Nevada v. Delaware: The New Market for Corporate Law

Law Working Paper N° 677/2251
July 2024

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University of Virginia and ECGI

ECGI Working Paper Series in Law

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For helpful comments and suggestions, I thank Tel Aviv University Fisher Center Corporate Workshop participants.

Abstract

For decades and decades, Delaware has been the undisputed leader in the market for corporate law. And yet, it is now clear that Delaware's superiority is being publicly challenged. Elon Musk has vocally criticized Delaware courts, incorporated X (formerly Twitter), X.Ai, and Neuralink in Nevada, and intends to move Tesla to Texas. TripAdvisor's shareholders claim that its controlling shareholder's attempt to reincorporate from Delaware to Nevada amounts to a breach of fiduciary duties. And the increasing competition that Delaware faces from Nevada, Texas, and other states has captured news headlines. This Article analyzes Nevada's corporate law, the competitive pressures it poses to Delaware, and the potential effects this pressure could have on Delaware corporate law. The Article makes three main contributions. First, it provides a detailed analysis of Nevada corporate law, finding that it poses insurmountable obstacles to shareholder litigation that diminish important pillars of Delaware corporate law. Second, the Article explores the judicial scrutiny of reincorporations and draws implications for future litigation concerning moves from Delaware to Nevada, Texas, and other states. The analysis supports the recent decision in the Delaware Court of Chancery, suggesting that reincorporation to Nevada constitutes a self-dealing transaction. It also explains why Elon Musk has redirected Tesla's destination from Nevada to Texas. Third, the article analyzes the effects of this increasingly competitive environment on both Delaware corporate law and the general market for corporate law. It argues that this competition could pressure Delaware to relax its corporate law. Lastly, the Article argues that the proposition currently being considered by the Delaware Supreme Court in Match to relax constraints on controlling shareholders could counterintuitively contribute to a snowballing effect toward the bottom of American corporate law. The analysis exposes a rising fragility in the market for corporate law with potential ramifications for American corporate law.

Keywords: Delaware, Nevada, Corporate Law, State competition, Controlling Shareholder, Duty of Loyalty, Duty of Care, Duty of Good Faith, Texas, Business Court, Musk

JEL Classifications: K22, K20, M21, G3, G30

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The New Market for Corporate Law

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For decades and decades, Delaware has been the undisputed leader in the market for corporate law. And yet, it is now clear that Delaware's superiority is being publicly challenged. Elon Musk has vocally criticized Delaware courts, incorporated X (formerly Twitter), X.Ai, and Neuralink in Nevada, and intends to move Tesla to Texas. TripAdvisor's shareholders claim that its controlling shareholder's attempt to reincorporate from Delaware to Nevada amounts to a breach of fiduciary duties. And the increasing competition that Delaware faces from Nevada, Texas, and other states has captured news headlines.

This Article analyzes Nevada's corporate law, the competitive pressures it poses to Delaware, and the potential effects this pressure could have on Delaware corporate law. The Article makes three main contributions. First, it provides a detailed analysis of Nevada corporate law, finding that it poses insurmountable obstacles to shareholder litigation that diminish important pillars of Delaware corporate law.

Second, the Article explores the judicial scrutiny of reincorporations and draws implications for future litigation concerning moves from Delaware to Nevada, Texas, and other states. The analysis supports the recent decision in the Delaware Court of Chancery, suggesting that reincorporation to Nevada constitutes a self-dealing transaction. It also explains why Elon Musk has redirected Tesla's destination from Nevada to Texas.

Third, the article analyzes the effects of this increasingly competitive environment on both Delaware corporate law and the general market for corporate law. It argues that this competition could pressure Delaware to relax its corporate law. Lastly, the Article argues that the proposition currently being considered by the Delaware Supreme Court in *Match* to relax constraints on controlling shareholders could counterintuitively contribute to a snowballing effect toward the bottom of American corporate law. The analysis exposes a rising fragility in the market for corporate law with potential ramifications for American corporate law.

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I. Introduction

For decades and decades, Delaware has been the home of the largest corporations in the United States.[1] The state has long been praised for its efficient judicial system and experienced judiciary. Delaware has faced almost no competition,[2] as there have never been serious candidates to compete with.[3] Half of the publicly-traded companies are incorporated in Delaware, with the others mainly incorporated in their home states where their headquarters are.[4] Nevada has long been second to Delaware in attracting out-of-state incorporations, attracting less than ten percent of the market and primarily small firms.[5]

And yet, it has now become clear that Delaware's undisputed superiority is being challenged. Recent headlines note that Elon Musk has reincorporated X (formerly Twitter), Neuralink, and X.Ai to Nevada and was planning on moving Tesla there as well.[6] Shareholders of TripAdvisor filed suit in Delaware to block the firm's reincorporation to Nevada: they failed to receive an injunction, but were allowed to proceed with a damages claim.[7] The rising competitive threats to

[1] *See, e.g.*, 2022 *Annual Report*, Delaware Division of Corporations (2022), https://corp.delaware.gov/stats/(noting that 68.7% of Fortune 500 companies are incorporated in Delaware).
[2] *See* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002) (arguing that no state competes with Delaware).
[3] *See* Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Re-considering the Competition over Corporate Charters,* 112 YALE L.J. 553 (2002) (arguing that Delaware's dominant position imposes insurmountable barriers to entry).
[4] *See* Lucian Babchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J. L. & ECON 383 (2003).
[5] *See* Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593 (2014).
[6] *See e.g.*, Sean Hmmersmeier, *Elon Musk forms 3 companies in Nevada, filings show*, Las Vegas Review (April 17, 2023) https://shorturl.at/eoyB2; Alexa Corse, *Twitter Inc. Changes Its Name to X Corp. and Moves to Nevada*, WALL ST. J. (April 12, 2023) https://shorturl.at/jmY37; X Corp. formation Nevada https://shorturl.at/drwKO
[7] *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL (Feb. 20, 2024).

