOTNOTE

1. The case for appraisal in the case of closely held corporations is quite different because of the absence of any market-determined benchmarks of firm value and because the dissenting shareholder may have been sufficiently involved in the business to have personal information that is relevant to the valuation of the company. Neither condition obtains in the case of publicly held firms.

Stuart M. Grant and Michael J. Barry

Delaware's Appraisal Statute: A Relic in Need of Reform

Delaware's appraisal statute is in dire need of reform. The amendments adopted in 2007 were largely cosmetic in nature, keeping the existing structure in place while standardizing the interest rate and conforming the language of the statute to recent changes in the securities industry. They did not, however, address the more fundamental problems with Delaware's appraisal statute.

As currently structured, § 262 is inequitable because (a) it denies shareholders the right to seek appraisal even if the consideration received in a merger does not compensate the shareholder for its proportionate interest in the value of a corporation, based simply on the type of consideration paid by the acquiring company; and (b) it forces the former shareholder to become an unsecured creditor of a corporation in which it did not choose to invest. In contrast to the many provisions of Delaware law that place this state at the forefront of the development of corporate law, Delaware's appraisal statute is distinctly deficient.

Under the express terms of § 262, the right to appraisal is governed by the type of consideration to be received by shareholders in a merger. Appraisal rights are triggered only if shareholders receive anything *other* than stock (or cash for fractional shares). If a merger is structured as an all-stock deal, shareholders have no right to appraisal regardless of the adequacy of the consideration offered.

The theory behind providing a right to appraisal in the merger context is to provide shareholders with the opportunity to be compensated for the fair value of their shares in the company as a "going concern" as if the merger had not happened. By eliminating appraisal rights in mergers where the consideration offered is stock, the statute fails to meet its goals.

Shareholders in an acquired corporation must consider the same fundamental question regardless of whether the consideration offered is stock or cash — that is, "will I be receiving a fair price for my stock?" Receiving stock as consideration may allow for an exit strategy (sale of the stock in the public market), but it does not ensure the receipt of fair value.

A substantially better alternative would be to tie the availability of appraisal rights to the role of the board of directors and officers in the transaction. Any transaction in which none of the officers or directors receives anything different from any other shareholder should not be subject to appraisal. In this type of true "arm's-length" transaction, appraisal should not ordinarily be needed because the directors and officers should protect the stockholders from any transaction that does not provide full and fair value.

Conversely, any transaction in which any director or officer participates in a manner different from that of every other stockholder has the potential to provide less than full value. In those instances, there is less reason to rely on the directors or officers, and appraisal should be provided. By focusing on the character of the transaction, rather than the character of the consideration, the appraisal statute would be far more effective in reaching its goal.

The one thing that is *not* in dispute in an appraisal proceeding is that the former shareholder is actually owed money. Under § 262, a shareholder exercising appraisal rights only gets paid for the fair value of his stock after the appraisal proceeding is resolved and all appeals are exhausted. Meanwhile, the company retains the use of the former shareholder's money. While § 262 does attempt to provide some recompense to shareholders for the lost use of funds through an award of interest, the award of a fixed amount of interest is unlikely to match the risk profile that the former shareholder, now an unsecured creditor, is asked to assume during the appraisal process.[1]

The proposed appraisal statute suggested in the Revised Model Business Corporation Act (RMBCA), promulgated by the American Bar Association, addresses this problem. Section 13.31 of the RMBCA requires the company — at the inception of an appraisal proceeding — to pay to the shareholder exercising appraisal rights the *company's* estimate of the fair value of the shares, plus interest.

By requiring this prepayment, the RMBCA dramatically reduces the risk that one must assume to pursue an appraisal action. Thus, the decision to bring an appraisal action will be far more likely to be based on the merits of the transaction rather than the risk of default or the threat of illiquidity. ◆

FOOTNOTE

1. For example, the interest rate that one freely entering into an unsecured creditor relationship would require from a highly leveraged acquirer would be vastly different than the one required from a far less leveraged acquirer. Moreover, the investor who sought to hold the equity of a well-capitalized company may not be interested in holding unsecured debt of a highly leveraged company at any commercially reasonable price. Why should such an investor be deprived of the fair value of his equity investment because he does not want to hold illiquid leveraged debt for an undefined time period?

