Corporate Law and Legal Determinacy

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Abstract

Delaware corporate law has long become the de facto national law for large corporations. Yet while the status and influence of Delaware corporate law is beyond dispute, its efficiency is not.

One of the most prominent criticisms today concerns the determinacy of Delaware law: Some prominent scholars argue that regulatory competition between states has made Delaware law excessively vague and indeterminate—a claim that is rejected outright by other voices in the literature.

What both sides have in common, though, is a dearth of hard evidence to support their respective accounts. This gap in the literature is unsurprising. To show that regulatory competition makes—or does not make—corporate law less determinate, one has to demonstrate how corporate law would look in the absence of regulatory competition—hardly an easy task.

To overcome this problem of evaluation and shed some empirical light on the matter, this article relies on a comparative approach: It contrasts Delaware law with two other major Western corporate law systems, namely those of Germany and the United Kingdom. Neither country's law on public corporations has been shaped by regulatory competition, despite recent steps toward a European charter market. However, as I show, both legal systems tend to rely even more strongly on indeterminate standards than Delaware does. These clear indications of indeterminacy in the absence of competition are difficult reconcile with the theory that Delaware's reliance on standards arises out of regulatory competition.

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I. INTRODUCTION

In the world of corporate law, Delaware is king. It is home to more than half of all existing public corporations[1] and to almost 90% of those corporations that have gone public in recent years.[2] Even for large privately held corporations, long thought immune to Delaware's charms, this tiny state has become the corporate domicile of choice.[3]

Yet while the importance of Delaware corporate law is beyond dispute, its efficiency is not. And one of the most prominent criticisms today concerns the determinacy of Delaware law: Some prominent scholars argue that regulatory competition between states has made Delaware law excessively vague and indeterminate.[4] The reasons advanced to explain this phenomenon are manifold.[5] For example, it has been suggested that Delaware creates highly vague law in part because this makes it harder for other states to copy Delaware's law, thus allowing Delaware to cement its leading position in the market for corporate charters.[6]

Of course, the claim that Delaware law is overly vague is itself the subject of harsh criticism. Scholars supportive of the status quo flatly deny that Delaware law is overly indeterminate.[7] Indeed, their defense of

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[1] Del. Div. of Corporations, Why Choose Delaware As Your Corporate Home?, http://www.state.de.us/corp/ (last visited February 15, 2010).

[2] Jens Dammann & Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations*, J. L. ECON. & ORG. (forthcoming 2011) (manuscript at 9), *available at* http://jleo.oxfordjournals.org/cgi/reprint/ewp015v1 (finding that out of 270 U.S. corporations that had their IPO in 2006 or 2007, "237 (88%) were incorporated in Delaware at the time of their IPO").

[3] *Id.* at 6 (finding that of those privately held corporations with 5000 or more employees, almost half (49.75%) are incorporated in Delaware).

[4] *E.g.*, Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1252 (2001) [hereinafter Kahan & Kamar, *Price Discrimination*] (arguing that indeterminacy resulting from efforts to engage in price discrimination "likely reduces social welfare"); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1911 (1998) (noting that "Delaware can . . . profit from adopting ambiguous legal standards, even if they render Delaware law suboptimal."). *Cf.* Mohsen Manesh, *Legal Asymmetry and The End of Corporate Law*, 34 DEL. J. CORP. L. 465, 511 (2009) (arguing that "[t]he abundance of indeterminate corporate law promotes confusion and uncertainty-and likely increases transaction costs").

[5] *See infra* Part III.

[6] Kamar, *supra* note 4, at 1910–11.

[7] ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 87 (2002) [hereinafter ROMANO, ADVANTAGE]. *Cf.* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 683 (2005) (claiming that "the overall body of

Delaware comes in two flavors. Some scholars acknowledge that the use of fact-intensive standards makes Delaware law highly indeterminate, but also note that such indeterminacy may not be inefficient.[8] Other voices in the literature go even further and reject the indeterminacy claim itself. They argue that despite its use of indeterminate standards, Delaware law is relatively predictable overall[9] and stress that corporate practitioners choose Delaware corporate law precisely for the legal certainty that it offers.[10]

What is conspicuously absent from the debate, however, is a body of hard evidence regarding the effect of regulatory competition on legal determinacy. Of course, this gap is unsurprising. To determine whether regulatory competition between states has made Delaware law overly indeterminate, one has to answer the hypothetical question of how corporate law would look in the absence of such competition. That is by no means an easy task.

To overcome this problem and shed some empirical light on the questions at hand, I rely on a comparative approach: I examine whether the traditional absence of regulatory competition in the United Kingdom and Germany—two major corporate law jurisdictions outside the United

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[Delaware] case law" allows practitioners to proceed in ways that are "relatively risk free").

[8] E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1412 (2005) (asserting that Delaware law "is indeterminate and that this indeterminacy is good"). Fisch, *supra* note 19, at 1081, concludes that Delaware law is "largely . . . indeterminate" but argues that this quality allows Delaware to be particularly responsive to developments in the business world. A similar position is taken by William Bratton. He acknowledges that Delaware law is indeterminate. William W. Bratton, *Delaware Law as Applied Public Choice Theory: Bill Cary and the Basic Course after Twenty-Five Years*, 34 GA. L. REV. 447, 467 (2000). However, while conceding that indeterminacy may theoretically make Delaware's law less valuable to firms, *id.* at 470, he is quick to point out that the benefits of a less standard-based approach may not be "sufficient to justify a change of direction," *id.* at 472. Myron T. Steele & J.W. Verret, *Delaware's Guidance: Ensuring Equity for the Modern Witenagemot*, 2 VA. L. & BUS. REV. 189, 193 (2007), concede that the standards used in Delaware law "are not exact." However, they stress that the Delaware Court of Chancery has to balance the need for legal certainty with the need for flexibility. *Id.* at 192.

[9] *E.g.,* ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 87 (2002) [hereinafter ROMANO, ADVANTAGE]; Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQ. L. 387, 521 (2001).

[10] *E.g.*, ROMANO, ADVANTAGE, *supra* note 9, at 87. *Cf.* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 683 (2005) (claiming that "the overall body of [Delaware] case law" allows practitioners to proceed in ways that are "relatively risk free").

States—has led their corporate law systems to make more sparing use of vague standards than does Delaware corporate law.

Crucially, neither Germany nor the United Kingdom has traditionally been subject to regulatory competition in corporate law. Admittedly, the European Union has recently made important steps towards a market for corporate charters.[11] However, because the legal rules allowing for corporate mobility have only been adopted in the last few years, corporate mobility has so far been limited to very small privately held firms.[12] In other words, an active charter market for publicly traded firms has yet to develop. Hence, any indeterminacy that may plague the German and U.K. law on public corporations cannot be blamed on regulatory competition.

I concentrate on the area of corporate law that is typically cited as the chief example for Delaware's allegedly excessive use of standards: fiduciary duty law.[13] My study reveals that, remarkably, both German and

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[11] For an overview of the relevant developments see, for example, William W. Bratton et al., *How Does Corporate Mobility Affect Lawmaking? A Comparative Analysis*, 57 AM. J. COMP. L. 347, 366–73 (2009).

[12] *Cf.* Marco Becht, Colin Mayer, & Hannes Wagner, *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241–56 (2008). In this study, Becht et al. find that "[b]etween 2003 and 2006, over 67,000 new private limited companies were established in the U.K. from other E.U. Member States." *Id.* at 242. However, they note that there is no evidence for migration among publicly traded firms and stress, instead, that "[m]ost of the new foreign limited companies are small entrepreneurial firms." *Id.* *Cf.* Bratton et al., *supra* note 11, at 385 (noting that the pressure to compete for corporate charters in Europe "is largely limited to economically-negligible small entrepreneurs").

[13] *E.g.* Marshall E. Tracht, *Insider Guaranties in Bankruptcy: A Framework for Analysis*, 54 U. MIAMI L. REV. 497, 509 (2000) (referring to "the vague standards of fiduciary duty law"); *see, e.g.*, Kamar, *supra* note 4, at 1909 ("While Delaware law offers relatively clear rules that govern technical aspects of corporate governance, the fiduciary duties at its core are open-ended."); *see also* Reza Dibadj, *Reconceiving the Firm*, 26 CARDOZO L. REV. 1459, 1525 (2005) (noting that "corporate law couches fiduciary duties in vague terms"); Wayne O. Hanewicz, *Director Primacy, Omnicare, and the Function of Corporate Law*, 71 TENN. L. REV. 511, 558 (2004) (noting, with respect to Delaware corporate law, that the "fiduciary duties are notoriously vague and context specific"); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 459 (2001) (referring to "the notoriously vague and open-ended U.S. case law that articulates the fiduciary duties of loyalty and care"); Robert W. Hillman, *Closely-Held Firms and the Common Law of Fiduciary Duty: What Explains the Enduring Qualities of a Punctilio?*, 41 TULSA L. REV. 441, 442 (2006) (noting that "contemporary fiduciary law is soft at the core and indeterminate in application"); Darian M. Ibrahim, *Solving the Everyday Problem of Client Identity in the Context of Closely Held Businesses*, 56 ALA. L. REV. 181, 218 (2004) (categorizing the fiduciary duties of majority shareholders as "vague standards"); Mark J. Loewenstein, *Delaware as Demon: Twenty-five Years after Professor*

U.K. law rely on indeterminate fiduciary duties in much the same way that Delaware does. If anything, the United Kingdom and Germany seem even more prone to using vague standards than Delaware.

This finding is of significant importance to the debate on legal determinacy in corporate law. The evidence I present makes it hard to reconcile with the claim that regulatory competition leads Delaware to make excessive use of fact-intensive standards.

My argument is also relevant to the broader debate on regulatory competition in corporate law: How regulatory competition between states affects the quality of corporate law has long been the subject of a passionate dispute. Critics maintain that regulatory competition tends to harm the interests of shareholders,[14] whereas its defenders embrace the opposite view.[15] Answering the question of how regulatory competition affects the determinacy of corporate law will not end this debate. However, by showing that regulatory competition has not in fact made Delaware law

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Cary's Polemic, 71 U. COLO. L. REV. 497, 508 (2000) (asserting that "[m]ost corporate statutes, including Delaware's, provide little guidance on the content of the fiduciary duties owed by directors and others to corporate shareholders"); D. Gordon Smith, *A Proposal to Eliminate Director Standards from the Model Business Corporation Act*, 67 U. CIN. L. REV. 1201, 1206–09 (1999) (using Delaware's law on fiduciary duties as an example of vague and ambiguous norms); Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 286 (2001) (asserting that "Delaware fiduciary-duty law is notoriously indeterminate"). Indeed, the standard-based nature of corporate fiduciary duties is also recognized for U.S. law more generally.

[14] Lucian A. Bebchuk, *Response to Increasing Shareholder Power: Reply: Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1812 (2006) (asserting that "[o]verall, there is a strong basis for concluding that state law . . . continues to be distorted in management's favor"); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1199 (1999) (arguing that "[t]here are strong theoretical reasons to expect that state competition will work to produce a body of corporate law that excessively protects incumbent managers"); Bebchuk et al., *Evidence, supra* note 6, at 1821 (arguing that "the view supportive of state competition . . . does not have the empirical basis believed to exist by supporters").

[15] *See, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 16 (1993) [hereinafter ROMANO, GENIUS] (claiming state competition for corporate charters "benefits rather than harms shareholders"); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 847 [hereinafter Romano, *Competition*] (asserting that state competition benefits investors "on balance"); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2383 (1998) [hereinafter Romano, *Empowering Investors*] (expressing the view that "investors are at a minimum not harmed from the competition and, in all likelihood, benefit from changes in corporate domicile to states such as Delaware").

more indeterminate, this Article refutes at least one of the main criticisms directed at the present system of regulatory competition.

Moreover, the analysis undertaken in this article is relevant to various other debates in the legal literature. In particular, it tends to undermine the widely held view that civil law judges are less open to the use of standards than are common law judges.[16] Furthermore, the evidence contributes to the so-called convergence debate—the debate on whether corporate law systems around the world are in the process of becoming more alike—by demonstrating how practical exigencies will lead states to adopt similar solutions to similar practical problems.[17]

Part II reviews the various theories that seek to explain why Delaware law excessively relies on indeterminate standards. Part III elucidates why it is difficult to prove or refute these theories by looking at federal law or at the law of other U.S. states. Part IV lays out the case for using foreign law as a benchmark. Part V compares the Delaware law on fiduciary duties to the relevant law in Germany and the United Kingdom, showing that the latter two countries are at least as prone to use indeterminate standards as Delaware is. Part VI discusses the implications of this finding. Part VII summarizes and concludes.

II. POTENTIAL REASONS FOR EXCESSIVE INDETERMINACY

Why should we believe that regulatory competition has made Delaware law excessively vague and indeterminate?

Central to understanding the relevant arguments is the well-established distinction between rules and standards. *Rules* are norms whose content is determined ex ante. For example, a norm specifying a certain number of days within which a certain action has to be taken constitutes a rule because the meaning is obvious to all even without litigation. By

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[16] *E.g.*, Gerard Hertig & Hideki Kanda, *Creditor Protection*, *in* THE ANATOMY OF CORPORATE LAW 71, 87 (Reinier Kraakman et al. eds., 2004) ("Judges in civil law jurisdictions such as France and Germany are traditionally uncomfortable with open ended standards, and much prefer to enforce relatively bright-line rules."); *id.* at 97 ("French and German legislators . . . are reluctant . . . to vest so much discretion in civil courts."); Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 WM. & MARY L. REV. 1055, 1106–07 (2004) (arguing that "judges in a civil law system may be reluctant to exercise the kind of discretion required to apply open-ended fiduciary duties"). *Cf.* John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market Failure*, 25 IOWA J. CORP. L. 1, 27 (1999) (arguing that "the civil law jurist lacks the same freedom and discretion as the common law judge to search through a vast storehouse of legal precedents to find the rule best suited for the case before the court").

[17] *See infra* Part VI.C.

contrast, *standards* are norms whose content is determined ex post by the courts.[18] A norm requiring corporate directors to exercise "reasonable" care constitutes a standard to the extent that the parties will learn only at the litigation stage—and hence ex post—whether a particular conduct was reasonable or not.

The current disagreement among corporate law scholars is not about whether standards play an important role in Delaware corporate law; in fact, there is widespread agreement that they do.[19] Rather, the central question is whether regulatory competition between states has driven Delaware to rely *too much* on standards. This difference matters because it is well established in the general law and economics literature that the use of standards can have benefits as well as costs and that the former may outweigh the latter under certain circumstances.[20]

For example, the creator of a rule—be it the legislature or the courts—has to determine ex ante what the content of the rule shall be, making the promulgation of rules more expensive than the promulgation of standards.[21] And if the norm will only be applied in a few rare cases, the costs of creating a rule may not seem justified; an indeterminate standard would therefore be a more appropriate choice.[22]

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[18] *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 557 (1992) (relying on the ex ante/ex post distinction in his analysis of the economic efficiency of rules and standards).

[19] *See, e.g.*, Lucian A. Bebchuk & Assaf Hamdani, *Lessons from History*, 106 COLUM. L. REV. 1793, 1817 (2006) (noting Delaware's "heavy reliance on judge-made standards to regulate corporate affairs"); Robert K. Clagg Jr., Comment, *An "Easily Side-Stepped" and "Largely Hortatory" Gesture?: Examining the 2005 Amendment to Section 271 of the DGCL*, 58 EMORY L.J. 1305, 1322 (2009) (stressing that "Delaware corporate law has grown 'to rely on fact-intensive, standard-based tests.'"); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1081 (2000) (noting that Delaware law is "largely indeterminate and standard based"). *Cf.* Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 108 (1990) (finding "circumstantial evidence of a certain amount of indeterminacy in Delaware corporate law"). *But see* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 17 (2009) (criticizing the indeterminacy of Delaware, but attributing this indeterminacy, in part, to the fact that the duties of care, good faith, and loyalty have "devolved into a series of mini-standards that could fairly be described as rules").

[20] *Cf.* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 596-620 (1992) (analyzing various factors that have an impact on the relative efficiency of rules and standards).

[21] *Id.* at 568-69.

[22] *Id.* at 573.

Against this background, the mere fact that Delaware law sometimes uses indeterminate standards does not imply that it is inefficient. Rather, the decisive question is whether regulatory completion has led Delaware to rely *excessively* on indeterminate standards. As mentioned above, one camp in the legal literature argues that the answer to this question is "yes."[23] And interestingly, they have advanced not just one, but several explanations in support of this assertion.