Delaware have grabbed news headlines[8] and have even been addressed by the Chief Justice of the Delaware Supreme Court.[9]

Current critics of Delaware's system do not complain about the efficiency of the state courts, the invaluable expediency in which it handles non-jury business trials, the unmatched expertise of its judiciary, or the richness of its body of corporate case law. Instead, they are lured to Nevada because of its lax corporate law, embodied primarily by the more robust protections that it offers to directors and officers from shareholder litigation. In early 2024, right after a Delaware judge decided that Musk had to rescind his $56 billion compensation package to Tesla,[10] he tweeted, "[n]ever incorporate your company in the state of Delaware."[11] TripAdvisor's attempted 2023 reincorporation to Nevada similarly followed numerous shareholder lawsuits against its controlling shareholder, Gregory Maffei, who has a decades-long history of self-dealing.[12] Relying on these developments and statements, commentary in the business press also posits that Nevada's protection from litigation is the primary motivation for these reincorporations.[13]

Despite this wide general recognition of Nevada's lax regime, the exact contours of Nevada law and how and to what extent it insulates management from liability relative to Delaware are less understood. Indeed, legal scholarship, textbooks, and corporate law courses focus on Delaware law and pay little attention to Nevada's alternative approach to corporate law. This ignorance was so ingrained that, for decades, it was wrongly assumed that Nevada was trying to attract corporations by *copying, not differentiating from,* Delaware's law.[14] More than

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[8] *See e.g.,* Theo Francis & Erin Mulvaney, *Elon Musk Isn't the Only Billionaire Fighting Delaware*, WALL ST.J. (Feb. 11, 2024) https://shorturl.at/moSU7; Akiko Fujita, *Elon Musk threatens Delaware's hold on corporation*s, Yahoo Finance (February 13, 2024) https://shorturl.at/jrFKV; Lydia Moynihan, *Why CEOs are Rolling the Dice on a Move to Nevada*, NYPost, Business (April 27, 2023) https://shorturl.at/luNV0; Sarah McBride, *Musk's Neuralink Ditches Delaware, Reincorporates in Nevada*, Bloomberg News (Feb. 9, 2024) https://shorturl.at/mNS34; Andrew Ross Sorkin et al., *Elon Musk Extends His Anywhere-but-Delaware Campaign,* DealBook, N.Y.TIMES (Feb. 15, 2024) https://shorturl.at/dvyOS

[9] Chief Justice Collins J. Seitz, Jr., *Presentation for the Judiciary*, Joint Finance Committee of the 152nd General Assembly, (Del. 2024), available at https://shorturl.at/hrtvK ("as you've probably read in the newspaper - there's a lot of competition for corporate business across the United States. Nevada has tried, through enacting what might be called fairly liberal laws that maybe do not require as much supervision over companies, and then Texas has started its own business court.")

[10] *Tornetta v. Musk*, No. 2018-0408-KSJM (Jan. 30, 2024).

[11] *See* @elonmusk, X, (Jan. 30, 2024, 5:14 PM) https://shorturl.at/lwY05.

[12] *See infra* Part IV.

[13] *See e.g.*, Theo Francis & Erin Mulvaney, *Elon Musk Isn't the Only Billionaire Fighting Delaware*, Wall St. J. (Feb. 11, 2024), https://shorturl.at/estQ4 (discussing the "broad protections for directors and officers" that Nevada provides).

[14] *See, e.g., Hilton Hotels Corp. v. ITT Corp.,* 978 F. Supp. 1342, 1346 (D. Nev. 1997); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1067 (2000); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 Colum. L. Rev. 1908, 1911 (1998) ("Nevada adopted Delaware law wholesale and yet failed to make significant inroads into Delaware's market share"); Kresimir Pirsl, *Trends, Developments, and Mutual*

two decades after Nevada adopted its broad protection, an Article published in the *Virginia Law Review* exposed Nevada's strategy and its significant protections to protect corporate directors and officers from liability.[15] The Article shifted the conventional assumption, and yet, more than a decade later, the significance of the differences between Nevada and Delaware is still not fully recognized by academics, jurists, and even corporate attorneys. The indeterminacy of these differences is also reflected in the courts. In a recent order, a Delaware judge allowed a case to proceed to trial largely to litigate the differences between the corporate laws in the two states.[16]

This Article analyzes Nevada's corporate law, the competitive pressures it currently presents to Delaware, and the potential effects of this pressure on Delaware corporate law. The stakes for corporate law and corporate America are high. As Nevada's protections for directors and officers gain prominence and more firms are tempted to incorporate in Nevada, more firms will be governed by Nevada law. Furthermore, Nevada's law may lead to changes in other states' laws. Delaware might face increasing pressure to relax some of its legal constraints on managers, further upending the market for American corporate law. Other states that seem to enter the competition, such as Texas, might be tempted to move in that direction.

Furthermore, the extent to which Nevada law diverges from Delaware law has direct implications on whether reincorporation to Nevada will be considered a self-dealing transaction and thus subject to an entire fairness review in Delaware courts. This precise issue is moving through litigation now. In the TripAdvisor litigation, the Delaware Court of Chancery allowed the actual comparison between Delaware and Nevada law to proceed to trial, where the parties can argue on the merits whether these differences are material.[17] If the trial proceeds to its conclusion, the materiality of these differences will bear directly on the level of scrutiny Delaware courts apply to Nevada reincorporations.

Lastly, managers and controlling shareholders can arbitrage information gaps concerning Nevada law with their legal advisors' assistance. Indeed, in 2017, Scientific Games reincorporated into Nevada with the votes of its controlling shareholder, Ron Perelman.[18] Two years later, minority shareholders were

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Influences between United States Corporate Law(s) and European Community Company Law, 14 COLUM. J. EUR. L. 277, 317 (2008) ("Nevada was the only state that actively tried to take incorporation business from Delaware, copying the Delaware General Corporation Code almost to the letter"); Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 277 n.41 (1990) ("Nevada has attempted to duplicate Delaware's doctrine").