James C. Morphy

Doing Away with Appraisal in Public Deals

After decades of struggling with the application of appraisal rights to publicly held corporations, it is time for the Delaware legislature to rely on the judgment of the marketplace and eliminate appraisal rights in all cases where there is a liquid public market for a company's securities. Judges should not be called upon to enter the "appraisal casino," seeking to guesstimate the fair value of a company, unless there is no public market to look to for value.

It is often recited that appraisal statutes were created to compensate for eliminating the common law rule requiring a unanimous vote for a merger. It was the *quid pro quo* for the minority's loss of its veto power. That quaint, turn-of-the-century concept obviously makes no sense in modern corporate America — so there is no longer any "quo" in the equation.

Section 262 was designed to provide stockholders with "fair value" for their share of the "going concern value" of a company when cashed out in a business combination. For decades, Delaware courts have valiantly tried all manner of valuation methodologies and legal contortions to give meaning to the statutory language, but with limited success. Many judges have candidly admitted that courts are a poor substitute for the marketplace. Chancellor Chandler famously wrote:

> [I]t is one of the conceits of our law that we purport to declare something as elusive as *the* fair value of an entity on a given date. … Experience in the adversarial, battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to make with anything approaching complete confidence.

Because the appraisal statute requires a determination of the "fair value" — not even the fair *market* value — § 262 sets the Delaware courts adrift on a rudderless ship, buffeted about in every direction by the winds of experts and navigating by means of every conceivable valuation technique, none of which are permitted to be the lodestar.

Apparently recognizing the problem, however, several Delaware judges have been willing to treat market valuations as close to dispositive. As now-Justice Jacobs wrote, "The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair."

Judicial determinations of fair value can never be better than the underlying key assumptions — about which reasonable people can and do disagree, often by a wide margin, and appraisal litigants seem to disagree even more. This leads to the scenario where a judge, having no divine ability to see the future better than the dueling experts, is forced to essentially make up some kind of "reasonable" answer.

To take one of many possible examples, in *Cede & Co. v. MedPointe Healthcare, Inc.*, the Court rejected the \$20.44 "break-up" value arrived after an exhaustive two-year sale process — one in which nobody offered to buy the whole company — and picked a value 20 percent higher, resulting in a "windfall" to the dissenter not available in the marketplace. The major difference between the actual sale value and the appraisal value was that the Court's DCF analysis did not consider the corporate tax consequences that unavoidably came with selling the company in two pieces.

As demonstrated by the *MedPointe* case and many others, this casino-like aspect of the appraisal process and its potential rewards has not escaped the attention of some investors. As one commentator noted, a review of selected appraisal cases in recent years indicates that premiums of 200-300 percent are not uncommon. The requirement to provide appraisal rights also can provide "hold-up" value to market players that can threaten the closing of a deal, where the buyer, to protect itself against an unpredictable appraisal outcome, conditions consummation on dissenters not exceeding a certain percentage of the outstanding shares.

Permitting appraisal rights in public company mergers not only creates opportunities for "judicially created" windfalls but also wastes valuable resources. In one appraisal case, the initial litigation began in 1983 and ended in 2003. There were five remands by the Delaware Supreme Court and two appraisal trials. Beyond its waste of judicial resources, an appraisal remedy can be very costly to the litigants. Perhaps more importantly, it also portrays the judicial process as more of a lottery than an exercise in fact-finding.