A. Warding off Federalization

One such explanation for Delaware's excessive reliance on indeterminate standards has to do with the ever-looming possibility that corporate law might be federalized. Currently, Delaware reaps substantial benefits from the charter market.[24] For example, in 2009, the revenues from franchise fees amounted to $574 million, or about 18% of Delaware's total revenues.[25] However, these revenues will keep flowing in only as long as corporations have an incentive to incorporate in Delaware. Any federal intervention in corporate law reduces that incentive by chipping away at the importance of Delaware law. Hence, as Mark Roe has rightly pointed out, Delaware has every reason to seek to avoid federal interventions in the area of corporate law.[26]

Against this background, various scholars have argued that indeterminacy can be part of Delaware's strategy to avoid the federalization of U.S. corporate law. This argument comes in two flavors.

According to the more benign version, Delaware will generally try to avoid adopting rules that the U.S. Congress strongly dislikes.[27] But it is

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[23] Kahan & Kamar, *Price Discrimination, supra* note 4, at 1252 (arguing that indeterminacy resulting from efforts to engage in price discrimination "likely reduces social welfare"); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1911 (1998) (noting that "Delaware can . . . profit from adopting ambiguous legal standards, even if they render Delaware law suboptimal.").

[24] *E.g.*, Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 590, 601 (2003).

[25] STATE OF DELAWARE, OFFICE OF MANAGEMENT AND BUDGET, FISCAL YEAR 2011: GOVERNOR'S BUDGET FINANCIAL SUMMARY, CHARTS, AND SCHEDULES 6 (2010), http://budget.delaware.gov/fy2011/operating/11opfinsumcharts.pdf (showing Delaware's total revenues in the 2009 fiscal year to amount to 3,254.8 million dollars and its franchise tax revenues to amount to 574.2 million dollars).

[26] *See* Roe, *supra* note 24, at 601 (arguing that "Delaware players have reason to fear that if they misstep, they will lose their lawmaking business" as a result of federal intervention).

[27] *Id.* at 636.

sometimes not clear what Washington politics will be.[28] In this situation, Delaware players may find it useful to produce vague law and thereby avoid taking a clear position that would expose them to criticism if it proves to be at odds with whatever the U.S. Congress favors.[29]

Those who believe that Delaware law is excessively friendly to managers advance a more cynical version of this argument. They suggest that Delaware is torn between two competing goals. On the one hand, it seeks to pander to managers in order to attract and retain corporations.[30] On the other hand, it has to avoid provoking congressional intervention—intervention that may occur if Delaware is too obviously beholden to managers.[31] By relying heavily upon standards, the argument runs, Delaware can mask the extent to which it favors managers over shareholders, thereby making federal intervention less likely.[32]

Both explanations have the same implication: They suggest that Delaware may find it in its best interest to rely upon indeterminate standards even when bright-line rules would be more efficient.

B. Cementing Market Power

An alternative explanation for why Delaware law may be inefficiently vague has been suggested by Ehud Kamar. Essentially, he argues that Delaware enjoys a certain amount of market power in the charter market[33] and that the use of vague standards allows Delaware to cement that market power.

According to Kamar, Delaware's market power arises from several factors.[34] These factors include Delaware's highly proficient judiciary, network benefits resulting from Delaware's leading position in the charter market, and Delaware's credible commitment to corporate needs, the last of which is signaled by the state's dependency on the charter market.[35] Delaware can enhance these advantages—and thus the market power that

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[28] *Id.*

[29] *Id.* at 636–37.

[30] Bebchuk & Hamdani, *supra* note 19, at 600.

[31] *Id*. at 604.

[32] *Id.* at 602 (arguing that "indeterminate standards applied by courts in case-specific ways make the extent to which Delaware's law favors managers much less salient," whereas "[e]xplicit, bright-line rules favoring managers could conceivably encourage shareholder groups to push for federal intervention.").

[33] Kamar, *supra* note 4, at 1910.

[34] *Id.*

[35] *Id.*

flows from them—by making its law indeterminate.[36] For example, other states that seek to compete with Delaware in the charter market may try to offer their corporations the same network benefits by simply copying Delaware law.[37] By making its law indeterminate, Delaware makes such a move much more difficult. Other states can still copy Delaware's law, but such a strategy would no longer be as effective since the courts in those states would likely interpret the relevant standards in a different manner.[38]

This approach provides yet another theory for why Delaware law may be inefficiently vague: If Delaware can strengthen its market power by adopting indeterminate law, then it may find the use of vague standards profitable even in those cases in which shareholders would be better served by bright-line rules.[39]

C. Price Discrimination

The notion that Delaware enjoys market power in the market for corporate charters has also given rise to a third—and closely related—theory as to why Delaware law may be inefficiently indeterminate: Ehud Kamar and Marcel Kahan suggest that excessive indeterminacy can be in Delaware's interest because such indeterminacy allows Delaware to engage in price discrimination.[40]

One of the general insights from antitrust economics is that a seller with market power can increase his profits if he is able to discriminate between his customers based on their willingness to pay.[41] Essentially, the

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[36] *Id.* at 1911. This view has subsequently been embraced by other scholars as well. *E.g.*, Michal Barzuza, *Price Discrimination in the Market for Corporate Law*, 26 CARDOZO L. REV. 127, 174 n.192 (2004).

[37] In fact, some states have resorted to that strategy. *See, e.g.*, Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 104 n.18 (2002) (noting that "Nebraska [has] copied the Delaware corporate statutes word by word"); Carney & Shepherd, *supra* note 19, at 57 n.304 (noting that Kansas and Oklahoma have copied the Delaware General Corporation Law). Delaware, in turn, copied New Jersey's corporate law when New Jersey was still the dominant player in the market for corporate charters. *E.g.*, Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 970 (1995); Roe, *supra* note 24, at 609.

[38] Kamar, *supra* note 4, at 1911.

[39] *Id.* But see Steele & Verret, *supra* note 8, at 192–96 (pointing out that Delaware's judges engage in various extrajudicial activities—such as giving speeches and publishing articles—that help to reduce legal uncertainty and arguing that this shows that any indeterminacy of Delaware law is not intended by Delaware's judges).

[40] Kahan & Kamar, *Price Discrimination*, *supra* note 4, at 1232.

[41] *Id.* at 1215.

seller will try to charge higher prices to those willing to pay them and lower prices to those who are not.[42]

Delaware, the argument runs, enjoys market power in the market for corporate charters.[43] Therefore, it has an incentive to engage in price discrimination via the corporations that constitute Delaware's customers.[44] And making its law heavily reliant upon fact-intensive standards is one way of charging corporations different prices for the use of Delaware's law, albeit in an indirect fashion. The explanation can be summarized as follows:

The use of fact-intensive standards leads to more litigation, benefitting Delaware's corporate bar and, indirectly, Delaware.[45] And the costs of litigation are part of the price that Delaware charges for incorporating there. Litigation costs are not spread evenly across all Delaware firms—rather, they are shouldered primarily by firms that engage in litigation-prone transactions such as mergers or freeze-outs.[46] Delaware therefore engages in price discrimination by imposing higher litigation costs on some firms than on others. As a result, these firms end up paying a higher price for incorporating in Delaware than other firms.

Of course, as pointed out above, for price discrimination to make sense from the seller's perspective, it is crucial that differences in price correlate with the buyers' willingness to pay. In other words, the seller has to charge the higher price to those firms that are willing to pay a higher price. According to Kamar's account, price discrimination via indeterminacy meets that requirement because litigation-prone firms are also the ones that are *willing* to pay a higher price.[47] The reason is that those firms that are likely to engage in litigation-intensive transactions are also the ones that benefit the most from Delaware's proficient judiciary, well-developed case law, and ready market for law firm services.[48]

One implication of this account is that Delaware law may be excessively indeterminate:[49] Delaware may find it profitable to adopt indeterminate standards not because they improve the quality of Delaware

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[42] *Id.*

[43] *Id.* at 1211–14.

[44] *Cf. id.* at 1215 (noting that Delaware uses its market power to engage in price discrimination).

[45] *Id.* at 1246.

[46] *Id.* at 1242.

[47] *Id.*

[48] *Id.*

[49] *Cf. id.* at 1252 (concluding that "to the extent that price discrimination shapes Delaware law, it likely reduces social welfare").

law but because they provide Delaware with a means to engage in price discrimination.[50]

D. Lawyers as an Interest Group

Jonathan Macey and Geoffrey Miller have advanced yet another explanation for why Delaware law may be excessively indeterminate—namely the influence of the Delaware corporate bar.[51] From the perspective of Delaware's corporate lawyers, inefficient indeterminacy is a double-edged sword. On the one hand, it threatens to deter some corporations from incorporating in Delaware, which is detrimental to the interests of Delaware's corporate lawyers[52] On the other hand, indeterminacy increases the volume of litigation and thereby increases the profits made by Delaware corporate lawyers.[53] To the extent that the latter effect outweighs the former, Delaware lawyers have an incentive to lobby for more indeterminate corporate law—even when such indeterminacy reduces the efficiency of Delaware law.[54]

There is an important difference between this theory and the three previously presented ones: Macey and Miller seek only to explain why Delaware law may be excessively indeterminate. By contrast, they do not make the claim that regulatory competition is to blame for this development. And it is easy to see why. Even assuming that interest group pressure from Delaware corporate lawyers has made Delaware law inefficiently indeterminate, it is not at all clear that this effect can be blamed

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[50] Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 741 (2002) [hereinafter Kahan & Kamar, Myth].

[51] The major insight underlying the explanation—namely the recognition that Delaware lawyers form a powerful interest group with incentives that are not perfectly aligned with either those of corporate managers or those of shareholders—was pioneered by John Macey and Geoffrey Miller. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 498–523 (1987) (analyzing the political forces that shape Delaware corporate law and arguing that the influence of the corporate bar has led Delaware law to be more litigation-intensive than it would otherwise be).

[52] Macey & Miller, *supra* note 51, at 505 (noting that "[t]he bar as a whole does not have an interest in making the law so unclear that corporations begin to move elsewhere in large numbers"). *Cf.* ROMANO, ADVANTAGE, *supra* note 9, at 91 (noting that "[a] competitive market for lawyers reduces the Delaware bar's ability to create a legal regime that increases litigation, and hence attorney income, at the expense of shareholder wealth").

[53] *See* Macey & Miller, *supra* note 51, at 505 (noting that the Delaware corporate bar "has some interest in reducing the clarity of Delaware law to enhance the amount of litigation"). *See also* Kahan & Kamar, *Price Discrimination*, supra note 40, at 1246 (explaining how more litigation-intensive law benefits Delaware lawyers).

[54] Macey & Miller, *supra* note 51, at 505.

on regulatory competition. After all, if corporate law were federalized, corporate lawyers would still have an incentive to lobby for more litigation-intensive corporate law. Indeed, one can plausibly argue that regulatory competition provides at least a partial antidote to the problem of the powerful litigator lobby: Under a regime of state competition, Delaware lawyers cannot afford to go too far in pushing for an indeterminate corporate law lest corporations start migrating elsewhere.[55] No such check would exist if corporate law were federalized.

However, the situation is not entirely clear. One can also various arguments for why lobbying by the corporate bar would likely be less of a problem if corporate law were federalized.

To begin, it can be argued that lawyers are more influential as an interest group under the current system of state competition than they would otherwise be. For example, the Delaware legislature relies strongly upon its corporate bar in assessing the needs and preferences of its corporate clients.[56] And the Delaware judiciary—both at the Chancery Court and the Supreme Court level—includes former corporate attorneys, a fact that has led some to argue that the Delaware judiciary will have an open ear for the corporate bar.[57] If corporate law were federalized, it's not clear that the U.S. Congress would rely as strongly upon the advice of corporate attorneys. Moreover, precedents would be set by federal judges that, given the diversity of their responsibilities, are less likely to include former corporate lawyers. Accordingly, if corporate law were federalized, lawmakers and courts might be less inclined to give in to pressure by the corporate bar to make corporate law less determinate.

Moreover, under a system of federal corporate law, corporate attorneys as a group may not be as interested in indeterminate law as the Delaware corporate bar are suspected of being under the current system. The reason is that the Delaware corporate bar tends to be dominated by

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[55] *Id.*

[56] *Cf.* Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 69 (2009) ("Delaware corporate lawyers are a highly influential interest group affecting the development of the state's corporate law."); Macey & Miller, *supra* note 51, at 506 (noting that "many members of the Delaware legislature are themselves members of the bar").

[57] *Cf.* Macey & Miller, *supra* note 51, at 502 (noting that "[t]he members of the Delaware Supreme Court are drawn predominantly from firms that represent corporations registered in Delaware" and suggesting that "it is unsurprising that Delaware judges believe strongly in the efficacy of the Delaware legal system or that such judges often agree with the legislature that firms will be better off if Delaware corporate lawyers play an active role in their affairs").

corporate litigators rather than by lawyers doing transactional work.[58] And it is corporate litigators who stand to profit most from the additional litigation that arises out of the indeterminacy of Delaware law.[59] Accordingly, the average corporate lawyer practicing in Delaware is likely to be far more interested in indeterminate corporate law than the average corporate lawyer across the nation. It follows that if corporate law were federalized, corporate lawyers as a group might be less inclined to lobby for indeterminate corporate law than Delaware corporate lawyers are currently thought to be. Consistent with this thesis, a recent study finds that in Israel, where corporate legislation is enacted at the national level, corporate lawyers do not seem to be pushing for more litigation-intensive law.[60]

In sum, an interest group account of Delaware corporate law does not necessarily imply that regulatory competition has made Delaware law inefficiently indeterminate. However, it does provide a narrative of how regulatory competition *may* have had such an effect: Corporate litigators have an interest in pushing for greater indeterminacy, and regulatory competition may have strengthened their hand to do so.

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[58] William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 630–31 (2006) (pointing out that "Delaware's . . . bar conducts a litigation practice"). The reason for the dominance of corporate litigators is that the Delaware Chancery Court and Supreme Court require a Delaware-licensed lawyer to participate in litigation before them. DEL. SUP. CT. R. 12; DEL. CH. CT. R. 170. Accordingly, corporate litigation has long been a major playing field for Delaware corporate lawyers. By contrast, transactional work involving Delaware corporate law is done by large corporate law firms across the nation. *Cf.* William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 630 (2006) (noting that lawyers in the nation's financial centers render advice on Delaware corporate law without sharing fees with Delaware lawyers).

[59] The likely effect of indeterminacy is to make the law more litigation-intensive. Daniel Klerman, *Jurisdictional Competition and the Evolution of the Common Law*, 74 U. CHI. L. REV. 1179, 1196 (2007) (noting that "it is usually thought that standards produce more litigation"). This should benefit corporate litigators. By contrast, corporate lawyers doing transactional work may well be harmed by greater indeterminacy. The intuition here is that greater indeterminacy translates into higher transaction costs. *E.g.*, Manesh, *supra* note 23, at 511 (arguing that "the abundance of indeterminate corporate law [in Delaware] . . . likely increases transaction costs."). And if transaction costs are higher, there should be fewer transactions—to the detriment of corporate lawyers doing transactional work.

[60] Yael T. Ben-Zion, *The Political Dynamics of Corporate Legislation: Lessons from Israel*, 11 FORDHAM J. CORP. & FIN. L. 185, 319–20 (2006) (finding that "the Israeli Bar has stressed the need for greater clarity and certainty in corporate legislation" and that "as opposed to Delaware's lawyers, Israel's lawyers do not seem to encourage higher litigation costs").

III. VERIFYING THE INDETERMINACY CLAIM

Of course, all of the above-described theories on the indeterminacy of Delaware corporate law share one common trait. They all provide explanations for why Delaware law *may* be excessively indeterminate, but cannot conclusively show that it *is* so, let alone that such indeterminacy presents a serious problem. In other words, the various theories described above simply do not provide a definitive answer to the question of whether regulatory competition does or does not lead to excessive indeterminacy.

To find that answer, one is compelled to look to other evidence—a difficult undertaking.