[15] Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability Free Jurisdiction,* 98 VA. L. REV. 935 (2012); *See also* Melissa Castro Wyatt, *Professor Saw Elon Musk and TripAdvisor Moves to Nevada Coming – 11 Years Ago*, UVATODAY (June 13 , 2023), https://shorturl.at/ewxNR.

[16] *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL (Feb. 20, 2024).

[17] *See Id.*, at 32.

[18] *See infra* Part II.B.3.

surprised to find out how Nevada law could be utilized against them. They then looked for remedies from the Delaware court, but the court's hands were tied.[19]

The Article finds that Nevada law is significantly different from Delaware, first and foremost in how it eliminates liability for most cases of breach of the duty of loyalty.[20] Self-interested, conflicted transactions in Nevada are not subject to meaningful judicial scrutiny. Nevada law poses significant hurdles to bringing derivative lawsuits, making it close to impossible to plead to demand futility that is required to pass the motion to dismiss stage.[21] On top of that, Nevada makes it much more difficult for shareholders to access board minutes, cutting off a crucial pathway to litigation in the first place.[22]

These lax constraints, the Article demonstrates, impair shareholder litigation rights significantly and facilitate self-dealing transactions, poor corporate governance practices, and managerial misconduct. This lax regime allowed Steve Wynn, the Las Vegas casino industry superstar, to extract so much money from his firm, Wynn Resorts, for decades.[23] He leased his art collection to the firm for $4 million yearly, plus insurance costs.[24] He charged the firm for his apartment and used the firm jet excessively.[25] He had the board reprice his options when the firm's stock fell relative to its peers and even won the dubious title of one of the country's most overpaid CEOs.[26] These practices were well-known, highly criticized, and lasted for decades. ISS and Glass Lewis criticized the firm's numerous self-dealing transactions and weak governance practices year after year, ranking it at the bottom of corporate governance quality, and recommended that shareholders vote against its compensation packages. As a result, over 40% of shareholders did not support the compensation in the say-on-pay votes—a rare example of dissent on an uncontroversial topic in most firms.

The Wynn saga suggests that legal accountability through litigation is essential concerning self-dealing transactions since market forces alone will not discipline conflicts of interest. Despite decades of self-dealing transactions, excessive compensation, and poor corporate governance practices, Wynn shareholders did not have a viable claim for a non-exculpated breach of fiduciary duty in Nevada. As long as directors and officers did not engage in "intentional misconduct, fraud, or knowing violation of law," recurrent and even outrageous self-dealing transactions were not subject to liability, nor sufficient to get past the motion to dismiss stage.[27] Eventually, in 2018, the *Wall Street Journal* reported

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[19] *See Sylebra Capital Partners v. Perelman*, C.A. NO. 2019-0843-JRS (Del. Ch. Oct. 9, 2020).
[20] *See infra* Part III.B.1.
[21] *See infra* Part III.B.2.
[22] *See infra* Part III.B.3
[23] *See infra* Part III.B.4
[24] Graef Crystal, *Steve Wynn Wins for Losing, Courtesy of Kirk Kerkoria*, BLOOMBERG (March 6, 2000), https://shorturl.at/lqCGH.
[25] *Id.*
[26] Rosanna Landis Weaver, *The 100 Most Overpaid CEOs: Are Fund Managers Asleep at the Wheel?*, AS YOU SOW (March 2019), available at https://shorturl.at/tuzT0.
[27] NRS 78.138(7)(B)(2).

dozens of accounts of systemic sexual misconduct by Steve Wynn against numerous individuals, among them casino employees. The revelations lead to Steve Wynn's resignation and to high-value settlements. The deterioration of Wynn Resorts demonstrates the potential harm that a lack of legal accountability can impose on shareholders, firms, and individuals.

Beyond exculpation and the demand futility bar, Nevada has diverged from Delaware's corporate law in several other significant areas. One important difference relates to the judicial scrutiny of management's defensive tactics.[28] Delaware courts apply enhanced scrutiny for managers' defensive tactics under three landmark cases—*Unocal*, *Revlon*, and *Blasius*— because they present classically fraught conflicts between managers and shareholders. Nevada has gone in a sharply different direction: in 1999, it repealed *Unocal* and *Revlon* in its law, meaning managers get deference for almost any defensive tactics.

As the profile of Nevada as a corporate haven has risen, so has the discussion of reincorporation to firms' home states.[29] This Article also explains why Elon Musk has redirected Tesla to Texas. Texas corporate law is not as protective of management as Nevada, and Musk contemplated moving Tesla to Nevada once. However, because Tesla is a publicly traded company, reincorporation to another state requires a shareholder vote, and shareholders might not support such a move. Indeed, when TripAdvisor attempted a similar move to Nevada, its unaffiliated shareholders voted resoundingly against it (only 5% of the minority shareholders supported it). Furthermore, as discussed above, a reincorporation to Nevada may be considered a self-dealing transaction and thus may trigger the high scrutiny of the entire fairness standard. This was the same standard of review that the Court of Chancery applied in its decision ordering the recission of Musk's $56 billion compensation package from Tesla.[30]

Texas, on the other hand, has not positioned itself as a lax corporate regime. Thus, it may be more challenging to argue that reincorporation in Texas is a self-dealing transaction that benefits directors and controlling shareholders at the expense of minority shareholders. Even though Texas is not as protective as Nevada, the potential litigation complications mean that it (and other home states for other firms) might be the more feasible option for reincorporation.

Yet, while the home states do not currently offer the same protection that Nevada offers, they might be inclined to increase protections in the future. In their home state, managers and controlling shareholders have political clout, which they can and have utilized to pressure the state to adopt management-friendly rules.[31] Indeed, in response to the takeover boom in the 1980s, management in different states lobbied successfully for antitakeover statutes that empowered

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[28] *See infra* Part III.B.5

[29] The term home state refers to the state where the firms' main headquarters are located. For a discussion of how home states may cater to local management with proactive corporate law, *see infra* Part III.C.