It is time for the Delaware legislature to eliminate appraisal rights when there is a liquid public market for the target. If desired, the legislature could borrow one of the SEC's liquidity standards. By proposing this change, I do not mean to suggest that the marketplace is perfect — and admittedly it is more imperfect in some situations than others — but there are other judicial means for addressing a corrupted sale process. In the meantime, with § 262 reformed as proposed, Delaware courts can be freed from time-consuming appraisal actions whose outcomes are, at best, a forced exercise in rough, and somewhat suspect, justice.[1] ◆

FOOTNOTE

1. If, as suggested, the elimination of appraisal rights is a "bridge too far," another possibility is to amend § 262 to substitute "fair market value" for "fair value," allowing the courts to rely on the market exclusively if the integrity of the sale process merits such a finding.

Frederick H. Alexander

An Optimal Mix of Clarity and Flexibility

These rules establish a trustworthy contract that investors and managers can use to raise capital without need to renegotiate the basic rules.

Rather than discussing particular changes, I want to offer some thoughts on two important qualities of modern corporate statute law: clarity and flexibility. Interrelated to these two principles are three types of rules used to implement these principles: enabling, default and mandatory.

The clarity to which I refer has two aspects: the first involves providing a basic model for managers and investors. Delaware General Corporation Law (DGCL), including caselaw, does this by providing basic rules that need not be addressed each time a corporation is formed. These rules establish a trustworthy contract that investors and managers can use to raise capital without need to renegotiate (or really even consider) the basic rules.

When an entrepreneur forms a Delaware corporation, he or she does not consider all of its attributes — he or she just knows that issuing stock is a time-tested way to raise equity. Similarly, a venture capitalist understands that stock in a Delaware corporation "works." The second aspect of clarity demands that the DGCL be clear and internally consistent so as to reduce uncertainty. While this second aspect may seem pedestrian, it is a key component of clarity: Delaware offers a ready-made package of entity law that is stable and knowable.

The second principle is flexibility. It is remarkable that some of the world's largest publicly traded international business organizations are organized under the same statute as garage-based start-ups. To make this possible, the DGCL provides corporations with tools to create myriad relationships among corporate constituencies.

As noted above, the rules have three elements, which can be used to implement the right mix of clarity and flexibility. The capital stock provisions of the DGCL are enabling; there is no prescribed or default capital structure, so that corporations may have any number of shares divided into any number of classes. Then there are default rules that apply to all corporations unless they specifically opt out. For example, the DGCL provides for straight voting for directors unless the corporation has expressly opted into cumulative voting. Finally, there are mandatory rules, which provide no flexibility but great clarity. Stockholder inspection rights provide a good example — every stockholder has the right to examine corporate books and records.

Alfred Jervis

Some may ask why mandatory elements have a place in the DGCL. Given the capitalistic milieu of the business corporation, it may seem counterintuitive to preclude participants from opting out of any rule. The theoretical answer is that too much freedom may sow confusion. By assuring a minimum level of governance, mandatory rules provide important clarity — an investor in a Delaware corporation need not read the charter or bylaws to know that there are certain bottom-line protections. (Despite this theoretical answer, I suspect that some mandatory rules are more creatures of historical contingency than a careful balancing of clarity and flexibility, but this history creates its own dynamic and settles certain expectations.)

These ideas are offered not as a unified theory of corporate law, but rather as a framework that may be more useful than simply balancing "management" interests against "investor" interests. The real tradeoffs involve flexibility versus clarity. While people often conflate flexibility with "pro-management," that simply is not the case.

For example, one cutting-edge question is whether stockholders can adopt bylaws mandating certain corporate actions relating to maters such as poison pills or proxy materials. Many practitioners (myself included) believe the answer is "no," and that Delaware has a mandatory rule, embodied in § 141(a), that the board has the final say on such matters. So in that important case, it is the stockholder activists who seek greater flexibility by permitting corporations to opt out of the rule that only directors have a final say in a corporation's business and affairs.