A. The Efficiency of Individual Norms

One can, of course, try to analyze individual Delaware norms to see if these norms are inefficiently indeterminate. But the problem with such an approach is that it is very difficult to determine the optimal level of determinacy in any given case.[61]

In part, this is due to the sheer number of factors that are relevant to the question of whether, in a particular situation, a rule is more efficient than a standard or vice versa. As Kaplow has shown in his seminal work on rules and standards, the relative efficiency of rules and standards depends on myriad different considerations, thus making it difficult to evaluate the efficiency of any particular rule or standard.[62]

The matter is further complicated by the fact that many of the standards used in Delaware corporate law are at least to some extent subject to modification in the corporate charter. For example, while there is widespread agreement that the parties cannot eliminate the duty of loyalty in the charter,[63] nothing prevents them from writing bright-line rules into

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[61] *See* ROMANO, ADVANTAGE, *supra* note 9, at 89 (noting that "the analytical question whether rules are superior to standards is . . . extremely complex"). *Cf.* Fisch, *supra* note 19, at 1084 (pointing out that "[w]hether [the] benefits [of indeterminacy] exceed [its] costs . . . is an empirical question").

[62] Kaplow, *supra* note 18, at 596–620 (analyzing various factors that have an impact on the relative efficiency of rules and standards).

[63] *E.g.*, Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 496 n.16 (2002); Jens Dammann, *Corporate Ostracism: Freezing Out Controlling Shareholders*, 33 IOWA J. CORP. L. 681, 734 (2008); Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 TULSA L. REV. 451, 474 n.173 (2006); Jill E. Fisch, *Picking a Winner*, 20 J. CORP. L. 451, 458 (1995) (reviewing ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993)); Tamar Frankel, *The Delaware Business Trust Act Failure as the New Corporate Law*, 23 CARDOZO L. REV. 325, 340 (2001). *But see* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1274–75 (1999) (noting that the duty of loyalty

the charter that go beyond the requirements of the duty of loyalty. Thus, it would be perfectly legal to avoid the existing standards on director self-dealing by imposing a blanket prohibition against transactions between the director and the corporation.[64] This default character of corporate law matters because, as Ian Ayres has shown, it can have a direct impact on whether standards are more efficient than rules: As long as corporate law can be modified by the parties, it can be efficient for lawmakers to choose a standard rather than a rule as the default norm even if most parties would prefer to be governed by a rule.[65]

In light of the above, it is extremely hard to assess whether a standard is more efficient than a rule in a given case, or vice versa. Accordingly, it is also exceedingly difficult to focus on an efficiency analysis of individual norms to determine whether Delaware law excessively relies upon standards.

B. The Law of Other States as a Benchmark

Another conceivable approach is to compare the determinacy of Delaware law to that of other U.S. states. Such an argument can come in two flavors: One can either compare the *overall level* of determinacy of different corporate law systems. In other words, one could ask whether Delaware corporate law as a whole is more or less determinate than that of other states. Or one can focus on *specific areas of corporate law* and compare them across different U.S. states. For example, one could ask whether the Delaware law on mergers offer more or less legal certainty than those of other states.

However, both approaches run into the same obstacle: just as Delaware law is shaped by regulatory competition, so are the laws of other U.S. states, albeit in a different manner. Accordingly, the laws of other U.S. states simply cannot provide a glimpse of what corporate law would look like in the absence of regulatory competition.

"cannot be waived completely," but asserting that it "may be limited in certain respects by agreement.").

[64] Interestingly, the major Western corporate law systems generally seem to avoid such blanket prohibitions. *See* Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 INT'L & COMP. CORP. L.J. 297, 302–30 (2002) (comparing the law on director self-dealing in the United States, the United Kingdom, France, Germany, and Italy).

[65] Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1405 (1992). The relevance of this work to the indeterminacy debate is rightly stressed by ROMANO, ADVANTAGE, *supra* note 9, at 89.

1. Overall Levels of Determinacy

Consider, first, the possibility of comparing overall levels of legal determinacy across states. To make such an argument may seem tempting, especially if one supports state competition. After all, as has been noted in the literature, corporate lawyers advise their clients to incorporate in Delaware precisely because they consider Delaware law to be more determinate than the law of other states.[66]

However, if we seek to determine the impact of regulatory competition on corporate law, the law of other U.S. states hardly provides a suitable point of comparison. Regulatory competition has allowed Delaware to become the primary forum for corporate law litigation in major corporate law cases.[67] And, by the same token, it has reduced corporate litigation in other states since many of the cases that are now litigated in Delaware would, in the absence of competition, have been litigated elsewhere. As a result, Delaware has a much more comprehensive set of precedents in that area of the law than any other state.[68] Owing to the richness of this case law, Delaware may score better on legal determinacy than other states *despite* the fact that Delaware makes excessive use of standards.[69]

But this does not preclude the possibility that regulatory competition has a detrimental effect on legal certainty. After all, if corporate law were federalized, all corporate cases would be decided under federal law, leading to an even more extensive set of precedents. In other words, the fact that Delaware law is more determinate than that of other U.S. states with fewer precedents on the law of publicly traded corporations does not allow the

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[66] *E.g.,* ROMANO, ADVANTAGE, *supra* note 9, at 88.

[67] *See, e.g.*, Jens Dammann & Henry Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 13 (2008) (calling Delaware "the preferred forum for cases involving publicly traded corporations"); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 881 (describing the Delaware Chancery Court as "the most prominent corporate law court"); Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 704 (1992) (noting the Chancery Court's "prominence as a forum for the adjudication of corporate law issues"); Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1987 (2006) (concluding from an empirical analysis of merger agreements that "Delaware . . . leads as a litigation forum choice").

[68] *See, e.g.*, Kahan & Kamar, *Price Discrimination*, *supra* note 40, at 1212 (noting that "[b]ecause many corporate disputes arise under Delaware law, Delaware's case law is more developed than the case law of other states"). *Cf.* Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 132 (noting the dearth of "reported non-Delaware case law dealing with large corporations").

[69] Kamar, *supra* note 4, at 1914.

conclusion that it is more determinate than a (hypothetical) federal corporate law with an equal or even more extensive set of precedents. It follows that if one seeks to measure the impact of regulatory competition on legal determinacy, there is little benefit in comparing the determinacy of Delaware law to that of the legal systems of other U.S. states.

2. Specific Provisions

As an alternative to comparing overall levels of legal determinacy, one may be tempted to assess the impact of regulatory competition on legal determinacy by comparing specific provisions in Delaware to their counterparts in other U.S. states. Yet this approach suffers from the same basic flaw: Just as Delaware law is shaped by charter competition, so are the laws of other states. This is true even if one concedes, for argument's sake, that states other than Delaware make little effort to compete for corporate charters.[70]

As noted above, Delaware's preeminence as a forum for public corporation cases is not without impact on the remaining states. If a disproportionate number of high-profile cases end up in Delaware, courts in other states may find it difficult to develop the kind of specialization and expertise that is needed to apply standards. Thus, they may find it efficient to adopt bright-line rules where, in the absence of regulatory competition, they might have adopted standards.[71] In other words, even if other states were found to rely more strongly on bright-line rules, this may be just as much the result of regulatory competition as Delaware's reliance on standards is thought to be.

By the same token, if the corporate laws of other U.S. states were found to be as standard-based as Delaware corporate law, this would not refute the possibility that regulatory competition makes Delaware corporate law excessively indeterminate. Regardless of whether Delaware law is optimally efficient, other states have strong incentives to follow Delaware precedents. And they often do.[72] Such a course of action allows them to participate in network benefits to some extent. And, more importantly,

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[70] Bebchuk & Hamdani, *supra* note 3, at 556; Kahan & Kamar, *Myth*, *supra* note 50, at 748; Kahan & Kamar, *Price Discrimination*, *supra* note 4, at 1213.

[71] *Cf.* ROMANO, ADVANTAGE, *supra* note 9, at 87 (arguing that "the fact that states other than Delaware tend to substitute bright-line rules for a standard to determine fiduciary issues is . . . evidence that they are seeking to make the best of what is a competitive disadvantage of their legal system").

[72] Kaouris, *supra* note 37, at 1004. For example, Nevada's legislature copied Delaware's case law wholesale, and Nevada courts seem to follow Delaware precedent. Fisch, *supra* note note 19, at 1067.

states that lack a specialized judiciary may hope (with some justification) that they can raise the quality and coherence of their case law by fashioning it upon the highly regarded Delaware law. In other words, if other states rely as strongly on indeterminate standards as Delaware does, this may not be because such standards are efficient, but because the relevant other states have copied Delaware law without regard to its efficiency or inefficiency.

C. Federal Law as a Benchmark

Can federal law serve as a more reliable benchmark for measuring the determinacy or indeterminacy of Delaware corporate law? Critics of state competition think so—they compare Delaware corporate law to federal securities law to show that Delaware law is unnecessarily indeterminate.[73] However, this example actually serves nicely to illustrate the shortcomings of federal law as a benchmark.

One of these shortcomings has been pointed out by Roberta Romano: It is not at all clear that federal securities law is less standard-based than Delaware corporate law.[74] In fact, fraud liability under rule 10b-5 arguably demonstrates that federal law, to the extent that it governs substance rather than procedure tends to rely on standards as well.[75]

The second problem with the comparison is even simpler: Given that the efficiency of standards versus rules depends upon numerous factors, it may vary from one regulatory context to another. Whereas standards may be preferable to govern question A, rules may be more efficient with respect to question B. That, of course, means that it makes little sense to use federal law as a benchmark for evaluating the determinacy of Delaware law. After all, federal securities law and Delaware corporate law tend to govern very different questions: securities law is concerned with disclosure of information [76] whereas corporate law largely focuses on the internal governance of firms.[77] Accordingly, the shape of federal securities law does not really allow any conclusions regarding the impact of regulatory competition on corporate law.

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[73] Kamar, *supra* note 4, at 1921 (comparing Delaware law to federal securities law to illustrate the indeterminacy of Delaware law).

[74] ROMANO, ADVANTAGE, *supra* note 9, at 88.

[75] *Id.*

[76] *Cf., e.g.* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2365 (1998) (describing the federal securities regime as "a mandatory system of disclosure regulation, bolstered by antifraud provisions").

[77] *Cf., e.g.*, STEPHEN BAINBRIDGE, CORPORATE LAW 11 (2d. ed. 2009) (noting, as a rule of thumb, that state corporate law "is concerned with the substance of corporate governance").

IV. FOREIGN LAW AS A BENCHMARK

In light of the various problems inherent in using U.S. law as a benchmark to assess the impact that regulatory competition has on legal determinacy, this Article takes a different path: It compares Delaware law to the law of two major foreign jurisdictions of the Western world, namely the United Kingdom and Germany. Focusing on the law of fiduciary duties, I will show that these two systems are just as likely to use fact-intensive standards as Delaware law is.

The obvious attraction of such an approach is that it avoids the shortcoming of making comparisons between different U.S. states: Within the United States, all corporate laws—even those of states that do not actively compete for corporate charters—are directly or indirectly shaped by regulatory competition.[78] Therefore, one cannot hope to learn how determinate corporate law would be in the absence of charter competition by comparing the law of Delaware to that of other U.S. states. By contrast, no such problem occurs when Delaware law is compared to U.K. or German law. This is because neither the U.K. nor the German law on fiduciary duties in public corporations can be viewed as having been shaped by regulatory competition.

A. The Absence of Regulatory Competition

The rejection of regulatory competition as a shaping factor in the U.K. and German law on public corporations may surprise some. After all, much recent scholarship has been devoted to regulatory competition in the European Union.[79] However, the crucial point is that the relevant developments are too recent to have exerted much influence on corporate law, let alone on the law governing public corporations. Until about ten years ago, no market for corporate charters existed in the European Union.[80] Most member states simply did not allow local businesses to be governed by the law of a foreign jurisdiction. Rather, they imposed their own corporate law on local businesses via the so-called real seat rule.[81] Under

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[78] *See supra* Part III.B.

[79] Recent contributions include Bratton et al, *supra* note 11; Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477 (2004); Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725 (2006).

[80] *Cf.* Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 480 (2004) (explaining how the real seat rule prevented corporate mobility in the European Community until recently); Mitchell A. Kane & Edward B. Rock, *Corporate Taxation and International Charter Competition*, 106 MICH. L. REV. 1229, 1270 (2008) ("Historically, there was no market for corporate charters in the European Union.").

[81] *E.g.*, Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1727 (2006).

that rule, a company's headquarters ("real seat"), rather than its place of formation, determined the applicable corporate law.[82] Accordingly, a company had to move its headquarters to another jurisdiction in order to gain access to another state's law[83]—a measure too expensive and complicated to be without practical importance.[84]

Over the last decade, the European Union has taken important steps toward a European charter market: In a triad of cases, starting with the famous *Centros* judgment of 1999,[85] the European Court of Justice made it clear that the real seat doctrine violates European law.[86] As a result, European courts now generally apply the law of the state of incorporation to a corporation's internal affairs.[87] Accordingly, European entrepreneurs seeking to incorporate their business can now choose the applicable corporate law by incorporating in the relevant member state.[88]

Crucially, though, *Centros* and its progeny only allowed corporations to choose the applicable corporate law at the time of their initial formation. By contrast, the relevant cases did not allow existing corporations to change the applicable corporate law by way of reincorporation,[89] at least not without suffering adverse tax consequences.[90]

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[82] *E.g.*, Larry E. Ribstein, *The Important Role of Non-Organization Law*, 40 WAKE FOREST L. REV. 751, 791 (2005). *Cf.* Clark D. Stith, *Federalism and Company Law: A "Race to the Bottom" in the European Community*, 79 Geo. L.J. 1581, 1600 (1991) (noting that the "real seat of a company has been described as the company's 'headquarters,' the 'brain of the enterprise,' or the place where the 'final decisions' are made").

[83] Dammann, *supra* note 80, at 480.

[84] *Id.*

[85] Case 212/97, Centros Ltd. v. Erhvers-og Selskabsstyrelsen, 1999 E.C.R. I-1459, [1999] 2 C.M.L.R. 551 (1999).

[86] The other two cases are Case C-208/00, Uberseering B.V. v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919; and Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10,155. For an analysis of these cases and the earlier *Centros* decision see, for example, Dammann, *supra* note 80, at 484–86; Peer Zumbansen, *Spaces and Places: A Systems Theory Approach to Regulatory Competition in European Company Law*, 12 EUR. L.J. 534, 543-46 (2006).

[87] *E.g.,* Bratton et al., *supra* note 11, at 348.

[88] *E.g.*, Jens Dammann, *A New Approach to Corporate Choice of Law,* 38 VAND. J. TRANSNAT'L L. 51, 56 (2005)

[89] *E.g.*, Hanne Sondergaard Birkmose, *A Market for Company Incorporations in the European Union?—Is Uberseering the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 60 (2005); Bratton et al., *supra* note 11, at 370.

[90] Following *Centros*, existing corporations could theoretically have been dissolved and newly formed in a different member state. However, such a way of proceeding typically has significant adverse tax consequences. When the company is dissolved, the difference between the (typically lower) book value of its assets and the

As a result, corporate "mobility" was limited to newly formed firms, whereas it remained off-limits to the vast majority of corporations, namely those that already existed.

The problem of reincorporating an existing company was only addressed much later: In 2005, the European Union adopted the so-called Cross-Border Merger Directive,[91] which the member states had to implement by the end of 2007.[92] In combination with an earlier directvive, the Cross-Border Merger Directive ensures that European corporations can merge with companies from other member states without suffering adverse tax consequences.[93] This in turn allows corporations to reincorporate freely since a reincorporation can be undertaken by merging the old corporation unto a newly formed corporation in the chosen state of destination.[94]

To be sure, the Cross-Border Merger Directive is not the only step that was undertaken in the direction of allowing existing corporations to reincorporate. Rather, the European Court of Justice also seemed to be sympathetic towards recognizing a constitutional right to corporate mobility in its case law: In *Sevic Systems*,[95] the Court was faced with a German statute that allowed mergers between domestic corporations, but did not allow for the possibility of cross-border mergers. The Court made it clear that this rule violated what was then[96] the Treaty Establishing the European Community[97]—suggesting that as a matter of European Constitutional law, states cannot allow domestic mergers while prohibiting cross-border

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(typically higher) market value is "realized" for income tax purposes and hence constitutes taxable income. For an analysis of the relevant tax rules, see Dammann, *supra* note 80, at 490–91.

[91] Council Directive 2005/56/EC, On Cross-Border Mergers of Limited Liability Companies, 2005 O.J. (L 310) 1 [hereinafter Cross-Border Merger Directive].

[92] *Id.* art 19 (1).

[93] *See* Council Directive 90/434/EEC, On the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, 1990 O.J. (L 225) 1 [hereinafter Merger Tax Directive], amended by Council Directive 2005/19/EC, 2005 O.J. (L 58) 19. According to that directive, "[a] merger or division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes." *Id.* art. 4 (1).

[94] In the United States, corporations have long reincorporated via cross-border mergers. Dammann, *supra* note 80, at 489.