[30] *Tornetta v. Musk*, NO. 2018-0408-KSJM (Jan. 30, 2024).

[31] *See infra* Part III.C.

them to fight hostile bidders, who sometimes offered significant premiums to shareholders.[32] Furthermore, as more home states are now interested in attracting firms, they might have additional motivation to cater to managers by offering protection from shareholder litigation.

The Article's analysis of the differences between Nevada and Delaware has direct implications for the pending TripAdvisor case.[33] As Vice Chancellor Laster concluded in his order denying the defendant's motion to dismiss, shareholders' "litigation rights" may be "inerrably less" in Nevada than in Delaware.[34] This article posits that, under current Delaware law, reincorporation to Nevada *should* be considered a self-dealing transaction for controlling shareholders, directors, and officers. The materiality of the differences in shareholder litigation rights and the corresponding benefit that flows to management through increased protection from liability is too significant to conclude otherwise.

The Article then discusses the potential effects of the competitive pressures from Nevada and other states on Delaware's law.[35] The analysis shows that the equilibrium in the market for corporate law has turned fragile: the pressure from the bottom has risen, and Delaware's arsenal of legal responses is limited. Moreover, if Delaware responds by weakening its legal constraints, there is a risk of a snowballing effect toward the bottom. Suppose Delaware law becomes more similar to Nevada. In that case, it might become more accessible to reincorporate out of Delaware—fewer substantive differences in the laws between the two states would correspondingly weaken the entire fairness arguments described above. As the barriers to reincorporation are lowered, and as more firms reincorporate, Nevada's market power will rise, and so will the pressure on Delaware to make *further* changes to its corporate law.

In a pending case involving a challenge to a large controlling shareholder, the Delaware Supreme Court is considering whether to relax scrutiny of conflicted transactions carried out by controlling shareholders.[36] The *Match* litigation in the Delaware Supreme Court does not deal explicitly with any question relating to state competition. On its surface, the Court is simply clarifying the standard of review it will apply to controlling shareholders who engage in conflicted transactions and potentially establishing a pathway for controllers to get business judgment deference through cleansing mechanisms. However, the broader context here requires recognizing that Nevada's profile as a legitimate threat to Delaware's corporate law importance has grown significantly in recent years and acknowledging that Delaware courts and lawmakers have reacted proactively to

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32 Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 225–32 (1985).
33 *See infra* Part IV.A.
34 *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL AT 11 (Feb. 20, 2024).
35 *See infra* Part IV.B.
36 *See* Delaware Supreme Court, Order for Supplementary Briefing (May 30, 2023), *In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ; *see also In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ (Del. Ch. Sept. 1, 2022).

similar threats in the past.[37] Nevada's rising threat to Delaware is not simply speculative.[38] More importantly, this Article argues that the *Match* proposition, if adopted, could contribute to the aforementioned snowballing effect toward the bottom of American corporate law.[39]

The Article proceeds as follows. Section II discusses Delaware's superiority in the market for corporate law and the rising competition it faces. Section III covers the critical differences between Delaware and Nevada corporate law. It also discussed the potential protections that managers and directors may gain in their firms' home states—section IV. A applies the analysis to judicial scrutiny of reincorporation. Section IV.B discusses the competitive threats to Delaware from Nevada and other states. This section also discusses the potential follow-on effects that may take place should the Delaware Supreme Court adopt the *Match* proposition and reshape its law to align more with Nevada's model.

II. From No Competition to Delaware Challenged

A. The Traditional View

1. Race to the Top/Bottom & Delaware's Undisputed Dominance

Fifty years have passed since Bill Cary published his seminal article in the Yale Law Journal, where he argued that the state of Delaware was leading a race to the bottom in the market for corporate law.[40] The article initiated a central debate in corporate law involving top scholarship by top corporate law scholars. Chicago School scholars Ralph K. Winter, Jr., Frank H. Easterbrook, and Daniel R. Fischel criticized Cary's argument because it did not consider market forces that would discipline firms who choose inferior law and, in turn, Delaware for offering such law.[41] Roberta Romano argued that Delaware is racing to the top, and Rob Dains found that Delaware firms are traded at a premium.[42] Lucian Bebchuk and others have pointed to the limitation of market forces in disciplining managers' demand for legal protections and, in turn, state offerings.[43]

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[37] *See infra* Part II.B.
[38] *See infra* Part II.A.2.
[39] *See infra* Part IV.B.
[40] William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).
[41] *See* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254–58 (1977); Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 212–27 (1991).
[42] *See* Roberta Romano, The Genius of American Corporate Law 14–31 (1993); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. Econ. & Org. 225, 225–32 (1985); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. Fin. Econ. 525 (2001).
[43] *See e.g.*, Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775 (2002), Lucian A. Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race To Protect Managers from Takeovers,* 99 COLUM. L. REV. 1168 (1999) ; Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111 (2001); Oren Bar-Gill, Michal Barzuza & Lucian A. Bebchuk, *The Market for Corporate Law*, 162 J. INSTIT. & THEORETICAL ECON. 134, 134–38 (2006).

More recent literature, however, challenged the assumption that competition even exists by offering a law different from Delaware law.[44] Most states, these studies argued, did not establish business courts; their courts decide cases with juries and seldom publish their cases.[45] Similarly, other than Delaware, no state charges a considerable incorporation tax,[46] and even if some states did, for the vast majority of them, that would constitute a considerable portion of their budget.[47] Furthermore, Delaware's charge of a significantly higher incorporation tax indicates its significant market power and the barriers to entry it poses to other states.[48]

2. Delaware Has Responded to Competitive Pressures in the Past

Despite its dominance, however, Delaware officials have long been aware of the threat of losing corporations to other states. They have responded to it more than once by issuing management-protective decisions and amending its corporate law.