Using this framework, changes that are intended to address uncertainty and ambiguity (i.e., the second aspect of clarity) do not involve difficult tradeoffs, and may produce great value in increased certainty, and thus may be low-hanging fruit. Accordingly, I suspect we could create more value for the constituents of Delaware corporations by clarifying the unexciting question of when a class or series vote is required under § 242(b)(2) then we could by trying to address a "hot" issue by creating new rules regarding options backdating.

On the other hand, if a proposed change creates new flexibility, we should consider whether it does so by eliminating a mandatory concept that the market is relying on, however implicitly. Thus, if we were to consider increasing flexibility by permitting bylaws that encroach on board power, we should consider whether we would undermine an implicit contract that assets will be managed by fiduciaries and create significant unforeseen consequences by changing that basic term of the corporate contract.

Conversely, if we add a new mandatory rule, we must consider whether it comes at too great a cost to the flexibility that market participants rely on. If we want to alter the standard contract in a non-mandatory fashion, how cumbersome should the process of opting out be, and who should decide whether to do so?

These decisions all involve tradeoffs that have to be made against the background of settled expectations and a capital market that has developed a set of contracts and behavioral norms that operate within the current parameters. Scandals and headlines notwithstanding, this model has been tremendously successful over the last century, and changes should be made with caution. ◆

Edward P. Welch and Robert S. Saunders

Enabling Delaware's Success

We have had the honor of attempting to carry on Professor Ernest L. Folk III's work by updating his treatise on the Delaware General Corporation Law (DGCL). That treatise tries to compile, without applause or criticism, the "rules" for Delaware corporations as established by the DGCL and the judicial opinions that have applied it.

We expect that many of the distinguished scholars and practitioners writing in this issue will contend that these rules should be changed. Some may contend that the rules should be changed to give stockholders more power. Others may contend that the rules should be changed to give directors a freer hand. Who is right? Who is wrong? We take no position on that here. We contend that the most important rule is simply that the parties to a Delaware corporation be permitted to decide, in advance, what their rules will be. The most important rule is freedom of contract.

Unlike the Delaware statutes governing limited partnerships and limited liability companies, the DGCL has never included an express statement of legislative policy to give "maximum effect to the principle of freedom of contract." Nevertheless, more than 55 years ago, in *Sterling v. Mayflower Hotel Corp.*,[1] the Delaware Supreme Court held that the stockholders of a Delaware corporation had broad power to include provisions in the certificate of incorporation departing from the common law and many sections of the DGCL.

The notion that corporation statutes should be "enabling" — that is, should enable incorporators freely to establish corporations with a wide variety of governing terms — is hardly new. Professor Folk noted in 1968 that "the long run trend has been to remove restrictions from the corporation law" and, in the first edition of our treatise, noted that for decades Delaware had been the "pace-setter" for American corporation statutes. But Delaware's leading role has drawn criticism.

In 1974, Professor William Cary famously accused Delaware of leading a "race for the bottom," in which states competed for franchise tax revenue through the adoption of corporate law rules favoring management over stockholders. Other states have attempted to distinguish themselves from Delaware by adopting statutes that impose mandatory rules thought to be attractive either to management or to stockholders.

For instance, North Dakota's Publicly Traded Corporations Act, adopted in April 2007, contains what one scholar called a "shareholder rights advocate's wish list" — including majority voting in director elections, advisory votes on executive compensation, and reimbursement of stockholders' proxy expenses. The Act requires these measures to be adopted (or not) as a complete package. At the other end of the spectrum, Pennsylvania's anti-takeover statute, which authorizes directors presented with a takeover proposal to consider the interests of customers, employees and communities in addition to the interests of stockholders, is also mandatory.

But the answer to Professor Cary's charge does not lie in mandatory rules. What turns the "race for the bottom" into a "race to the top" is the recognition that giving incorporators and stockholders freedom to craft their own governance rules creates a market in which investors will seek out and reward corporations whose governance rules maximize their wealth. Because it is broadly enabling, the DGCL does just that.