[95] Case C-411/03, Sevic Systems 2005 E.C.R. I-10805.

[96] With the entry into force of the Treaty of Lisbon, the Treaty Establishing the European Community has been renamed the Treaty on the Functioning of the European Union. Consolidated Version of the Treaty on the Functioning of the European Union, art. 157 (1), December 13, 1997, 2008 O.J. (C115) [hereafter TFEU].

[97] *Id.* at para. 32.

mergers.[98] Once more, however, the timing of this development needs to be taken into account. The relevant judgment occurred only in 2005—the same year that the Cross-Border Directive was finally adopted.

Partly because of the relatively recent nature of these developments, corporate mobility in the European Union has thus-far remained a phenomenon whose importance is limited to very small privately held firms.[99] Such firms make use of the changes brought by *Centros* to avoid the often high costs of incorporating in their home state. Their destination of choice is the United Kingdom, where the costs of incorporating are relatively low: According to one study, over 67,000 new companies were formed in the United Kingdom from 2003 to 2006 by entrepreneurs located in other Member States.[100]

By contrast, corporate mobility has not yet obtained any relevance for publicly traded firms.[101] This may very well change in the future.[102] But the fact remains that that, *so* far, the U.K. and German law on fiduciary duties in public corporations has not been shaped, directly or indirectly, by regulatory competition.

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[98] For a somewhat more cautious interpretation of the relevant judgment, see Bratton et al., *supra* note 11, at 370 (noting that "[t]he ECJ took a step in th[e] direction [of granting a right, under the EC Treaty, to undertake cross-border mergers] in its decision involving the merger between Security Vision Concept SA and Sevic Systems AG.").

[99] *See supra* note 12.

[100] Becht et al., *supra* note 12, at 242.

[101] *See supra* note 12.

[102] Scholars are divided regarding the likelihood that a European market for corporate charters will emerge. The most contentious point is the question of whether member states have sufficient incentives to compete for corporate charters. Some voices in the literature believe that they do. *E.g.*, John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition*, *in* AFTER ENRON 497, 520 (John Armour & Joseph M. McCahery eds., 2006); Dammann, *supra* note 80, at 520–30. Others are more skeptical. *See, e.g.*, Birkmose, *supra* note 89, at 106 (finding it "questionable whether the Member States will have sufficient incentives to compete for company incorporations"); Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 6 (2008) (claiming that the member states "are not now engaged in a competition for corporate charters, and cannot be expected to engage in one in the near future"); Ehud Kamar, *Beyond Competition for Incorporations,* 94 GEO. L.J. 1725, 1728 (2006) (seeing "no reason to believe that European countries will be any more interested in incorporations than most American states, which make little effort to compete with Delaware"); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law—Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3, 14–30 (2005) (doubting whether the member states will compete).

B. Selection Bias

A potentially more significant objection against the use of foreign law as a benchmark concerns the risk of selection bias: Different laws may achieve different degrees of determinacy with respect to different legal issues. For example, while one corporate law system may use vague standards in the context of fiduciary duties, another may use them primarily in the context of the law governing limited liability and the protection of creditors.

This creates a potential challenge in the form of a so-called selection bias for studies seeking to compare the determinacy of different legal systems:[103] If one picks an area of Delaware law that is considered particularly indeterminate and then compares that area across various jurisdictions, one is likely to overstate the comparative indeterminacy of Delaware law. After all, one is comparing what is arguably the least determinate portion of Delaware law with what may be an uncharacteristically determinate part of the foreign legal system.

However, this potential selection bias is not a problem for the case at hand. In technical terms, this is because the bias runs counter to the findings made in this article and therefore cannot explain them away. More simply put, one has to recall that I am focusing on the very area—fiduciary duties of corporate directors—that is considered to be the very paradigm for the use of vague standards in Delaware law.[104] In other words, I am choosing the one area of corporate law where Delaware law is deemed to be particularly indeterminate. Accordingly, the only danger inherent in my approach is that it may well *overstate* Delaware's comparative tendency to use indeterminate standards. Yet, as already mentioned, I show that even with respect to fiduciary duties, Delaware is, in fact, *less* standard-based than U.K. or German law. The fact that my analysis may well overstate Delaware's comparative indeterminacy only lends additional weight to my claim that Delaware law is no more indeterminate than U.K. or German law.

V. FIDUCIARY DUTIES OF DIRECTORS

So how does the Delaware law on the fiduciary duties of corporate directors compare to its German and U.K. counterparts? As a preliminary matter, it should be noted that all three legal systems impose the basic

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[103] For a useful introduction to the problem of selection bias in comparative studies, see David Collier & James Mahoney, *Insights and Pitfalls: Selection Bias in Qualitative Research*, 49 WORLD POL. 56, 56–91 (1996).

[104] *See supra* note 13.

fiduciary duties of loyalty[105] and care[106] upon directors. For a meaningful comparison, therefore, one has to be more specific and look at the main contexts in which these fiduciary duties apply.

For the purpose of clarity, it should be noted that the following analysis covers the principal issues in this field. In other words, I do not strive to give a complete account of every last doctrinal wrinkle of the legal systems involved. It would be impossible to do so within the confines of a single article, and it would also be misleading: For economic actors, it is not terribly important how clear the law is on certain remote legal questions that only arise in unique once-in-a-lifetime scenarios. Consequently, those concerned with the determinacy of corporate law are well advised to focus their attention on the relevant practical questions that are bound to arise with some regularity.

A. Liability for Bad Business Judgments

In terms of real life importance, perhaps the single most important question concerns the conditions under which directors can be held liable for bad business decisions.

1. Common Ground

The grounds for directors to be held liable for bad business decisions is a well-settled issue in Delaware. Outside the context of corporate takeovers, courts generally apply the so-called business judgment rule.[107] Under this rule, the courts will not second-guess directors as long as they are reasonably informed and have acted without a conflict of interest and in

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[105] Regarding Delaware law, see, for example, Mills Acq'n Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1988) (noting that "the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders"). As regards German law see, for example, UWE HÜFFER, AKTIENGESETZ 427 (7th ed. 2006) (noting that the members of the managing board have a duty to be loyal to the corporation), *id.* at 591 (noting that the members of the supervisory board have a duty of loyalty towards the corporation). Regarding U.K. law, see, for example, PAUL L. DAVIES ET AL., GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 595–97 (8th ed. 2008) (summarizing the duties of loyalty of U.K. directors).

[106] Regarding Delaware law, see, for example, Mills Acq'n Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1988). Concerning German law, see Aktiengesetz (AktG) [Stock Corporation Act], Sept. 6, 1965, BGBI. I at 1089, § 93 (1) (F.R.G.) (requiring the members of the managing board to act with the care of a prudent and responsible manager) and § 116 (extending the duty of care imposed by section 93 to the members of the supervisory board). For U.K. law see, for example, DAVIES ET AL., *supra* note 105, at 488 (noting that corporate directors have duties of skill and care).

[107] *E.g.*, Kahn ex rel. DeKalb Genetics Corp. v. Roberts, 679 A.2d 460, 465 (Del. 1996).

good faith.[108] At least in part, these requirements rely on standards. In particular, this is true for the duty of care: It simply has not been possible to define in a bright-line manner what is "reasonable" and what is not.

Crucially, though, all of these three elements—good faith, disinterestedness, and reasonableness of information—also part of the German and U.K. law dealing with director liability for bad business judgments. Germany, in particular, has taken an approach that is quite similar to that pursued by Delaware law: In 1997, Germany's highest court in civil law matters, the Bundesgerichtshof, adopted its own version of the business judgment rule,[109] and the relevant principles soon found their way into the German Stock Corporation Act.[110] And just like its Delaware counterpart, the German business judgment rule requires that the directors have acted in good faith and been reasonably informed and disinterested.[111]

In the United Kingdom, the situation is somewhat more complicated because U.K. law has no direct equivalent to the Delaware business judgment rule.[112] However, this difference should not be exaggerated. Directors in the United Kingdom are protected by a broad presumption of good faith.[113] As a result, U.K. law is not entirely dissimilar to U.S. law.[114]

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[108] *Id.*

[109] Bundesgerichtshof [BGH] [Federal Court of Justice], Apr. 21, 1997, 135 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 244 (F.R.G.). The fact that Germany has adopted the business judgment rule is often overlooked in the comparative literature. *See, e.g.*, Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimensions of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1157 (1999) (claiming that "under German law, no business judgment rule exists").

[110] *See* Gesetz zur Kontrolle von Unternehmensabschlüssen [BilanzkontrollG, Act Regarding the Control of Corporate Balance Sheets], Dec. 15, 2004, BGBl. I at 3408, 3414, art. 5 (FRG) (inserting the business judgment rule into the German Stock Corporation Act).

[111] *E.g.*, HÜFFER, *supra* note 105, at 484–85 (stressing the need disinterestedness, reasonable information, and good faith); Georg Wiesner, *Organpflichten des Vorstands [Duties of Managing Directors]*, in IV MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS: AKTIENGESELLSCHAFT 296, 302 (Michael Hoffmann-Becking ed., 3rd ed. 2007) (noting that in order for the business judgment rule to apply, the directors must act in a disinterested fashion, in good faith, and based on reasonable information).

[112] *See, e.g.*, Bernard Black et al., *Legal Liability of Directors and Company Law Officials Part 1: Substantive Grounds for Liability (Report to the Russian Securities Agency)*, 2007 COLUM. BUS. L. REV. 628, 682 (2007) (noting that "[a]side from the general presumption of good faith, the United Kingdom does not have a United States style business judgment rule").

[113] *E.g.*, Black et al., *supra* note 112, at 681 (noting the general presumption under U.K. law that all persons—including corporate directors—have acted in good faith). *Cf.* SALEEM SHEIKH, A GUIDE TO THE COMPANIES ACT 2006, at 375 (2008) (explaining the breadth of the presumption of good faith in U.K. company law).

And, importantly, the elements of Delaware's business judgment rule can also be found in U.K. law. Thus, directors are required to act in good faith,[115] but—as under the business judgment rule—there is a general presumption that they have acted in compliance with this requirement.[116] Similarly, the directors are required to exercise "reasonable care, skill and diligence,"[117] but the burden of showing that the directors have failed that duty is on the plaintiff.[118] And, finally, the presence of a conflict of interest can lead directors to be held personally liable if they do not comply with the particular rules on conflict of interest transactions.[119]

In sum, the central elements of Delaware law's business judgment rule—good faith, disinterestedness, and reasonable information—can be found not only in Delaware, but also in German and U.K. law.

2. *Differences*

Despite the considerable common ground that is shared by the three legal systems, there also exist some very notable differences—differences that make German law and to some extent U.K. law substantially more indeterminate than Delaware law.

a) Manifestly Unreasonable Decisions

One of these differences concerns those business decisions that are manifestly unreasonable. With respect to such decisions, Delaware has adopted an extremely generous approach. Delaware courts have gone to great lengths to stress that, as long as the directors acted reasonably

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[114] In its influential report which preceded the enactment of the 2006 Companies Act, the Law Commissions pointed out that, "[t]he courts of . . . the United Kingdom have expressed an unwillingness to second guess directors on commercial matters" and stressed that this "approach is comparable to the rule known in the United States as the business judgment rule." THE LAW COMMISSION & THE SCOTTISH LAW COMMISSION, COMPANY DIRECTORS: CONFLICTS OF INTEREST AND FORMULATING A STATEMENT OF DUTIES 295 para. 15.30 (1999) [hereinafter: LAW COMMISSIONS, CONFLICTS OF INTEREST], *available at* http://www.lawcom.gov.uk/docs/cp153.pdf.

[115] Companies Act, 2006, ch. 46, § 172 (1) (U.K.), *available at* http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf.

[116] *E.g.*, Black et al., *Legal Liability*, *supra* note 112, at 113.

[117] COMPANIES ACT, *supra* note 115, § 174 (1).

[118] *E.g.*, Charles Wynn-Evans, *The Companies Act 2006 and the Interests of Employees*, 36 INDUS. L.J. 188, 189 (2007) (explaining that the Companies Act 2006 leaves the burden of proof to the plaintiffs).

[119] For an overview of the law governing conflict of interest transactions between directors and their corporations, see Lloyd Tamlyn, *Declaration of Interest in Existing Transaction or Arrangement*, *in* COMPANY DIRECTORS: DUTIES, LIABILITIES, AND REMEDIES 369, 369–80 (Simon Mortimore ed. 2009).

informed and in good faith, the fact that a business decision was manifestly unreasonable does not preclude the application of the business judgment rule.[120] As a result, Delaware courts do not usually have to apply any vague standard of reasonableness simply because the reasonableness or unreasonableness of a decision is largely irrelevant to the application of the business judgment rule. At most, the patent absurdity of a decision may gain relevance in that it may have show that the director acted in bad faith.[121] Even in this context, the Delaware courts take a very restrictive line: The decision must be "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[122] Making such a showing has aptly been described as "a near-Herculean task,"[123] meaning that the detrimental effect on legal certainty will be quite limited.

By contrast, U.K. courts have professed far fewer reservations when it comes to holding directors liable for manifestly unreasonable decisions. Thus, in the leading case of *Charterbridge Corporation Ltd. v. Lloyds Bank Ltd.*, the High Court's Chancery Division described the relevant principle as follows:

> The proper test, I think, in the absence of actual separate consideration, must be whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company. If that is the proper test, I am satisfied that the answer here is in the affirmative.[124]

Accordingly, the state of law is widely understood to be that the courts will probably not defer to "manifestly unreasonable" decisions by corporate directors.[125] Because it is inherently difficult to determine ex ante what will be deemed manifestly unreasonable as opposed to merely

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[120] Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1051–53 (Del. Ch. 1996). Interestingly, courts in other states have been more inclined to limit business judgment rule protection to decisions that were not manifestly unreasonable. *See, e.g.*, *In re* Logical Software, Inc., 66 B.R. 683, 686 (Bankr. D. Mass. 1986) (citing Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1047 (4th Cir. 1985) for the proposition that "in the bankruptcy context, the debtor's decision to reject an executory contract should be accepted by the court unless it is shown to be 'so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, whim, or caprice.'").

[121] Parnes v. Bally Entertainment Corp., 722 A.2d 1243, 1246 (Del. 1999).

[122] *Id.* (citing *In Re* J.P. Stevens & Co., 542 A.2d 770, 780–81 (Del. Ch. 1988)).

[123] Stanziale v. Nachtomi (*In re* Tower Air, Inc.), 416 F.3d 229, 238 (3rd Cir. 2005).

[124] [1970] 1 Ch 62.

[125] LAW COMMISSIONS, CONFLICTS OF INTEREST, *supra* note 114, at 31 n.37.

unreasonable, this feature of U.K. law adds a considerable amount of indeterminacy to the law.

Germany has opted for a similar approach. According to Germany's highest court in civil law matters, the business judgment rule applies only as long as the willingness to take on entrepreneurial risks has not been "irresponsibly exceeded."[126] The statutory codification of the business judgment rule has embraced this limitation by demanding that the directors "could reasonably assume" that they were acting in the best interest of the company.[127] Not surprisingly, therefore, the "reasonableness" limitation is now generally accepted as part of the German business judgment rule.[128] One could, of course, argue that this limitation may well turn out to be an empty threat in the long run. However, the contrast with the U.S. case law is jarring. Given that the U.S. business judgment rule is well-known in German corporate law circles, it is hard to argue that the Bundesgerichtshof—and indeed the German legislature—did not purposefully put German directors on a tighter leash than their U.S. counterparts. All of this implies that German corporate planners face precisely the sort of vague reasonableness inquiry that Delaware courts are so plainly eager to avoid.

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[126] Bundesgerichtshof [BGH] [Federal Court of Justice], Apr. 21, 1997, 135 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 244, (F.R.G.) (noting that the personal liability of directors can be considered inter alia where "the willingness to take on entrepreneurial risks has been irresponsibly exceeded") (translation by author). In the same vein, one of the leading treatises on German corporate law notes that in order for the business judgment rule to be applicable, the decision must be within the limits of what is ex ante objectively plausible ("nachvollziehbar"). Wiesner, *supra* note 111, at 302.