For example, following the adoption of poison pills by firms in Delaware in response to a wave of hostile takeovers, Chancellor Allen in *Interco* limited management's use of poison pills.[49] *Interco* held that managers could use the pill for a limited time and only to solicit a better offer for shareholders or to prove that their long-term plan for the company was superior to the premium the hostile bidder offered.[50] The decision caused Martin Lipton, the inventor of the poison pill, to publish a client memorandum arguing that it was time to consider moving out of Delaware to other states that would better empower managers to defend against hostile bidders.[51] The Delaware Supreme Court responded quickly, reversing *Interco* and allowing managers to use the poison pill to "just say no" to hostile bidders and remain independent at all costs.[52]

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[44] *See* Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Re-considering the Competition over Corporate Charters*, 112 YALE L.J. 553, 563–64 (2002) (arguing that Delaware's dominant position imposes insurmountable barriers to entry); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684–85 (2002) (arguing that no state competes with Delaware).
[45] *See* Kahan & Kamar, *supra* note 44, at 712–13.
[46] *See* Kahan & Kamar, *supra* note 44 at 687–92.
[47] *Since* Delaware is a small state, incorporation taxes constitute a considerable portion of its annual budget. *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2429 TBL.1 (1998)
[48] *See* Bebchuk & Hamdani, *supra* note 44.
[49] *City Capital Associates v. Interco Inc.*, 551 A.2d 787 (Del. Ch. 1988).
[50] *Id.* at 802.
[51] Martin Lipton, *Client Memorandum: The* Interco *Case*, Wachtell, Lipton, Rosen & Katz (Nov. 3, 1988), available at https://shorturl.at/kqEHM.
[52] *See Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1989) (holding that the court would defer to managers who genuinely believe that their long-term plan is superior to an outside bid, regardless of the size of the premium it offers to shareholders above the current market price); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J. L. ECON. & ORG. 32, 52 (2004) (discussing Delaware's "just say no" doctrine); *Airgas, Inc. v. Air Products and Chemicals, Inc.*, No. 649, 2010 (Del.

A similar dynamic took place in Delaware after *Smith v. Van Gorkom*.[53] In this case, the Delaware Supreme Court declined to give the directors of a target company business judgment deference after they accepted an acquisition that offered a premium of 60% to shareholders.[54] The decision that exposed directors to personal liability in selling their firm at a significant premium was met with fierce criticism from the business and academic community: one preeminent corporate law scholar called Van Gorkom, "surely one of the worst decisions in the history of corporate law."[55] This time, the reaction and correction from the legislature was swift: Delaware adopted D.G.C.L §102(b)(7), which allowed Delaware firms to exculpate directors from personal liability for breaches of the duty of care, with shareholder approval.[56] In the decades since most firms have adopted such a provision.[57] More recently, in 2022, Delaware amended §102(b)(7) again to extend its optional exculpation provisions to senior officers, mirroring the protections that Nevada law provides to corporate officers.[58]

In the face of criticism from businesses, legal advisors, and academics, the state has tended to respond via its courts or legislature and properly adjust before it sees a mass migration of firms to other jurisdictions.

B. Increasing Pressure from Firms

1. Elon Musk - X, Twitter, Tesla, SpaceX, NeuraLink (2024)

Elon Musk has dealt with extensive and high-profile litigation in Delaware in the last several years. *Twitter v. Musk* involved a lawsuit to force the close of Musk's acquisition of the social media site.[59] *In re Tesla Motors, Inc. Stockholders Litigation* involved a stockholder challenge to a Tesla acquisition of SolarCity facilitated by Musk.[60] And most recently, *Tornetta v. Musk* involved a stockholder challenge to the $56 billion compensation arrangement the Tesla board of directors gave Musk.[61] While the outcomes for Musk have been decidedly mixed—he settled the lawsuit with Twitter, the court approved of the SolarCity deal's fairness, and the $56 billion arrangement was held to be unfair, Musk has recently begun moving many of the private companies under his control out of Delaware into other jurisdictions.

2010) (holding that Delaware courts may not intervene in the use of a poison pill even when its used by an entrenched, staggered board and thus provides a potent defensive tactic).

[53] 488 A.2d 858 (Del. 1985).

[54] *Id.*

[55] Daniel Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. L. 1437, 1455 (1985).

[56] *See* D.G.C.L §102(b)(7).

[57] *Delaware's 102(b)(7) Exculpation of Senior Officers - One Year Later*, Sean Sheely & Mark Reindheart, Jenner & Block (September 2023), https://shorturl.at/fwySY.

[58] *Id.*

[59] *Twitter, Inc. v. Musk*, C. A. 2022-0613-KSJM (Del. Ch. Aug. 23, 2022).

[60] No. 181, 2022 (Del. 2023).

[61] *Tornetta v. Musk*, No. 2018-0408-KSJM (Jan. 30, 2024).

After concluding the take-private transaction with Twitter, Musk merged it with a Nevada entity, effectively moving it to a new corporate home.[62] In the wake of the *Tornetta* judgment regarding his Tesla pay package, Musk made further moves: he reincorporated his brain-implant company Neuralink, valued at $5 billion, to Nevada,[63] and moved his rocket company SpaceX, valued at $180 billion, to Texas.[64]

Perhaps most prominently, Musk has begun to advocate for moving Tesla's corporate home out of Delaware. Unlike his other companies, Tesla is publicly traded and has a market value of about $640 billion.[65] Musk stated that a shareholder vote would be held on redomesticating the company to Texas[66]—where Tesla's corporate headquarters is located—and that such a proposed transaction could raise issues in the Delaware courts. Such a domestication or merger would require shareholder approval and could also increase the question of whether Musk is, in fact, a controlling shareholder.[67] If a Delaware court decides he is, the transaction could be challenged based on potential self-dealing. Even if shareholders overwhelmingly approve such a move, just as they did with the compensation agreement in *Tornetta*, Musk and Tesla might still face a high risk of litigation in the Delaware courts.