Of course, incorporators and stockholders cannot draft explicit charter provisions addressing all possible contingencies. No doubt there will always be a need to rely on flexible concepts of fiduciary duty and a need for a judiciary capable of applying them in specific circumstances to protect the reasonable expectations of the parties. Thus, as Professor John Coffee argued in a 1989 symposium, the "stable mandatory core" of corporate law is not any particular substantive rule but rather "the institution of judicial oversight." Delaware's expert judiciary is well-suited to this role.

Incorporators and stockholders also benefit from a statute that provides a responsible structural framework in which to operate. Thus, as Dean Latty observed on the eve of the 1967 revision, "what is wanted, then, is a statutory chart-blueprint to tell the decision-makers what they can do and how to do it." Delaware's constant review of this framework to ensure that it is up-to-date and offers "the best elements of a blue print for building, mending, expanding and dismantling the corporate mechanism" has worked with unrivalled success.

We are confident that Delaware's three-prong approach — enabling incorporators and stockholders freely to establish their own governance rules, maintaining a strong judiciary to apply those rules, and providing a clear structural framework through the DGCL — will serve it well for another 40 years. ◆

FOOTNOTE

1. 93 A.2d 107, 117–18 (Del. 1952).

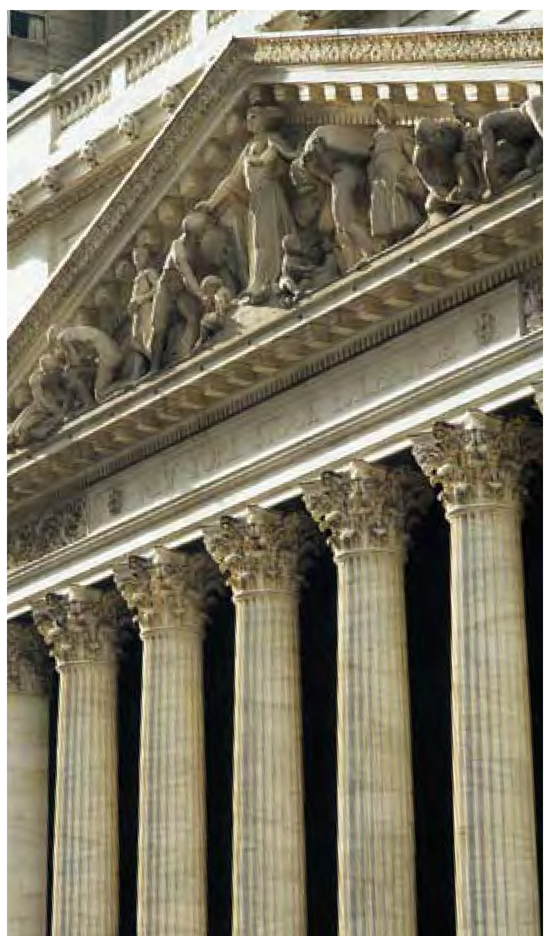
Joel Edan Friedlander

Overturn *Time-Warner* Three Different Ways

Time-Warner remains good law, but it is mocked by the continuing economic stagnation and cultural impoverishment of the corporation that bears its name.

Shortly after the 1967 revision of the Delaware General Corporation Law, Ernest L. Folk III published the following observation, which suggests a cultural link between corporate law revisers and hippies:

> *Almost without exception, the key movement in corporation law revisions is towards ever greater permissiveness. … [S]tatutory revisors in the most recent period have usually sought to enlarge the ambit of freedom of corporate management to take whatever action it may wish.*[1]



This "movement … towards ever greater permissiveness," Folk observed, was not limited to statutory revisions. Then-recent cases, such as *Cheff v. Mathes*,[2] "seemingly throw[] the protective mantle of the 'business judgment' doctrine around a transaction savoring of conflict of interest."[3] Folk wondered whether state corporation statutes would become "insignificant, even contemptible, things" and what new legal structures would arise to preserve "the principle of management responsibility."[4]

A generation later, Delaware jurists kept moving "towards ever greater permissiveness." Boards of directors were authorized to take unprecedented steps to prevent the purchase of corporate control, such as adopting a poison pill that made the purchase economically impractical or entering into a transaction that discriminated against the shareholder purchaser.