[127] Aktiengesetz, *supra* note 106, § 93 (1) (2) ("when the member of the managing board . . . could reasonably assume … that he was acting in the best interest of the corporation.") (translation by author). The official justification for the relevant legislative amendment explicitly confirms the legislature's intent to codify the relevant limitation that the Bundesgerichtshof had developed when it created the business judgment rule. BUNDESREGIERUNG [FEDERAL GOVERNMENT], ENTWURF EINES GESETZES ZUR UNTERNEHMENSINTEGRITÄT UND MODERNISIERUNG DES AKTIENRECHTS [BILL ON BUSINESS INTEGRITY AND THE MODERNISATION OF THE STOCK CORPORATION ACT], BUNDESRAT DRUCKSACHE 3/05, 19 (2005) (on file with author).

[128] *E.g.*, HÜFFER, *supra* note 105, at 485 (decision must remain within the limits of what is objectively understandable); Gerd Krieger & Viola Sailer, *§ 93 Sorgfaltspflichten und Verantwortlichkeit der Vorstandsmitglieder* [*Duties of Care and Liability of Managing Directors*], in I AKTIENGESETZ KOMMENTAR 1055, 1063 (Karsten Schmidt & Marcus Lutter eds., 2008) (stressing that the decisive question is whether the directors could reasonably assume that they were acting in the best interest of the corporation).

b) Factual Uncertainty

Unlike Delaware or U.K. law, German law has yet another feature that adds considerably to the vagueness of its business judgment law. Not all lawful business decisions made by the board are business judgments in the sense of the German business judgment rule. Rather, business decisions are thought to obtain the protection of the business judgment rule only if they involve a measure of factual uncertainty.[129]

Given that almost every decision can be argued to involve some uncertain elements, this requirement might have turned out to be little more than an ornamental flourish without practical significance. Yet, the case law of the German Bundesgerichtshof suggests that the Court accords considerable importance to the uncertainty requirement. The much-discussed[130] *Mannesmann* case[131] may serve to illustrate this problem.

The facts of the case are easily summarized. Vodafone, a British cell phone company, had launched an attempt to take over Mannesmann, a publicly-traded corporation.[132] The CEO of Mannesmann, Esser, had initially tried to ward off the takeover attempt.[133] Ultimately, however, his attempts to preserve Mannesmann's independence proved unsuccessful:[134] Vodafone ended up becoming Mannesmann's sole shareholder,[135] and Esser left the company.[136]

In this context, the question arose as to whether Esser had been sufficiently rewarded for his work as CEO of Mannesmann. Given that he had greatly benefited Mannesmann by transforming it into a successful mobile phone company, Mannesmann's supervisory board—the body in charge of determining Esser's compensation, believed that an additional

[129] *E.g.*, HÜFFER, *supra* note 105, at 484; Mathias Habersack, *Die Freistellung des Organwalters von seiner Haftung gegenüber der Gesellschaft* [*The Freedom of Liability that the Director Enjoys vis-a-vis the Corporation*], in FESTSCHRIFT FÜR PETER ULMER ZUM 70. GEBURTSTAG AM 2. JANUARY 2003, 151, 168 (Mathias Habersack et al., eds., 2003).

[130] For an English-language discussion of this case, see, for example, Franklin A. Gewurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 459–92 (2007). A brief summary is provided by Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability*, 2008 COLUM. BUS. L. REV. 1, 73–74 (2008).

[131] Bundesgerichtshof [BGH] [Federal Court of Justice], Dec. 21, 2005, 59 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 522 (2006).

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *Id.* at 522–23.

[136] *Id.* at 523.

reward was in order. Ultimately, the compensation committee decided to pay him a bonus of ten million Euros.[137]

In judging this bonus payment, the Bundesgerichtshof argued that in order to be valid under German law, this payment had to produce benefits for the corporation—benefits that stood in a reasonable relationship to the expense borne by the corporation.[138] The court explicitly conceded that such a benefit might lie in the desire to provide better incentives for the recipient of the payment or for third parties.[139] However, based on factual findings made by the lower court, the Bundesgerichtshof came to the conclusion that the payment had not produced any benefits for the corporation in the form of improved incentives or public relations benefits.[140] From the perspective of a Delaware corporate lawyer, such a finding is at the very least surprising. As long as the procedural requirements imposed by the business judgment rule are complied with, Delaware courts will generally decline to second-guess the benefits of compensation payments that have been approved by disinterested directors.[141] Yet the Bundesgerichtshof explicitly refused to accord the directors any margin of appreciation in this regard, claiming that the decision required no business judgment of a prognostic and in that sense "risky" nature.[142]

It is not yet entirely clear whether the requirement of a prognostic and in that sense "risky" decision—the so-called uncertainty requirement—as a precondition for business judgment rule protection possesses much bite outside the context of executive compensation or hostile takeovers.

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[137] *Id.*

[138] *Id.* at 524.

[139] *Id.*

[140] *Id.* 525.

[141] *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 9–46 (2004) (noting that, under the business judgment rule, "courts defer to and refuse to review the substantive merits of board decisions as long as these decisions satisfy certain process requirements").

[142] Bundesgerichtshof [BGH] [Federal Court of Justice], Dec. 21, 2005, 59 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 526–27 (2006) (translation by author). *Cf.* the apt criticism by JAN VON HEIN, DIE REZEPTION US-AMERIKANISCHEN GESELLSCHAFTSRECHTS IN DEUTSCHLAND 91 (2008), who notes that by focusing on a juridically rather than economically defined interest of the corporation, the Bundesgerichtshof manages to replace the business judgment of those responsible with its own business judgment according to which non-compensatory bonuses are useless. *Cf.* Michael Hoffmann-Becking, *Vorstandsvergütung nach Mannesmann* [*Executive Compensation after Mannesmann*], 9 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 127, 128 (2006) (criticizing the Bundesgerichtshof for not according the supervisory board any business judgment deference regarding the question of whether the corporation received reasonable benefits in return for the bonus payment).

However, it is noteworthy that neither the case law nor the literature seems to restrict the uncertainty requirement to these areas.[143] And in any case, the uncertain-requirement's uncertain reach only adds to the indeterminacy of the relevant standard.

In sum, then, the German law on director liability for bad business decisions seems substantially less determinate than Delaware law. And, to a lesser extent, the same is true of U.K. law vis-a-vis Delaware law. Moreover, while future cases may reduce this indeterminacy to some extent, it is noteworthy that the main problem does not lie in a lack of cases. Rather, it lies in the conscious decisions by courts in the United Kingdom and Germany to impose additional hurdles that directors have to meet—hurdles that are vague in nature and thus increase the law's indeterminacy.

B. Self-Dealing by Corporate Directors

Beyond the questions associated with the business judgment rule, there are various other contexts in which the fiduciary duties traditionally play central roles. A core problem that arises within the context of the duty of loyalty is how to deal with those transactions in which corporate directors do face a conflict of interest. Critics cite the applicable norms in Delaware law as prime examples of indeterminate standards.[144] But are they truly more indeterminate than their U.K. and German counterparts?

1. Delaware

The Delaware law on this issue is well-settled: As a general principle, a director standing on both sides of the transaction has to show that the transaction was entirely fair to the corporation[145]—a test that involves considerations of both procedural fairness and fair pricing.[146] And even if there is some disagreement as to how vague the entire fairness test actually is, most scholars would presumably agree that it constitutes a standard rather than a bright-line rule.[147]

However, not all transactions between the director and the corporation are subject to the entire fairness test. Rather, there is an important rule-based safe haven: Unless the transaction involves a

[143] *See supra* note 129.

[144] Kamar, *supra* note 4, at 1917 n.34.

[145] *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1993); Strassburger v. Earley, 752 A.2d 557, 570 (Del. Ch. 2000); Reddy v. MBKS Co., 945 A.2d 1080, 1087 (Del. Ch. 2008).

[146] *Weinberger*, 457 A.2d at 711.

[147] *Cf.* Kamar, *supra* note 4, at 1917 n.34 (listing the entire fairness test as one example of an indeterminate standard).

controlling shareholder,[148] its approval after full disclosure by a majority of the disinterested directors or by the shareholders brings the transaction back into the ambit of the business judgment rule.[149] Accordingly, in the absence of a controlling shareholder on both sides of the transaction, the entire fairness test becomes relevant only in those cases in which approval by the independent directors was not sought or was denied.

2. Germany

The German law on conflict of interest transactions is somewhat similar to Delaware law, and, if anything, less determinate. As a preliminary matter, it should be noted that German stock corporations have a two-tier board structure. The structure consists of the managing board, which actually manages the corporation, and the supervisory board, which appoints and supervises the members of the managing board.[150] In transactions with members of the managing board, the corporation is always represented by the supervisory board.[151] Consequently, German law assures that the—usually disinterested[152]—members of the supervisory board have to approve the transaction.

However, none of this prevents the law from subjecting self-dealing transactions to standard-based scrutiny. On the contrary, it is generally acknowledged that, in transactions between a member of the managing

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[148] In the case that the transaction is between the corporation and a controlling shareholder, even approval by a majority of disinterested directors will not preclude the courts from applying the entire fairness test. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997); McMullin v. Beran, 765 A.2d 910, 916–17 (Del. 2000). Instead, approval by the disinterested directors will only shift the burden of proof to the plaintiff attacking the transaction. *Kahn*, 694 A.2d at 428; *McMullin*, 765 A.2d at 917.

[149] Cooke v. Oolie, No. 11134, 2000 Del. Ch. LEXIS 89, at *44 (Del. Ch. May 24, 2000); Chaffin v. GNI Group, Inc., No. 16211-NC, 1999 Del. Ch. LEXIS 182 (Del. Ch. Sept. 3, 1999).

[150] *See* AKTG, *supra* note 106, § 76 (1) (assigning the managing board the task of managing the corporation), § 84 (1) (1) (providing that the supervisory board appoints the members of the managing board). *See also* Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1421 (2006) (noting that the supervisory board appoints and monitors the management board).

[151] AKTG, *supra* note 106, at § 112 (providing that the supervisory board represents the corporation in transactions with managers of the managing board).

[152] A member of the managing board cannot, at the same time, be a member of the corporation's supervisory board. AKTG, *supra* note 106, at § 105 (1). Furthermore, the law precludes supervisory board members from filling certain other executive positions in the corporation. *Id.* In that sense, the supervisory board members are necessarily outside directors. Cheffins & Black, *supra* note 150, at 1421. Of course, that does not always guarantee that they are disinterested in the sense of having no financial or other stake in the outcome of transactions between managing directors and the corporation.

board and the corporation, the managing board member is still under a duty to deal fairly with the corporation even though the company is represented by the supervisory board.[153]

In other words, just like Delaware law, German law subjects self-dealing transactions by corporate directors to standard-based scrutiny. But unlike Delaware, Germany does not limit the scope of application of this standard by way of a rule-based safe haven: Under German law, the approval of director transactions by shareholders or disinterested directors does not insulate such transactions from judicial scrutiny.[154] It follows that the German law on director self-dealing is even more standard-based than Delaware law.

3. United Kingdom

The determinacy or indeterminacy of U.K. law is somewhat more difficult to assess. As with the business judgment rule, the United Kingdom has chosen an approach to conflict of interest transactions that, as a doctrinal matter, is quite different from the U.S. or German approach. Yet, as before, it is not at all clear that U.K. law is more determinate then Delaware law.

U.K. courts do not review the fairness of conflict-of-interest transactions.[155] Instead, the basic principle is that conflict-of-interest transactions have to be disclosed to the board.[156] The idea is to alert the other directors to the transaction. The other directors can then take the steps they deem necessary to protect the interests of the corporation.[157] Of course, the other directors are bound by their duties of loyalty and care, and they may be found to have violated these duties if they take inadequate steps to safeguard the corporation's interests.[158] But as long as the other

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[153] *See, e.g.*, Krieger & Sailer, *supra* note 128, at 1064 (noting that managing directors entering into transactions with the corporation are obliged to guard the interests of the corporation and to abstain from entering into contracts that are not compatible with the arm's-length principle). An exception from this duty is sometimes acknowledged with respect to the employment contract between a manager and the corporation. *See* KATJA LANGENBUCHER, AKTIEN- UND KAPITALMARKTRECHT [CORPORATE LAW AND SECURITIES REGULATION] 55 (2008) (noting that, outside of the context of their own employment contract, the duty of loyalty bars managing directors from using their particular expertise at bargaining against the corporation's interests).

[154] *Cf.* Krieger & Sailer, *supra* note 128, at 1064 (discussing the law on director self-dealing).

[155] DAVIES ET AL., *supra* note 105, at 531.

[156] COMPANIES ACT, *supra* note 115, § 177 (1).

[157] DAVIES ET AL., *supra* note 105, at 533.

[158] *Id.*

directors are disinterested, they profit from the various presumptions that shield directors from personal liability when they make business judgments.[159]

With respect to legal determinacy, the beauty of this approach is that it avoids a Delaware-style fairness test. However, whether the U.K. approach leads to a net gain in legal certainty is rather doubtful.

The lack of a fairness test notwithstanding, the U.K. disclosure rules are laced with indeterminate standards. In particular, they contain a string of reasonableness inquiries. For example, the director does not need to disclose her interest in a transaction if that interest "cannot reasonably be regarded as likely to give rise to a conflict of interest."[160] Furthermore, the director only has to disclose those conflicts of interest of which she is or "reasonably" should be aware.[161] In addition, the director does not have to disclose her interest in a transaction if the other directors are already aware of that interest or if they "reasonably" should be aware of that interest.[162] And to the extent that disclosure is necessary, it has to be made "as soon as it is reasonably practicable."[163]

The situation gets even more complicated if the corporation is listed on the main market of the London Stock Exchange. In order for its shares to be traded on the main market, a company must first be admitted to the so-called "Official List," which is maintained by the Financial Services Authority (FSA).[164] Currently, that list includes around 1,100 U.K. companies.[165] These companies are subject to the listing rules that the FSA promulgates,[166] and these listing rules impose additional requirements for self-dealing transactions.[167]

In particular, the listing rules subject related-party transactions to shareholder approval.[168] There are, however, exceptions to the shareholder-

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[159] *Id.* For an overview of the relevant presumptions, see *supra* Part V.B.1.

[160] COMPANIES ACT, *supra* note 115, § 177 (6) (a). In other words, in defining which interests prompt the application of the conflict-of-interest rules, U.K. law relies upon the very type of reasonable person test that the Delaware Supreme Court has rejected as "unhelpful and . . . confusing." Cede & Co. v. Technicolor, 634 A.2d 345, 364 (Del. 1993).

[161] COMPANIES ACT, *supra* note 115, § 177 (5).

[162] *Id.* § 177 (6) (b).

[163] *Id.* § 182 (4).

[164] DAVIES ET AL., *supra* note 105, at 16–17.

[165] *Id.* at 17.

[166] THE FINANCIAL SERVICES AND MARKETS ACT [FSMA], 2000, § 96 (U.K.). The Listing Rules are available at http://fsahandbook.info/FSA/html/handbook/LR.

[167] FINANCIAL SERVICES AUTHORITY [FSA], LISTING RULES, Rule 11.1.7 (2005) (governing "related party transactions").

[168] *Id.* Rule 11.1.7.3.

approval requirement,[169] and these exceptions make the shareholder-approval-norm much less determinate than it may seem at first glance. Most importantly, transactions in the "ordinary course of business" are usually exempted from the shareholder approval requirement.[170] And, rather than providing a bright-line rule of what constitutes a transaction in the ordinary course of business, the listing rules contain list various factors that the FSA will consider—namely "the size and incidence of the transaction and . . . whether the terms and conditions of the transaction are unusual."[171]

In sum, despite the absence of a Delaware-style fairness test, it is not at all clear that the U.K. law on conflict-of-interest transactions is more determinate than its German and Delaware counterparts.

C. Managerial Compensation

Within the wider context of self-dealing transactions, one issue deserves particular attention—the law on executive compensation. After all, in practice, managerial compensation agreements are the most common—and perhaps also the most significant[172]—type of transaction between the director and the corporation.

1. Delaware

In Delaware, managerial compensation is subject to the general rules on self-dealing—meaning that a compensation decision's approval by interested directors will lead courts to grant business judgment rule protection.[173] Executive compensation packages can also be attacked under the so-called waste doctrine.[174] However, for that doctrine to apply, the consideration that the corporation receives in a transaction must be "so disproportionately small as to lie beyond the range at which any reasonable

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[169] *Id.* Rules 11.1.5 (exempting transactions in the ordinary course of business) and 11.1.6 (exempting so-called "small transactions" as well as certain other enumerated types of transactions).

[170] *Id.* Rule 11.1.5. (1).

[171] *Id.* Rule 11.1.5. (2).