2. TripAdvisor (2024)

TripAdvisor has dealt with litigation in Delaware stemming from its recent attempt to redomesticate to Nevada. Greg Maffei, the influential controlling shareholder, convinced the TripAdvisor board to adopt the plan, which was approved after a shareholder vote. However, Maffei's significant stake controlled the outcome of that vote—only 5% of unaffiliated TripAdvisor stockholders voted to approve the plan.[68]

Shareholders filed suit challenging the transaction, alleging that the move out of Delaware left them unfairly reduced litigation rights and was thus a form of self-dealing. The case has made it through the motion to dismiss stage: Vice Chancellor Travis Laster declined to grant the plaintiffs an injunction but has allowed their claim for damages under the entire fairness theory they proffered to continue to later stages of litigation.[69]

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[62] Alexa Coarse, *Twitter Inc. Changes Its Name to X Corp. and Moves to Nevada*, Wall St. J. (Apr. 12, 2023), https://shorturl.at/szOV1.
[63] Tom Krisher, *Elon Musk's Neuralink moves legal home to Nevada after Delaware judge invalidates his Tesla pay deal*, A.P. (Feb. 10, 2024), https://shorturl.at/jknAH.
[64] Mike Ives, *SpaceX Is Now Incorporated in Texas, Elon Musk Says*, N.Y. Times (Feb. 15, 2024), https://shorturl.at/qrGM3.
[65] *Id*.
[66] Shubham Kalia & Maria Ponnezhath, *Musk Seeks Tesla Shareholder Vote on Moving Incorporation to Texas*, Reuters (Feb. 1, 2024), https://shorturl.at/rAQV5.
[67] *See In re Tesla Motors, Inc. Stockholders Litigation* No. 181, 2022 (Del. June 6, 2023).
[68] *See Palkon v. Maffei*, C.A. No. 2023-0449-JTL (Feb. 20, 2024).
[69] *See* Part IV, *infra*, for a richer discussion of *Palkon* and its implications.

The TripAdvisor case has received considerable coverage in the press, given its implication for Delaware's long-dominant corporate regime.[70] Given that Delaware has long been a beneficiary of firms reincorporating on its turf, the threat of being cast as a "Hotel California" by critics is a novel issue Delaware is contending with.[71] The question leaves Delaware with a choice between options with two unsatisfactory results. On the one hand, if the court agrees with the plaintiffs and characterizes the domestication as a self-dealing transaction requiring an entire fairness review, firms could be deterred from coming to Delaware to begin in the future for fear of becoming trapped. On the other hand, if the transaction is allowed to stand and TripAdvisor redomesticates to Nevada without much friction, then controlling shareholders of other firms might note how straightforward it is to move out of Delaware with their votes relatively quickly.

3. Sylebra Capital Partners v. Perelman (2017)

The Maffei-TripAdvisor litigation is not the case that challenges a reincorporation from Delaware to Nevada. Another case, *Sylebra Capital Partners v. Perelman*, attracted attention, though shareholders sued only after reincorporation.[72] In 2017, Ron Perelman held roughly 40% of Scientific Games.[73] The company had another significant but minor shareholder, Sylebra Capital Partners. Perelman sought to take over Sylebra's stake at a discounted price, so a reincorporation to Nevada was effectuated and approved by a shareholder vote.[74] Because the firm was publicly traded, the majority vote of shareholders was met—but only because Perelman's votes were counted, and he controlled over 40%.

Instead of challenging the reincorporation-merger itself in court, Sylebra later tried to sue in Delaware once the company was incorporated in Nevada, challenging the new Nevada forum selection bylaw and arguing that Delaware law should apply.[75] While the court agreed that the plaintiffs had a claim based on how the transaction was carried out, it had to comply with the internal affairs doctrine and dismissed the suit.[76] This left the Sylebra plaintiffs with two undesirable options: sue in Nevada, where the law would be on Perelman's side, or sell the shares back to Scientific Games at a discounted price.

Perelman began to exit Scientific Games in 2020. When this was announced, the company's stock soared over 40%, consistent with the idea that he could have

[70] Theo Francis & Erin Mulvaney, *Elon Musk Isn't the Only Billionaire Fighting Delaware*, Wall St. J. (Feb. 11, 2024), https://shorturl.at/estQ4.
[71] Keith Paul Bishop, *TripAdvisor Suit Invites Delaware To Become The Hotel California*, C.A. Corp. & Sec. L. (May 1, 2023), https://shorturl.at/dmCGZ.
[72] *See Sylebra Capital Partners v. Perelman*, C.A. No. 2019-0843-JRS (Del. Ch. Oct. 9, 2020)
[73] *Id*. at 6.
[74] *Id*.
[75] *Id*. at 2.
[76] *Id*. at 10.

appropriated minority shareholders.[77] This reincorporation occurred in September 2017 and could have been a red flag for Delaware, alerting the state to the potential attractiveness that Nevada might have for controlling shareholders, together with the increasing use of forum selection bylaws around 2017. The case exemplifies Nevada law working to the disadvantage of shareholders and the continuing lack of attention paid to these material differences in Delaware.

4. TransPerfect & "Dexit" (2018)

Another firm to incorporate with more visibility and negative coverage for Delaware was TransPerfect Translation, the translation and language services company based in New York City. Founded by NYU students in their dormitory room in 1992, TransPerfect grew to become a company with revenues of more than $1 billion and more than 7,000 employees while remaining private.[78] However, from 2015 to 2018, TransPerfect was involved in litigation in Delaware courts that ended with the court forcing the sale of the company to one of the founders to end a long-term dispute between the founders.

Eventually, to resolve this dispute, the Court of Chancery decided that the company would be sold to a third party in a public auction. The decision was very unusual, so much so that even New York Mayor Rudolph Giuliani said that it could harm Delaware's reputation and position.[79] There were also questions about whether the court interpreted Delaware law correctly.