The leading case of *Paramount Communications, Inc. v. Time Inc.* (*"Time-Warner"*)[5] punctuated the trend, by permitting Time's Board to recast its proposed merger with Warner Communications Inc. as an acquisition, thereby foreclosing Time's stockholders from voting down the Warner transaction and selling their shares to Paramount Communications — all while tacitly endorsing the Board's professed desire to preserve the "Time Culture."[6]

Time-Warner remains good law, but it is mocked by the continuing economic stagnation and cultural impoverishment of the corporation that bears its name.[7] I advocate three statutory revisions that would overturn *Time-Warner* and reverse the "movement … towards ever greater permissiveness."

First, the scope of director discretion should be narrowed by drafting a statutory standard of fiduciary duty specifying that a director's duty in deciding whether or not to oppose a purchase of corporate control is to act reasonably and in good faith to maximize the company's value and the return to its investors. *Time-Warner* rejected judicial inquiry into the relative value of the proposed combination with Warner and the price offered by Paramount. Time's board was allowed to consider "other threats," as well as "Time's objectives," "Time's needs," Time's "well being," "the preservation of Time's culture" and the "impact on constituencies other than shareholders."[8]

These open-ended concepts neces-

Ernest L. Folk III, 1985

Almost without exception, the key movement in corporation law revisions is towards ever greater permissiveness.

sarily allow a board to disregard or slight the best interests of shareholders when the potential loss of value is greatest, and they impair a court's ability to discern whether impermissible motivations are at work, such as a hubristic desire for empire building, or a venal interest in increased compensation. As a consequence of *Time-Warner,* a sharp distinction exists in Delaware law between the heightened scrutiny applied when directors decide to sell the corporation and the deferential review applied to a decision to acquire, merge or remain independent. Requiring directors to justify the latter decision with reference to a statutory standard of maximizing firm value would better assure that that goal is realized.

Second, stockholders should be empowered to set the terms by which they may sell their shares. This can be done by amending § 109(b) to clarify that stockholders may adopt bylaws that restrict the duration or use of a board-adopted poison pill. *Time-Warner* pointedly criticized prior Chancery Court decisions that forbade boards from foreclosing shareholder choice by maintaining a poison pill in the face of a structurally non-coercive tender offer. Clarifying language to § 109(b) would moot the scholarly debate about the permissible scope of a stockholder-adopted bylaw.

Third, majority stockholder consent should be required before a board undertakes a corporation-transforming acquisition such as that by Time of Warner. Before the statutory revisions of the late 19th century, unanimous stockholder consent was needed to fundamentally change the corporation. Current law requires majority stockholder consent for a merger, a charter amendment, a sale of "all or substantially all" assets, and voluntary dissolution.

These vote requirements are a salutary check on board power, but the required vote on all mergers is easily evaded by acquirors. Stockholders should have the power to vote down an acquisition that more than doubles the size of the corporation, just as they now may vote down a major divestiture. Instead of allowing boards to reenact the permissiveness of the Summer of Love, our statutory revisers should rediscover the maxim of the medieval canonists who founded corporation law: "what touches all should be approved by all."[9] ◆

FOOTNOTES

1. Ernest L. Folk III, *Some Reflections of a Corporation Law Draftsman*, 42 Conn. B.J. 409, 410 (1968).
2. 199 A.2d 548 (Del. 1964).
3. Folk, *supra* note 1, at 431.
4. *Id.* at 432, 434.
5. 571 A.2d 1140 (Del. 1990).
6. *Id.* at 1143 n.4.
7. *See generally* Joel E. Friedlander, *Corporation and* Kulturkampf: *Time Culture as Illegal Fiction*, 29 U. Conn. L. Rev. 31 (1996).
8. 571 A.2d at 1152–55 (internal quotation marks omitted).
9. *See* Friedlander, *supra* note 7, at 109–12.