[172] On the practical importance of director self-dealing with respect to executive compensation, see LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 9–10 (2004) (pointing out, *inter alia*, that "[d]uring the five-year period 1998–2002, the compensation paid to the top five executives at each company in the widely used ExecuCom database, aggregated over the 1500 companies in the database, totaled about $100 billion (in 2002 dollars))."

[173] *Id.* at 46.

[174] *Id.*

person might be willing to trade."[175] Because of the exacting nature of this test, the waste doctrine has almost no practical significance for executive compensation payments.[176] In other words, even if one concedes that the waste doctrine constitutes a standard, its limitation to the most outrageous cases means that it cannot create much indeterminacy.

2. United Kingdom

The United Kingdom also subjects compensation payments to the general rules on self-dealing. In addition, shareholders are granted an advisory vote on executive compensation—a relatively recent innovation known as say-on-pay.[177] However, because this additional restriction comes in the form of a rule rather than a standard, it does not make the law more indeterminate.

3. Germany

By contrast, Germany has opted for a much higher degree of judicial scrutiny. A special provision of the German Stock Corporation Act requires that the compensation of the directors of the managing board stand in a reasonable relationship to the director's responsibilities and merits as well as to the situation of the corporation.[178] Among the factors that are thought to be relevant in assessing the reasonableness of a managing director's compensation are the director's qualifications, the market value of her services, the specific circumstances in which the negotiations take place, the question of how long the director has belonged to the corporation, and—rather curiously from a U.S. perspective—her family situation.[179] Beyond such general guidelines, it has not been possible to provide a more specific definition of what reasonableness means.[180] In other words, the reasonableness test imposed by the German Stock Corporation Act is the paradigm of a vague standard.

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[175] Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997).

[176] *E.g.*, BEBCHUK & FRIED, *supra* note 172, at 46.

[177] For an overview, see, for example, Jeffrey N. Gordon, *"Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-In*, 46 HARV. J. ON LEGIS. 323, 340–46 (2009).

[178] AKTG, *supra* 106, § 87 (1). What is more, if the corporation's situation deteriorates substantially after the compensation has been established, and if, as a result, it would be unfair for the corporation to have to continue paying the compensation, the supervisory board shall unilaterally lower the compensation paid to the members of the managing board. *Id.* § 87 (2).

[179] HÜFFER, *supra* note 105, at 441.

[180] *Id.*

A 2009 amendment[181] has added further uncertainty by requiring that the compensation paid to members of the managing board may not exceed the usual compensation except in the presence of special reasons:[182] Until the meaning of this provision is illuminated by the courts, it is not entirely clear which factors count as special reasons or how closely courts will scrutinize the reasons that corporations advance to justify unusually high salaries.

Moreover, one cannot argue that the relevant statutory provisions lack practical relevance. While there is relatively little case law,[183] this is at least partially explained by a particularity of the German legal system. Depending upon the circumstances, supervisory board members that consent to unreasonably high—and therefore illegal—compensation payments to managing directors risk being criminally prosecuted for criminal breach of trust.[184] Accordingly, directors have strong—and

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[181] GESETZ ZUR ANGEMESSENHEIT DER VORSTANDSVERGÜTUNG [LAW REGARDING THE REASONABLENESS OF EXECUTIVE COMPENSATION] [VORSTAG], July 31, 2009, BGBl. I, 2509. This amendment also introduced a provision according to which the shareholder meeting can adopt a non-binding resolution regarding executive compensation. AKTG, *supra* 106, § 120 (4).

[182] AKTG, *supra* 106, § 87 (1).

[183] It should be noted, though, that the relevant provision was invoked in the famous Mannemann case. Bundesgerichtshof [BGH] [Federal Court of Justice], Dec. 21, 2005, 59 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 522, 524 (2006). Also, various lower courts have applied section 87 (1) of the German Stock Corporation Act. *See, e.g.*, Landgericht München [LG München] [Court of Appeals of Munich], March 29, 2007, 10 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 477, 477 (2007) (refusing to find a violation of § 87 (1) (1) despite atypically high compensation payments because the specific circumstances justified the amount of the compensation); Oberlandesgericht München [OLG München] [Higher Court of Appeal], May, 7, 2008, 10 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 631, 632–33 (2007) (finding that section 87 (1) (1) had been violated). Moreover, this principle has repeatedly become relevant in the law on close corporation where it lacks a statutory basis but is recognized as judge-made law. *E.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice], June 15, 1992, 45 Neue Juristische Wochenschrift [NJW] 2894, 2896 (1992) (holding that a director's fiduciary duty may require the director to consent to a lowering of his compensation and noting that this requires the court to analyze whether the director's compensation is unreasonably high ("überhöht")).

[184] That, indeed, was the situation in the Mannesmann case where several of the supervisory board members were prosecuted for criminal breach of trust. Bundesgerichtshof [BGH] [Federal Court of Justice], Dec. 21, 2005, 59 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 522, 524 (2006). For a systematic analysis of when excessive compensation constitutes criminal breach of trust, see Thomas Rönna & Christian Hohn, *Die Festsetzung (zu) hoher Vorstandsvergütungen durch den Aufsichtsrat—ein Fall für den Staatsanwalt?* [*(Excessively) High Executive Compensation—A Case for the District Attorney?*], 24 NEUE ZEITSCHRIFT FÜR STRAFRECHT [NStZ] 113, 113–23 (2004) (pleading

perhaps even excessive—incentives not to venture into the gray areas of the law where executive compensation is concerned. That disincentive, however, does not reduce existing legal uncertainty—it only makes the uncertainty more burdensome since it prevents the courts from gradually transforming the reasonableness standard into a rule by means of precedent.

In sum, the German law on executive compensation is far more indeterminate than either Delaware or U.K. law.

D. Corporate Opportunities

As part of their duty of loyalty, Delaware directors are prohibited from usurping business opportunities that rightly belong to the corporation.[185] Those who criticize Delaware for using vague standards cite this doctrine as a paradigm of an indeterminate standard.[186] And there is no question that this categorization is entirely justified. As shown in the following, though, the relevant law in Germany and the United Kingdom is hardly less indeterminate.

1. Delaware

The crucial difficulty in applying the corporate opportunity lies in defining when exactly a business opportunity belongs to the corporation. That Delaware follows a standard rather than rule-based approach to this problem has long been obvious. Thus, in the landmark case of *Guth v. Loft*, the Delaware Supreme Court made clear that it will consider a wide variety of often vaguely worded factors to determine whether an opportunity is a corporate one:

> [I]if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business, and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.[187]

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for a more restrictive understanding of criminal breach of trust and criticizing what they perceive as an overly aggressive prosecution of managers).

[185] *E.g.*, Guth v. Loft Inc., 5 A.2d 503, 511 (Del. 1939). It is generally recognized that the corporate opportunity doctrine is part of the duty of loyalty. *E.g.*, Jonathan R. Macey, *Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1278 (1999).

[186] Kamar, *supra* note 4, at 1916.

[187] *Guth*, 5 A.2d at 511.

To make the matter even more obvious, the Delaware Supreme Court has since stressed that there is no easy test for determining what constitutes a corporate opportunity. Rather, the Court explained in *Broz v. Cellular Information Systems*:

> It is important to note . . . that the tests enunciated in Guth and subsequent cases provide guidelines to be considered by a reviewing court in balancing the equities of an individual case. No one factor is dispositive, and all factors must be taken into account insofar as they are applicable. Cases involving a claim of usurpation of a corporate opportunity range over a multitude of factual settings. Hard and fast rules are not easily crafted to deal with such an array of complex situations. As this Court noted in Johnston v. Greene . . . the determination of "whether or not a director has appropriated for himself something that in fairness should belong to the corporation is 'a factual question to be decided by reasonable inference from objective facts.'"[188]

There is, however, an important safe haven that makes Delaware's law at least somewhat more determinate: The director can make use of a corporate opportunity if she has submitted it to the board and the board has rejected the opportunity after full disclosure.[189]

2. United Kingdom

Given that Delaware law has opted for a standard-based approach to the corporate opportunity problem, does this mean that Delaware law is more indeterminate than that of the United Kingdom? Not so much, it turns out. In fact, U.K. law pursues a rather similar approach.

As in the United States, directors breach their duties in the U.K. when they usurp business opportunities belonging to the corporation.[190] And, just as in Delaware law, the main difficulty with this rule lies in determining whether or not a particular opportunity belongs to the corporation.[191]

In this context, it is noteworthy that there exists a slight doctrinal difference in how Delaware and the United Kingdom view the corporate opportunity doctrine. Under Delaware law, the corporate opportunity doctrine is viewed as part of the duty of loyalty.[192] This is true under U.K. law as well. However, in the U.K., the corporate opportunity doctrine is

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[188] Broz v. Cellular Info. Sys., 673 A.2d 148, 155 (Del. 1996).

[189] Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002).

[190] *E.g.*, *Re* Southern Counties Fresh Foods Ltd, [2008] EWHC 2810 (Ch), [2008] All ER (D) 195 (Nov), (approved judgment) (holding that "no fiduciary may . . . exploit for himself the benefit of an opportunity which might have been exploited by the company to which he owes his duty").

[191] *Cf.* DAVIES ET AL., *supra* note 105, at 560.

[192] *See* sources cited *supra* note 185.

viewed as part of the more general duty to avoid conflicts of interest.[193] Accordingly, in determining whether an opportunity belongs to the corporation, U.K. courts have asked whether the exploitation of the opportunity conflicts with the interests of the corporation.[194]

Of course, this formula is far too vague and abstract to give any real guidance. And while courts have specified certain factors that matter—such as whether exploitation of the opportunity would have been commercially attractive to the company[195]—it is generally recognized that the courts need to examine all of the facts of the particular case.[196] The indeterminacy of this approach is apparent from the following passage of the much-cited case *Bhullar v. Bhullar*:[197]

> [W]here a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question, in my judgment, is not whether the party to whom the duty is owed (the company, in the instant case) had some kind of beneficial interest in the opportunity: in my judgment that would be too formalistic and restrictive an approach. Rather, the question is simply whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule. . . . [F]lexibility of application is of the essence of the rule. . . . [T]he application of the principle is entirely fact-related. . . . The full circumstances have to be examined in order to ascertain whether the rule applies. . . .

In other words, the U.K. law on corporate opportunities relies just as much on vague and open-ended standards as its Delaware counterpart.

Finally, it is noteworthy that even the safe haven that Delaware law offers has its equivalent in U.K. law. As under Delaware law, directors do not violate their duties under U.K. law by making use of a business opportunity as long as the relevant opportunity has been presented to and rejected by the board.[198]

In sum, while the Delaware law on corporate opportunities can justifiably be characterized as standard-based, the same is equally true for U.K. law.

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[193] COMPANIES ACT, *supra* note 115, § 175 (2).

[194] *E.g.*, *Re* Southern Counties Fresh Foods Ltd, [2008] EWHC 2810 (Ch), [2008] All ER (D) 195 (Nov), (approved judgment).

[195] Bhullar v. Bhullar, [2003] EWCA Civ 424, [2003] 2 BCLC 241.

[196] Mark Arnold & Marcus Haywood, *Duties to Avoid Conflicts of Interest and not to Accept Benefits from Third Parties*, *in* COMPANY DIRECTORS: DUTIES, LIABILITIES AND REMEDIES 303, 310 (Simon Mortimore ed. 2009) ("The court has to weigh all the relevant factors and decide whether the opportunity is sufficiently closely connected to the company to be considered an opportunity of the company.")

[197] Bhullar v. Bhullar, [2003] EWCA Civ 424, [2003] 2 BCLC 241.

[198] COMPANIES ACT, *supra* note 115 § 175(4)(b).

3. Germany

What about the German law on corporate opportunities? This time around, German law arguably proves somewhat less standard-based than U.S. law, although the picture is not entirely clear.

The main difference between German and U.S. law is that the German Stock Corporation Act imposes a blanket prohibition on directors doing business in the corporation's line of business.[199] Thus, the corporate opportunity doctrine is indeed a case in which Delaware law relies upon standards while German law makes use of a more rule-like provision. As is so often the case in corporate law, however, this difference turns out to be far less profound than it may seem at first glance. The reason is that the general prohibition on doing business in the corporation's line of business only applies until the director has lawfully resigned.[200]

Once the director has lawfully resigned, she is still prohibited from usurping corporate opportunities.[201] But the rule-like prohibition mentioned above is now replaced with a vague standard that very much resembles Delaware law. For lack of cases regarding the stock corporation, the literature generally refers to the (richer) case law on limited liability companies and partnerships.[202] There, the Bundesgerichtshof has made it clear that the question of whether something is a corporate opportunity depends upon the particular circumstances of the case.[203] In the words of

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[199] AKTG, *supra* note 106, at § 88.

[200] HÜFFER, *supra* note 105, at 447. There is some dispute as to whether the prohibition also becomes inapplicable if the director's resignation was unlawful. Some scholars believe that, in this case, the prohibition still applies. *E.g.*, HÜFFER, *supra* note 105, at 447. Others, however, take the opposite view. *E.g.*, Christoph H. Seibt, *§ 88 Wettbewerbsverbot* [*Prohibition against Competition*], *in* SCHMIDT & LUTTER, *supra* note 128, at 992, 995 (arguing that prohibition ends upon resignation, regardless of whether resignation was rightful or not).

[201] *E.g.*, Holger Fleischer, *Gelöste und ungelöste Probleme der gesellschaftsrechtlichen Geschäftschancenlehre* [*Answered and Unanswered Questions Relating to the Corporate Opportunities Doctrine*], 6 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 985, 990 (2003).

[202] *See, e.g.*, HÜFFER, *supra* note 105, at 447 (citing various cases on partnership law); Fleischer, *supra* note 201, at 987 (addressing the question about which business opportunities can be categorized as corporate opportunities and citing various cases pertaining to limited liability companies and partnerships).

[203] *Cf.* Bundesgerichtshof [BGH] [Federal Court of Justice], May 8, 1989, 42 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2687, 2688 (1989) (holding that a limited partner in a general partnership cannot usurp opportunities that fall into the line of business of the corporation and that can be attributed to the corporation based on specific, concrete circumstances; also noting that no general statement can be made as to when these conditions are met).

the Bundesgerichtshof, it is illegal to exploit opportunities that fall into the line of business of the enterprise and can be allocated to the enterprise because of certain specific circumstances, but "no general statements can be made as to when these conditions are fulfilled."[204]

In sum, the German law on director self-dealing is at least somewhat more rule-like than Delaware law with respect to the usurpation of corporate opportunities—but only as long as the relevant director is in office. Once she has resigned, German law applies a standard which is every bit as vague as its Delaware counterpart.

E. Hostile Takeovers

The general Delaware law on fiduciary duties is modified considerably when it comes to the context of corporate takeovers. This is unsurprising. Given that directors often have a personal stake in the outcome of a takeover battle, it would hardly be appropriate to grant full business judgment rule protection to defensive measures.[205]

For the purpose of this article, it is noteworthy that the Delaware law on corporate takeovers has been cited as evidence of the standard-based nature of Delaware law.[206] Of course, this presents an obvious problem: The sheer volume and complexity of takeover law makes it impossible to attempt an exhaustive comparison between Delaware takeover law and foreign takeover law within one article, let alone within an article that also covers other aspects of corporate law.

I therefore proceed in a more selective manner and focus on the one area that Delaware's critics use as their main example: the fiduciary duties of corporate directors who seek to preserve their company's independence in light of a hostile takeover offer.[207]

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[204] *Id.*

[205] *Cf.* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (noting "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders").

[206] *See* Kamar, *supra* note 4, at 1915–16.