One of the founders appealed and hired the preeminent constitutional law professor Alan Dershowitz to represent her. Leo Strine, the Chief Justice of the Delaware Supreme Court, decided the case, affirming the decision of the Court of Chancery.

The saga ended with one of the founders, Phil Shawe, buying the other out in the auction.[80] He then reincorporated the company to Nevada and began an outspoken campaign against the Delaware Judiciary generally and against the author of the original opinion, Chancellor Bouchard, specifically. The group started a website called "Dexit, Exit from Delaware" and accused the Court of Chancery of corruption. After the company's move to Nevada, the CEO of TransPerfect wrote an article titled "Dexit to the Desert, Why I Left Delaware for Nevada."[81] He framed Nevada as "the future home of business incorporation," citing the recent moves by Twitter and DraftKings to support his point.

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[77] Keith P. Bishop, *Why Are Stockholders Of A Nevada Corporation Invoking The DGCL?*, C.A. Corp. & Sec. L. (Oct. 16, 2020), https://shorturl.at/ePSV1.
[78] Steven Davidoff Solomon, *TransPerfect is Threatened by Owners' Petulance,* N.Y. Times (Nov. 15, 2016), https://shorturl.at/bzAR7.
[79] *Id.*
[80] Phil Shaw, *Dexit: Why I Left Delaware for Nevada*, Nev. Ind. (Sept. 15, 2023), https://shorturl.at/qBQ17.
[81] *Id.*

These publicized cases of reincorporation out of Delaware exert increasing pressure on the state. The likelihood of mass migration of publicly traded firms out of Delaware is not significant. Among privately held firms, however, the situation might be slightly different, partially due to the relative ease in which they can reincorporate—Musk has moved three private firms he controls out of Delaware in the last year alone—but also because it is not highly likely to view a broader trend in real-time concerning private firms.

More importantly, however, officials in Delaware are risk averse concerning losing Delaware business, and they know that their success relies on the large number of firms incorporated in Delaware.[82] If the state loses a significant number of companies, similar to what happened between New Jersey and Delaware in the early 20th century, it might be difficult to correct such a trend.[83] In light of this history, it would be naive to believe that Delaware judges are not at least aware of this dynamic.

Indeed, as shown below, there is some evidence that Delaware may already be shifting its gears and starting to respond. The litigation involving TripAdvisor represents the most that the competing legal regime in Nevada has ever been interrogated in a Delaware court. That case has the potential to be precedent-setting in how courts view redomestications to Nevada in the future. Simultaneously, in the pending *Match* case, the Delaware Supreme Court is poised to issue a ruling that could reshape potentially—and sharply relax—the level of scrutiny applied to controlling shareholders in conflict transactions.[84]

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[82] *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757, 849–51 (1995).

[83] Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1443 (1992).

[84] *See* Part IV *infra*.

III. Nevada Corporate Law

A. History of Nevada Corporate Law - Compete by Offering Lax Law

Nevada has competed with Delaware for decades. Its strategy has been focused on clearly offering more protection from liability for corporate directors and officers than Delaware.[85] To that end, Nevada lawmakers have, over the years, explicitly considered Delaware's corporate law and designed their statutes to deviate from what Delaware offers toward less accountability. These competitive statutes have been consciously enacted by legislators repeatedly over decades.

Nevada enacted its expansive exculpation statute for corporate directors and officers in 1987.[86] As initially passed, this statute was significantly broader than Delaware's comparative provisions in §102(b)(7): the Nevada law allowed firms to waive liability for all categories except for "intentional misconduct, fraud, or knowing violation of law."[87]

The legislative history relating to this bill shows that Nevada state officials directly contemplated deviation from Delaware from the beginning: The secretary of State said at the time that it was incumbent on the state to "do as much as [it] can to out Delaware."[88] Senator William Raggio's testimony argued that broader protections for directors and officers are required to maintain Nevada's position in the market for corporate law:

> *"Senator Raggio reminded the committee that Nevada has, for many years, been trying to make the state attractive for incorporation of new companies and the attraction of foreign companies who qualify to do business in the state. .. S.B. 6 is the preferable bill because it broadens the immunity of directors to include the "breach of duty of loyalty to the corporation or its shareholders." He said this matter is "...essential for the State of Nevada/ if it continues to be a leading state for incorporation."*[89]

The legislative history also contemplates concerns arising from the director's liability in Delaware's *Van Gorkom* case as well—a holding that also caused considerable consternation in Delaware itself.[90]

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[85] *See* Barzuza, *supra* note 15.
[86] *See* NRS 78.037
[87] *Id.*
[88] *Hearing on S.B. 46 Before the S. Comm. on Judiciary*, 1987 LEG., 64TH SESS. (Nev. 1987) (Testimony of of Sec. of State Frankie Sue Del Papa).
[89] *Id.* (Testimony of Senator William Raggio).
[90] *Hearing on S.B. 46 Before the S. Comm. on Judiciary*, 1987 LEG., 64TH SESS. (Nev. 1987) (Testimony of Casey Vlautin, Attorney) ("Mr. Vlautin stated he represents five corporations domiciled in the area which have indicated they may leave Nevada if the law is not changed as it has been in Delaware.

While Nevada's exculpation statute was expansive, its impact was limited the year after its passage: the provision was optional, and Nevada firms needed a shareholder vote to avail themselves of the option. In 2001, however, in another intentionally competitive act, the state stepped in again to make a significant change on this front: it changed the default for firms incorporated in the state to no-liability (except for intentional misconduct, fraud, or knowing violation of the law).[91] This change was particularly notable, as it trumped and applied to all of Nevada's corporations upon passage: shareholders of firms did not even get a say in approving it. Again, minutes from the legislative consideration of this 2001 amendment reveal an explicit goal of trying to differentiate Nevada's law from Delaware as a strategy to attract incorporations.[92] These amendments sharply differed from Delaware's exculpation rule in how far they extended to exculpate directors and how it became a default, rather than an opt-in, rule.