Theodore N. Mirvis and William Savitt

The DGCL and Takeover Defense

Leave that statute alone! Everything is in it already. It's only a matter of knowing where to look.

Takeover defense is the best example. Section 251 of the Delaware General Corporation Law (DGCL) requires that any merger be the subject of resolution adopted by the board of directors "approving an agreement of merger … and declaring its advisability." That takes care of *merger* defense — the board must exercise its independent judgment, and can accordingly reject an offer it deems inadvisable.

But how about tender offers? Tender offers created a category problem. At first blush, the tender offer does not cross into the board's purview at all. A party outside the corporation offers to purchase something that neither the corporation nor the stockholder has entrusted to the fiduciary's safekeeping. The party simply offers to buy the stockholder's stock. Not the corporation's stock. Not the board's stock. As a formal matter, the board is an entire stranger to a tender offer.

Hence the greatest debate of the modern period, on a plane far higher than the current skirmishing about director- or stockholder-centric models of corporate governance. (The latter debate is merely about managing the corporation — an attempt to reargue the original and fundamental statutory understanding that, as an early decision put it, a board's powers are not derivative of shareholder authority but are instead "original and undelegated.") How is it that the directors might have any legitimate role in a proposed transaction that does not call on them to do anything, that does not require their action in any respect, that does not involve any property or authority entrusted to their domain?

The call on one side was for "director passivity." The opposite pole called for a right, even a duty, of the fiduciary to step into the line between prospective buyer and seller, if creativity could devise a tool equal to the task.

In the end, the statute itself solved the category problem. When, in *Unocal*, the Delaware Supreme Court finally had occasion to reject passivity, it relied on the "large reservoir of authority" that the DGCL invested in directors. As the Court recognized, § 141's broad grant of authority to "manage the business and *affairs*" of the corporation embraced the power and duty to protect the company and its stockholders from threats, irrespective of their source or technique.

And the Court invoked § 251 for the proposition that, "[e]ven in the traditional areas of fundamental corporate change … , director action is a prerequisite to the ultimate disposition of such matters." Reading the statute's provisions together, the Court declared that, "in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality."

The result could hardly have been otherwise. It would have made zero sense for the role *vel non* of the director-fiduciary to depend on whether the takeover bidder addressed its offer to the company, in the form of a merger proposal, or to the stockholders in the form of a tender offer. The DGCL did not contemplate the tender offer (the statute may not be omniscient) but it did, like every other corporation statute, place the directors as gatekeepers between a merger partner and the stockholders (i.e., it is fundamentally all-powerful). As the Supreme Court expressed it in a related context, the statute obligates directors to serve as "defenders of the corporate bastion," an obligation that obtains no matter the weapon or tactic an attacker may deploy.

But what was a board to do, how could it deal with the tender offer? Defensive acquisitions, massive recaps, white squires, scorched earth and the like became tired fast. So the gods gave us the Pill, fashioned from the clay of the DGCL. Section 157 became the source of board power to issue the rights underlying the Pill. In *Moran*, the Pill's enemies made the point that § 157 has nothing to do with takeover defense. But they underestimated the statute.

As the Supreme Court found, § 157, like the rest of the DGCL, will mean whatever it must to allow directors to fulfill their fundamental duties to companies and shareholders: "Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited." Again quoting *Unocal*, the Court thundered: "[O]ur corporate law is not static." Indeed.

With *Unocal, Moran* and its recognition of the elastic force of the DGCL, the Supreme Court placed directors squarely between the tender offeror and the stockholder. The answers were there all along — not in the granular, regulatory, in-your-face style of the Williams Act, but in the more subtle, broad, director-enabling terms of the Delaware statute. And the rest is history: a generation of unparalleled mergers and acquisitions activity, firmly grounded in the DGCL. The DGCL tamed the tender offer. It can handle the future. ◆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