[207] *Id.* (using the *Unocal*-standard as one of three examples to illustrate the indeterminate, standard-based nature of Delaware corporate law). Other scholars have also criticized the *Unocal* test as being vague. *See, e.g.*, Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 762, 823–24 (1995) (criticizing the fiduciary duties that apply to a board confronted with a hostile tender offer as "inherently vague" and calling the language of the *Unocal* test "vague and inapposite"); John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1488 (1991) (criticizing the "uncertainty facing directors regarding the optimal process for adopting and maintaining defensive measures"); Larry E. Ribstein, *Takeover Defenses and the Corporate Contract,*

1. Delaware

In Delaware, this scenario is governed by the so-called *Unocal*-standard. Under *Unocal*,[208] courts subject antitakeover defenses designed to protect the independence of a company to an intermediate standard of scrutiny: Before a defensive measure is accorded business judgment rule protection, it has to pass a preliminary test consisting of two prongs. First, directors "must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership."[209] Second, the defensive measures must be reasonable in relation to the threat posed.[210] As regards this second prong, the court lists numerous factors that may be relevant to the measure's reasonableness. These include "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders . . . , the risk of nonconsummation, and the quality of securities being offered in the exchange."[211]

In the literature, this test has been sharply criticized for being indeterminate:

> The law does not define what constitutes a cognizable threat in this regard, nor does it clarify what defensive measures are reasonable. Instead, it lists a host of considerations that may be relevant . . . At a certain stage during the evolution of the proportionality test, Court of Chancery decisions did seem to clarify what would amount to a cognizable threat by distinguishing between coercive and noncoercive takeover bids. The Delaware Supreme Court, however, overturned these decisions as unduly restrictive of the flexible proportionality test. To the dismay of many, the proportionality test is as indeterminate today as when the court first articulated it in 1985.[212]

Yet this criticism may be overstating the indeterminacy of the *Unocal* test. As with all standards governing director behavior, the decisive question is how strictly the courts apply them. And in the case of the *Unocal* standard, courts have shown such self-restriction as to impose very little limitation on the freedom of target managers to defend themselves against takeovers.[213]

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78 GEO. L.J. 71, 126 (referring to the "uncertainty inherent in the vague Unocal fiduciary duty approach").

[208] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[209] *Id.* at 955.

[210] *Id.*

[211] *Id.*

[212] *See* Kamar, *supra* note 4, at 1915–16 (footnotes omitted).

[213] *See, e.g.*, A.C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83, 106 (2004) (noting that the *Unocal* proportionality review leaves managers "essentially unconstrained"); Mark

Admittedly, this light-handed approach was not always obvious: During the 1980s, the Chancery Court repeatedly found defensive measures in violation of the *Unocal* standard.[214] However, the Delaware Supreme Court proved an effective check on the Chancery Court's penchant for policing target board managers.[215] Nowadays, as long as the managers of the target corporation seek to preserve its independence, they can essentially "just say no" to hostile takeovers.[216]

That leniency, of course, has considerable implications for the determinacy of Delaware law: While the *Unocal* standard may seem vague, the extremely soft touch with which it is applied prevents any real detriment to legal certainty.

2. United Kingdom

The U.K. policy on corporate takeovers, meanwhile, has been almost the opposite of its Delaware counterpart.[217] Whereas Delaware essentially allows target board managers seeking to preserve the

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Gordon, *Takeover Defenses Work. Is That Such a Bad Thing?*, 55 STAN. L. REV. 819, 821 (2002) (citing a study according to which no corporation has had to redeem a poison pill since 1989).

[214] Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1060 (Del. Ch. 1988); City Capital Assocs. v. Interco Inc., 551 A.2d 787, 790–91 (Del. Ch. 1988); Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227, 1238–39 (Del. Ch. 1988); I.P. Phillips v. Insituform of N. Am., Inc., No. 9173, 1987 Del. Ch. LEXIS 474, at *26 (Del. Ch. Aug. 27, 1987); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 112–13 (Del. Ch. 1986).

[215] Robert H. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 284 (2001) (noting that between 1985 and 2000, whenever the Chancery Court found defensive tactics to be disproportionate outside the *Revlon* context, the finding of disproportionality was reversed or pushed aside when the case reached the Delaware Supreme Court).

[216] *E.g.*, Jennifer Arlen & Eric Talley, *Precommitment and Managerial Incentives: Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 606 n.69 (2003); Gordon, *supra* note 177, at 331; Pritchard, *supra* note 213, at 106. *See also* Gordon, *supra* note 213, at 821 ("A target board of directors may . . . block a hostile takeover as long as the directors continue to believe that doing so is in the best interests of stockholders, and as long as the directors actually remain in office."). *But see* STEPHEN M. BAINBRIDGE, CORPORATE LAW 399 (2d ed. 2009) ("Time …does not necessarily compel one to conclude that the just say no defense will be deemed to be proportional to an adequate, non-coercive offer.").

[217] *E.g.*, Paul Davies & Klaus Hopt, *Control Transactions, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 157, 164 (Reinier Kraakman et al. eds., 2004); John Armour & David A. Skeel, *Jr., Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1738 (2007).

independence of their corporation to "just say no" to hostile takeovers,[218] the hands of U.K. managers are largely bound: Under the Takeover Code,[219] as soon as the target board has reason to believe that a takeover bid is imminent, the managers of the target corporation are prohibited from taking any action that might frustrate the bid without the consent of the shareholders.[220]

To implement this non-frustration principle, the Takeover Code also provides that certain actions cannot be taken without shareholder approval once a bid is imminent. For example, without shareholder approval, the board of the target corporation cannot issue stock options with respect to unissued shares,[221] nor can it issue any securities that can be converted into shares.[222] In essence, these restrictions amount to a strict prohibition against poison pills.[223]

Given the Takeover Code's reliance on a blanket prohibition against defensive measures, the greatest potential for legal indeterminacy arises with defensive measures that are adopted before a bid is imminent. These so-called "embedded" defenses are not subject to the prohibition imposed by the Takeover Code.[224] Rather, U.K. courts scrutinize them under the general principles governing business decisions by U.K. directors.[225] As pointed out, these principles are somewhat harsher than Delaware's business judgment rule. However, the resulting potential for indeterminacy seems limited. For both legal and factual reasons, U.K. directors enjoy less independence from the shareholder than their U.S. counterparts.[226] And as a result, they are much less likely to be able to erect embedded defenses in the first place.[227]

In sum, despite the fundamental differences between U.K. law and Delaware law in the area of corporate takeovers, both legal systems have one thing in common: The norms that apply to defensive measures seeking

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[218] Pritchard, *supra* note 213, at 106.

[219] THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS (2009) (U.K.) [hereinafter TAKEOVER CODE], *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf.

[220] TAKEOVER CODE, *supra* note 219, Rule 21.1.

[221] *Id.*

[222] *Id.*

[223] Armour & Skeel, *supra* note 217, at 1736.

[224] *E.g.*, DAVIES ET AL., *supra* note 105, at 988.

[225] *Id.*

[226] *See* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 18 HARV. L. REV. 833, 847–50 (2005) (describing the ways U.K. directors are far less independent from shareholders than their U.S. counterparts).

[227] Armour & Skeel, *supra* note 217, at 1736.

to preserve the independence of the company pose little threat to legal certainty.

3. Germany

German law is a different matter. It should be noted first that hostile takeovers are quite rare in Germany.[228] However, this has not prevented the country from developing a comprehensive set of norms governing such takeovers.[229]

Like the United Kingdom, Germany has embraced the general principle that the target board is not allowed to take defensive measures once a hostile takeover offer has been made.[230] But this formal rule-like prohibition has two major limitations. First, as in the United Kingdom, it does not prohibit measures that were taken before the takeover offer was published.[231] Second, the prohibition no longer applies once the defensive measures have been approved by the supervisory board.[232]

In practice, the latter exception takes most of the punch out of the general prohibition against defensive measures.[233] This is due to the peculiar board structure of German corporations. As noted above, German corporations have a two tier structure, with the supervisory board appointing and monitoring the managing board[234] Crucially, not all members of the supervisory board are elected by the shareholders. Rather, Germany's mandatory codetermination laws provide that a portion of the

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[228] *See* Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 194 n.216 (2009) (noting that "there is little hostile takeover activity" in Germany). This is not to say, though, that hostile takeovers are completely absent. *See* Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 66 (2005) (pointing to Vodafone's takeover of Mannesmann and noting that "there have been several smaller hostile takeovers since that time").

[229] WERTPAPIERERWERBS- UND ÜBERNAHMEGESETZ [WpÜG], Dec. 20, 2001, BGBl. I at 2479 (F.R.G).

[230] *Id.* at 2479 (F.R.G), § 33(1)(1) (prohibiting the target board from taking measures that might prevent the success of a tender offer).

[231] *Id.*

[232] *Id.* § 33(1)(2).

[233] *Cf., e.g.*, Kay-Michael Schanz, *Verteidigungsmechanismen gegen feindliche Übernahmen nach Umsetzung der Übernahmerichtlinie im deutschen Recht* [*Defensive Measures Against Hostile Takeovers Following the Implementation of the Hostile Takeover Directive in German Law*], 10 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 927, 928 (2007) (noting that this exception largely undermines the managing board's duty to be neutral in the face of a hostile takeover attempt).

[234] *See supra* note 150.

supervisory board members have to be elected by the employees.[235] Indeed, in a corporation with 2,000 or more employees, half of all supervisory board members must be employee representatives.[236] This, in turn, has obvious implications for the problem at hand: Because employees tend to oppose takeovers for fear of workforce reductions, their representatives will generally tend to view defensive measures favorably.[237] As a result, the need to obtain the backing of the supervisory board for defensive measures is a relatively modest hurdle.[238]

Moreover, this is not the end of the story. At least under the prevailing view, the mere fact that the supervisory board has authorized a defensive measure does not imply that the relevant defensive measure is legal. Just as under Delaware law, a defensive measure's formal legality is one thing, but the question of whether the relevant measure complies with the directors' fiduciary duties is quite another. Indeed, under German law, the directors' fiduciary duties enter into the picture at two levels. First, the members of the supervisory board are under a fiduciary duty to act in the best interest of the corporation when deciding whether or not to authorize a defensive measure.[239] Second, even after a defensive measure has been

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[235] For an overview of the German laws on codetermination, see Jens C. Dammann, *The Future of Codetermination after* Centros*: Will German Law Move Closer to the U.S. Model?*, 8 FORDHAM J. CORP. & FIN. L. 607, 618–22 (2003) (summarizing the various codetermination statutes).

[236] GESETZ ÜBER DIE MITBESTIMMUNG DER ARBEITNEHMER [MITBESTG], May 4, 1976, BGBl I 1153 (F.R.G.), art. 7 (1).

[237] This, at least, is the experience seen in the American context. *See, e.g.*, Brett McDonnell, *ESOP's Failures: Fiduciary Duties When Managers of Employee-Owned Companies Vote to Entrench Themselves*, 2000 COLUM. BUS. L. REV. 199, 260 (noting that "workers tend to vote in favor of management and against takeovers"); William H. Simon, *The Prospects of Pension Fund Socialism*, 14 BERKELEY J. EMP. & LAB. L. 251, 263 (1993) ("Managers count on employees to support them in takeover contests, relying on workers' fears that new owners will initiate wage or job cuts."). Whether these fears on the part of workers are well-founded is another question. *Cf.* Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 COLUM. L. REV. 1931, 1953 (1991) (pointing out that "[i]t is difficult even to trace a causal connection between takeovers and job loss").

[238] *Cf.* Schanz, *supra* note 233, at 928 (suggesting that the managing board's right to adopt defensive measures with the supervisory board's backing largely undermines the duty to remain neutral in the face of takeover attempts).

[239] *E.g.*, Gerd Krieger, *§ 69: Abhängige Unternehmen und faktische Konzerne* [*Dependent Enterprises and De-Facto Corporate Groups*], *in* IV MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS: AKTIENGESELLSCHAFT 1126, 1143 (Michael Hoffmann-Becking ed., 3d ed. 2007) (rejecting a general duty for the supervisory board to be neutral in the face of takeover attempts, but stressing that the members of the supervisory board, in deciding whether or not to authorize defensive measures, have to act in the interest of the enterprise ("Unternehmensinteresse")); Schanz, *supra* note 233, at 928 (noting that the members of the supervisory board, in deciding whether or not to authorize defensive

authorized by the supervisory board, the members of the managing board are under a duty to act in the best interest of the corporation in deciding whether or not to implement the relevant measure.[240]

Thus, the decisive question is what standards German courts will apply in monitoring the directors' compliance with their fiduciary duties. At this point, the answer to that question is unknown. Due to the rarity of takeover attempts in Germany[241] and the relatively recent adoption of the statutory regime on takeovers, the courts have not yet had a chance to address this issue. But, crucially, there is not any reason to believe that the relevant law will turn out to be less standard-based and more determinate than the parallel Delaware case law.

F. Derivative Suits

Arguably, one cannot hope to give an accurate assessment of the law on fiduciary duties if one focuses solely substantive law. Rather, one also has to take into account uncertainties created on the procedural side. Against this background, it is noteworthy that Delaware's critics have indeed highlighted the indeterminacy of its procedural law. More specifically, they criticize Delaware's law on derivative suit as a prime example of indeterminacy.[242] Given that shareholders seeking to enforce the directors' fiduciary duties usually have to rely upon derivative suits rather than direct suits,[243] it seems justified to address this criticism in this article.

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measures, are bound to act in the best interest of the corporation). *Cf.* Hermann J. Knott, *Freiheit, die ich meine: Abwehr von Übernahmeangeboten nach Umsetzung der EU-Richtlinie* [*Freedom That I Mean: Defense Against Takeover Offers After the Implemenation of the EU-Directive*], 9 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 849, 851 (2006) (arguing that in light of the increased monitoring responsibilities of the supervisory board, authorization of defensive measures is unlikely to allow the implementation of defensive measures that otherwise would not be possible).

[240] *E.g.*, Krieger, *supra* note 239, at 1143 (stressing that the members of the managing board have to act in the best interest of the enterprise when deciding whether or not to take defensive measures against hostile takeover attempts); Andreas Schwennicke, *§ 33: Handlungen des Vorstands der Zielgesellschaft* [*§ 33: Acts by the Board of the Target Corporation*], *in* WERTPAPIERERWERBS- UND ÜBERNAHMEGESETZ (WPÜG) 566, 591 (Stephan Geibel et al. eds. 2008) (pointing out that measures aimed at preventing the takeover without serving the interests of the target corporation remain illegal).

[241] *See supra* note 228.

[242] Kamar, *supra* note 4, at 1916–17.

[243] Baums & Scott, *supra* note 241, at 50.

1. Delaware

In case of a derivative suit, the plaintiff shareholder sues on behalf of the corporation.[244] The law sometimes allows this type of shareholder activism because directors, who may face a conflict of interest, cannot always be trusted to act in the best interest of the corporation when it comes to deciding whether or not to enforce the corporation's claims.[245]

Regarding the admissibility of derivative suits under Delaware law, one has to distinguish two main questions. The first is whether the derivative suit was *initially* admissible. The second is whether the corporation can get an initially admissible derivative suit dismissed *later on*.

Two of the relevant requirements for the initial admissibility of the derivative suit are in the form of bright-line rules: The plaintiff must be a shareholder,[246] and she must have been a shareholder when the challenged transaction occurred.[247]

The remaining two requirements are somewhat less determinate but can hardly be called overly indeterminate. One is that the plaintiff be able to represent the interests of the other shareholders in a fair and adequate manner.[248] This requirement may read like a typical standard, and the Delaware Chancery Court has listed a number of factors to be considered in applying it.[249] Yet in practice, little legal uncertainty seems to have resulted, largely because the Delaware judiciary has taken a rather generous view of when a plaintiff meets the requirement in question: The court will only dismiss the derivative suit on this ground if the defendant can show that "a serious conflict of interest exists."[250]

The other remaining hurdle for the plaintiff is the so-called demand-requirement:[251] If the shareholder has made a demand that the corporation bring suit and the board has refused, then the suit will only be admissible if the plaintiff can show that the board acted in bad faith or without being reasonably informed.[252] If the plaintiff has not made a demand on the corporation, her chances are somewhat better. In this case, it is sufficient for the plaintiff to plead particularized facts which create reasonable doubt

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[244] STEPHEN M. BAINBRIDGE, CORPORATE LAW 187 (2d ed. 2009).

[245] *Id.*

[246] DEL. CH. R. 23.1.

[247] *Id.*

[248] Youngman v. Tahmoush, 457 A.2d 376, 379 (Del. Ch. 1983); Katz v. Plant Indus., No. 6407, 1981 Del. Ch. LEXIS 549, at *2 (Del. Ch. Oct. 27, 1981).

[249] *Youngman*, 457 A.2d at 379–80.

[250] *Id.* at 381.

[251] DEL. CH. R. 23.1.

[252] Spiegel v. Buntrock, 571 A.2d 767, 777 (Del. 1990).

as to whether the directors were disinterested or as to whether the challenged business transaction was a valid exercise of business judgment.[253]

In other words, the principles governing the demand requirement rely upon the very same elements—good faith, disinterestedness, and reasonable information—that underlie the general business judgment rule. And, as shown above, the only one of these elements that really constitutes a standard is the duty to be reasonably informed.

It is therefore not surprising that the claim that the Delaware law on derivative suits is highly unpredictable is aimed not at the law governing the initial admissibility of derivative suits, but at the law governing the question of whether the corporation can get a properly initiated lawsuit dismissed later on.[254] And it is indeed true that the relevant law gives considerable discretion to the courts.

The leading case is *Zapata Corp. v. Maldonado.*[255] There, the board of the corporation formed a special committee consisting of two disinterested directors.[256] After investigating the facts, the committee resolved that the derivative litigation was inimical to the corporation's best interest and should be dismissed.[257] Accordingly, the question was how much weight the Chancery Court should attach to such a request. The case eventually reached the Delaware Supreme Court, which held that the trial court must apply a two-step test:[258] First, it needs to inquire whether the litigation committee's decision meets all three requirements of the business judgment rule—good faith, reasonable information, and distinterestedness.[259] The burden of proof, in this context, rests on the corporation.[260] Even if the corporation can demonstrate that these three conditions are fulfilled, the court should not automatically dismiss the derivative suit.[261] Rather, the court should then move to the second step, in

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[253] *E.g.,* Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000) (citing Aronson v. Lewis, 473 A.2d 805, 814 (1984)). Different rules apply where a majority of the directors responsible for the challenged transaction have been replaced, where the derivative action challenges something other than a business decision of the board, or where the challenged business decision was made in a different corporation. Demand is excused in each of these cases only if the plaintiff can plead particularized facts creating reasonable doubt that the company's board is disinterested. Rales v. Blasband, 634 A.2d 927, 933–34 (Del. 1993).

[254] Kamar, *supra* note 7, at 1916–17.

[255] Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1980).

[256] *Id.* at 780.

[257] *Id.* at 781.

[258] *Id.* at 788.

[259] *Id.*

[260] *Id.*

[261] *Id.* at 789.

which it applies its own business judgment on whether or not continuation of the derivative suit lies in the best interest of the corporation.[262] Obviously, this second step makes the law quite unpredictable because it requires plaintiffs to predict how courts will exercise their business judgment.

2. United Kingdom

Despite the considerable indeterminacy inherent in Delaware's law on derivative suits, U.K. law manages to be even more standard-based.

In the United Kingdom, every derivative suit needs the court's permission to continue after it has been filed.[263] The Companies Act lists three cases in which permission must be refused,[264] but for plaintiffs seeking to predict the court's decision, the relevant provisions are of little help. Two of the three cases simply describe situations in which the claim is obviously unfounded. Thus, permission for the derivative suit must be refused where the challenged conduct has been authorized by the corporation beforehand[265]—the director does not breach her duties if her conduct has been authorized. Further, permission for the continuation of the derivative suit must be denied where the challenged conduct has been validly ratified ex post.[266] This provision also aims at the prevention of obviously unfounded suits because ratification, which requires a shareholder resolution,[267] extinguishes any claim against the directors.

The third case in which permission must be refused has a much wider scope of application, and it is the prototype of a vague standard: The court has to deny where it is satisfied that a person seeking to promote the success of the company would not continue the claim.[268] In the words of a leading treatise, this means that "the Court will have to formulate its own view about whether the proposed litigation will fail to promote the success of the company."[269] This, of course, strikingly resembles the second step of Delaware's *Zapata* test. But under Delaware law, the courts have to apply their own business judgment only under certain strictly defined conditions: The derivative suit must have been admissible when it was initiated.[270] A

[262] *Id.*

[263] Civil Procedure Rules [CPR], Rule 19.9A(2) (U.K.), *available at* http://www.justice.gov.uk/civil/procrules_fin/contents/parts/part19.htm#IDAG4C5B.

[264] *Id.* § 263 (2).

[265] *Id.*

[266] *Id.*

[267] *Id.* § 239 (2).

[268] *Id.* § 263 (2).

[269] DAVIES ET AL., *supra* note 105, at 14.

[270] *See supra* Part V.f.1.

special litigation committee must have resolved that the continuation of the derivative suit does not lie in the corporation's best interest, and, crucially, the corporation must have demonstrated that this resolution meets all the requirements of the business judgment rule.[271] By contrast, under U.K. law, *all* derivative suits are subject to the balancing test of whether the litigation would fail to promote the company's success, unless the challenged conduct was authorized beforehand or ratified by the shareholders ex post.

What if the court comes to the conclusion that none of the three aforementioned grounds for refusing permission to continue the suit applies? In that case, it still has to decide whether or not to grant its permission. But instead of guiding the court's decision via bright-line rules, the law provides the court with a long list of factors that it has to "consider."[272] Some of these factors are relatively clear, such as the question of whether the plaintiff is acting in good faith or whether the corporation chooses to pursue the claim.[273] But, crucially, the list also includes more unpredictable factors, such as the importance that a person seeking to promote the success of the company would attach to continuing the suit and the likelihood of future authorization of the challenged conduct.[274] In sum, the U.K. law on derivative suits relies even more strongly on indeterminate standards than its Delaware equivalent.

3. Germany

The German law on derivative suits also proves quite reliant upon standards. As in the United Kingdom, a derivative suit in Germany must be permitted by the court in order to go forward.[275]

For the court to grant that permission, the plaintiffs need to meet various requirements. Some of these requirements are of a formal rule-like nature, yet none of them has much bite. Thus, the plaintiff or plaintiffs need to hold either 1% of the outstanding shares or €100,000 worth of shares.[276] They must also have held these shares before learning of the challenged transaction.[277] Further, the plaintiffs must have made a prior and fruitless demand upon the corporation to bring suit.[278]

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[271] *Id.*
[272] COMPANIES ACT, *supra* note 115, § 263 (3).
[273] *Id.*
[274] *Id.*
[275] AKTG, *supra* note 106, § 148 (1) (1).
[276] *Id.*
[277] *Id.*
[278] *Id.* § 148 (1) (2).

These hurdles are not, however, particularly challenging. This is true even for the €100,000 threshold given that, for most public corporations, this amount represents only a tiny fraction of their market capitalization.[279]

As a result, the main hurdles to the admissibility of derivative suits come in the form of vague standards. Here, the plaintiffs must establish facts justifying the suspicion that the corporation has suffered damage as a result of bad faith or through a "gross" violation of the law or the certificate of incorporation.[280] Needless to say, it has not been possible to state in a rule-like manner what distinguishes gross violations of the law from simple ones,[281] making this criterion highly indeterminate.

Even if the plaintiff meets all of the aforementioned requirements, the court will only permit the suit if the suit's benefits are not outweighed by the interests of the corporation.[282] In other words, as in the United Kingdom, no derivative suit can go forward in Germany unless the court has undertaken a cost-benefit analysis with a result that favors the plaintiffs.

VI. SUMMARY AND IMPLICATIONS

As the analysis in the preceding part shows, neither German law nor U.K. law seems more determinate than Delaware law. On the contrary, both Germany and the U.K. seem to rely even more strongly upon indeterminate standards than Delaware does.

The comparison with German law is particularly striking: In three of the six categories described above (judicial scrutiny of business judgments, director self-dealing, and executive compensation), Germany's reliance upon indeterminate standards is greater than Delaware's. In one category (derivative suits), the comparison is somewhat less clear. This lack of

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[279] In the past, the relevant provision of the German stock corporation act did not contain the €100,000 threshold. Instead, it solely relied on the 10% threshold. Especially for large publicly traded corporations with a market capitalization of billions of Euros, the 10% requirement was much more burdensome than the current rule. Accordingly, it was argued with some plausibility that the old law constituted a significant hurdle to derivative suits. *See* Kristoffel R. Grechenig & Michael Sekyra, *No Derivative Shareholder Suits in Europe - A Model of Percentage Limits, Collusion, and Residual Owners*, 3, 12–14 (Columbia Law & Economics Working Paper No. 312, 2007), *available at* http://ssrn.com/abstract=933105.

[280] AKTG, *supra* note 106, § 148 (1) (3).

[281] A leading treatise defines severe violations of the law as violations that are either evident or, based on their nature, cannot be tolerated by, a responsibly acting manager. Hüffer, *supra* note 105, at 811. Of course, that begs the question of which infractions are tolerable and which ones are not.

[282] AKTG, *supra* note 106, § 148 (1) (4).

clarity is because Germany erects somewhat higher formal hurdles for a derivative suit but also assigns a more central role to judicial balancing. In one other category (hostile takeovers), no useful comparison is possible because it simply cannot yet be foreseen what degree of judicial scrutiny German courts will apply. German law only seems substantially more formal in the one remaining category (corporate opportunities) due to its imposition of a blanket ban on the use of business opportunities in the corporation's line of business.

A comparison between the United Kingdom and Delaware yields somewhat less clear results. All in all, however, U.K. law, too, seems less determinate than Delaware law: In two categories (derivative suits and business judgments), U.K. law relies substantially more strongly upon indeterminate standards than Delaware. In two other categories (corporate opportunities and executive compensation), both legal systems use fairly similar approaches and show a comparable preference for standards over rules. And in one further category (defensive measures aimed at preserving the corporation's independence), both systems seem fairly determinate—Delaware because it imposes no meaningful restraint on target boards, and the United Kingdom because it imposes a blanket prohibition against defensive measures. That leaves one category (director self-dealing) where Delaware law is arguably more indeterminate. Yet, even there, the situation is not entirely clear. This is because the relevant norms in U.K. law, while avoiding a Delaware-style fairness test, are laced with other indeterminate standards.

These findings have significant theoretical implications.

A. Regulatory Competition and Indeterminacy

To begin, the findings described above are difficult to reconcile with theories that blame regulatory competition for making Delaware law excessively reliant upon indeterminate standards.

Of course, the analysis undertaken in this article yields no compelling evidence regarding the *optimal* level of legal determinacy. There is no way of knowing whether the heavy reliance upon standards that we see in all three legal systems is efficient. It is conceivable that Delaware, Germany, and the U.K. all make excessive use of indeterminate standards. Alternatively, all three countries may rely too little on standards, or they may use standards to just the right extent.

But the crucial point is a different one: Whether efficient or not, Delaware's proclivity for indeterminate standards can hardly be blamed upon the charter market. After all, neither German law nor U.K. law has been shaped by regulatory competition. Yet both are just as much, if not

more, reliant upon indeterminate standards as Delaware is. This result is the exact opposite of what one would expect if regulatory competition truly led to greater indeterminacy.

B. Convergence

The findings that my analysis has yielded are also relevant to what has become known as the convergence debate in corporate law.[283]

Some voices in the legal literature believe that the world's corporate law systems are in the process of convergence.[284] According to this view, the rise of the shareholder class and competitive pressures to adopt the most efficient legal solutions assure the triumph of the shareholder primacy model of corporate law.[285] Once the shareholder primacy model is widely accepted, the argument runs, "convergence in most aspects of the law and practice of corporate governance is sure to follow."[286]

Other scholars take a more skeptical view on the prospect for global convergence.[287] On a theoretical level, they stress the various factors contributing to path dependence in corporate law, such as sunk costs, complementarities with existing structures, network externalities, and endowment effects.[288] Furthermore, as an empirical matter, they point to the persistence of significant differences between corporate law systems.[289]

While the findings made in this article cannot resolve this debate, they are certainly very much consistent with the view that corporate law systems tend to converge. As I have shown, the corporate law systems of Delaware, Germany, and the United Kingdom are very similar in how they

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[283] Contributions to this debate include Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001); Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 334–37 (2001); Henry Hansmann, *How Close is the End of History?*, 31 IOWA J. CORP. L. 745 (2006); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L. J. 439 (2001); Brett H. McDonnell, *Convergence in Corporate Governance—Possible, but not Desirable*, 47 VILL. L. REV. 341 (2002).

[284] Hansmann & Kraakman, *supra* note 283, at 468.

[285] *Cf. id.* at 449–91 (discussing competitive pressures to converge), *id.* at 451–53 (discussing the rise of the shareholder class).

[286] *Id.* at 468.

[287] *E.g.*, Bebchuk & Roe, *supra* note 283, at 170 (claiming that "important differences might persist in the future"); Branson, *supra* note 283, at 362 (concluding that convergence in corporate governance "may occur in discrete areas," but is "far more likely to be regional rather than global").

[288] Bebchuk & Roe, *supra* note 283, at 139–141.

[289] *E.g.*, Bebchuk & Roe, *supra* note 283, at 129.

make use of standards: By and large, the same issues are governed by standards in all three legal systems. Indeed, even in the area of takeover law, where the underlying policy choices were almost diametrically opposed, the various systems did not seem far apart with respect to the degree of legal determinacy that they offered. This is certainly consistent with the thesis that the choice between rules and standards is driven by efficiency considerations. In other words, legal systems may simply make the choice between rules and standards based on "what works best," which in turn leaves different countries to end up with broadly similar legal regimes.

C. Common Law v. Civil Law

Last but not least, my findings are relevant to scholarship on the differences between common and civil law systems.

Much has been written on how common law systems and civil law systems differ, and on how these differences matter in the real world.[290] One of the more prominent differences perceived in the legal literature concerns the attitudes that civil law judges and common law judges have toward legal indeterminacy: According to a widely held view, civil law judges are more reluctant to use indeterminate standards than common law judges.[291] The underlying—and usually unspoken—assumption seems to be that civil law judges are usually career judges who lack practical business experience and are therefore more comfortable with clear rules than with standards that require them to balance competing economic interests.[292]

However, the findings of this article tend to undermine this view. As shown above, Germany, the paradigm of a civil law country, relies even

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[290] *E.g.*, Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

[291] *See supra* note 16.

[292] *Cf.* Kevin M. Clermont, *Exploring the Interaction between Emotions and Legal Institutions: Standards of Proof Revisited*, 33 VT. L. REV. 469, 472 (2009) ("Civil Law judges would prefer not to appear to have free rein to call close cases or to exercise discretion."); Rebecca Lee, *Fiduciary Duty Without Equity: "Fiduciary Duties" of Directors Under the Revised Company Law of the PRC*, 47 VA. J. INT'L L. 897, 915 (2007) (asserting that the adoption of a U.S.-style duty of loyalty met with little success in Japan because "civil law judges were not very comfortable in working with vague, open-ended standards"). *But see* Edward Rock, Hideki Kanda, & Reinier Kraakman, *Significant Corporate Actions*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 131, 154 (Reinier Kraakman et al. eds., 2004) (analyzing the law governing "significant corporate actions" across a variety of jurisdictions and concluding that "[o]ver the entire class" of such actions, "France and Germany rely as heavily on standards as the U.S. or the U.K.").

more strongly upon indeterminate standards than does either Delaware or the United Kingdom. This tendency cannot be blamed on the German Stock Corporation Act alone. After all, many of the relevant standards are not codified—such as the fiduciary duties governing the exploitation of corporate opportunities[293] or the standards governing the judicial scrutiny of director self-dealing transactions[294]—or were codified only ex post after having been developed by the courts, as is the case for the business judgment rule.[295]

VII. CONCLUSION

At the center of corporate law scholarship lies the debate on state competition for corporate charters. One of the most contentious topics within that debate concerns the impact of regulatory competition on legal determinacy: Critics claim that regulatory competition has led Delaware to rely excessively upon indeterminate standards, thereby inefficiently reducing legal certainty. Supporters of state competition reject that view.

A central challenge for this debate has been the shortage of hard empirical evidence supporting or refuting the view that regulatory competition has made Delaware less determinate. Of course, one can compare Delaware law to the law of other U.S. states, but since these other states' laws have also been shaped—either directly or indirectly—by regulatory competition, such a comparison proves to be of little value.

To overcome this problem, this article compares Delaware law to two foreign legal systems, namely those of the United Kingdom and Germany. Neither country's law on public corporations has been shaped by regulatory competition. Yet, as I show, both display an even greater tendency to rely upon indeterminate standards than Delaware does. This finding is hard to reconcile with the view that regulatory competition is to blame for making Delaware law more indeterminate.

Apart from its importance to the scholarship on regulatory competition, my analysis is also relevant to other longstanding debates in corporate law. In particular, it contributes to the traditional debate on the differences between common law and civil law systems. More specifically,

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[293] *Cf.* Fleischer, *supra* note 201, at 985–92 (describing the German law on the corporate opportunity doctrine).

[294] The German stock corporation act only decrees that when the corporation deals with members of the managing board, the corporation is represented by the supervisory board. AKTG, *supra* note 106, at § 112. By contrast, outside of the field of executive compensation, the act does not address the issue to what extent contracts between the corporation and members of the supervisory board are subject to judicial review.

[295] *See supra* text accompanying notes 109 and 110.

it tends to undermine the widely held view that civil law judges are more reliant than common law judges to create or apply indeterminate standards.