Nevada lawmakers also repeatedly clarified that Nevada courts should not follow Delaware law in corporate cases. In 1999, the Nevada legislature amended its corporate code to apply the highly deferential business judgment rule to management's defensive tactics, giving managers wide latitude to respond to offers.[93] The legislative history clarifies that the amendment was enacted with a clear purpose to explicitly reject two landmark Delaware cases —*Unocal*[94] and *Revlon*[95]—which applied a higher level of intermediate scrutiny to managers' use of defensive tactics.

Nearly two decades later, in 2017, the Nevada legislature made another change to its corporate law regime with Delaware in mind - by implementing a statutory internal affair doctrine. The legislature adopted NRS § 78.012, which reads in part:

> 2. The laws of this State govern the incorporation and internal affairs of a domestic corporation and the rights, privileges, powers, duties, and liabilities, if any, of its directors, officers, and stockholders…
>
> 3. The plain meaning of the laws enacted by the Legislature in this title, including, without limitation, the fiduciary duties and liability of the directors and officers of a domestic corporation…

He referred to a lawsuit that involved millions of dollars in liability against directors of a corporation and indicated that many people with personal assets would not want to sit on a board of directors with the threat of such liability and personal risk involved.")

[91] Barzuza, *supra* note __ at 953 (in fact it was first changed to be a mandatory rule, and then in 2003, was relaxed a bit to become the default).

[92] *Id*. at 953–54.

[93] *Proposed Amendment to S.B. 203*, *Hearing on S.B. 203 Before the S. Comm. on Judiciary*, 2017 LEG., 79TH SESS. (Nev. 2017) (proposed amendment submitted by U-Haul International, Inc.).

[94] *Unocal Corporation v. Mesa Petroleum Co*., 493 A.2D 946 (Del. 1985).

[95] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2D 173 (Del. 1986).

> must not be supplanted or modified by-laws or judicial decisions from any other jurisdiction.[96]

Adopting § 78.012 reflects a legislative policy that Nevada courts should not follow Delaware law. As a policy statement, it again reflects a conscious differentiation from Delaware by the Nevada legislature. And once again, the legislative history bears this interpretation: lawmakers explained that the language indicates that Nevada statutes should control business disputes in the state and that "Delaware cases that reflect a different law" should not be applied.[97]

These examples demonstrate that Nevada could hardly be more direct in its effort to differentiate its corporate law regime from that of Delaware competitively. Nevada officials have explained repeatedly that this strategy—differentiation from Delaware by offering lax law—is the only way to compete with Delaware on incorporations.

B. Distinguishing Nevada's Lax Corporate Law from Delaware

To assess the stakes of Nevada's increasingly competitive profile as a destination for incorporation, this Part will discuss Nevada corporate law, focusing on distinguishing the core doctrines where it differs from Delaware and other state laws. As it shows, Nevada's corporate law is significantly laxer. Firms that choose to be governed by Nevada law will be governed by the law that protects directors, officers, and controlling shareholders, even in the context of the most critical corporate transactions involving conflicts of interest. In this way, Nevada's law directly deviates from many—perhaps most—of the fundamental pillars that have emerged in Delaware corporate law over the past several decades.

Aside from the substance of the doctrine, discussed in detail in the following sections, the structural differences in the two states' judiciaries are vast. Delaware offers the renowned Court of Chancery, a court of equity stacked with judges with expertise in corporate litigation and Delaware corporate law. It has long been respected for its expertise, judiciousness in corporate affairs, and the speed at which it decides high-profile business disputes. The governor also appoints chancellors to the Court of Chancery. By contrast, judges in Nevada are elected—even those who sit on the state Supreme Court.[98] Also, while business courts are available in the state, Nevada allows juries to hear corporate cases.[99] Finally, unlike Delaware's extensive body of doctrine from the Court of Chancery, there used to be little corporate caselaw—applying Nevada law—from the Nevada courts that

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[96] NRS 78.012 (2)–(3)

[97] *Proposed Amendment to S.B. 203, Hearing on S.B. 203 Before the S. Comm. on Judiciary*, 2017 Leg., 79th Sess. (Nev. 2017) (testimony of Lorne Malkiewech).

[98] *Delaware Versus Nevada: What Are the Critical Distinctions in Nevada Corporate and LLC Law?*, Corp. Serv. Co. (June 24, 2019), https://shorturl.at/biDJ9.

[99] *Id.*

transactional planners and litigators could look to for guidance.[100] While the substantive differences in the law discussed below are the most important, these structural discrepancies also support the proposition that Nevada's system should be seen as utterly distinct from Delaware's.

1. Fiduciary Duties: Exculpation from Liability

(a) Fiduciary Duties: Duty of Care & Duty of Loyalty

Fiduciary duties placed on directors and officers serve as corporate law's primary accountability mechanism. The duty of care—an obligation to make deliberative and informed decisions—and duty of loyalty—a responsibility to act on behalf of the best interests of the company and its shareholders—together make up the heart of much of corporate law doctrine, as they both serve as vehicles for courts to review challenged corporate conduct.

Business Judgment Rule

Delaware courts have long applied the business judgment rule ("BJR") to management decisions made by directors. The rule is a "presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the company's best interests."[101] The rule allows directors to make informed business decisions with an expectation of deference from courts.

The rationale for this principle has been spelled out extensively in case law and academic commentary. One fundamental justification flows from a posture of judicial humility: courts recognize that their expertise lies in ruling on the proper process surrounding business decisions and not the substance of those decisions themselves.[102] Another rationale (reflected throughout Delaware's approach to corporate law) involves efficiency. Proceeding with a broad, deferential default like the business judgment rule means avoiding costly and lengthy litigation. It also allows boards — and their shareholders — to make business planning decisions with predictability.

Indeed, Delaware courts consistently apply the rule even in cases where managerial decisions are wrong. For example, in *Kamin v. American Express*, the board of American Express made a relatively straightforward accounting error that resulted in the company having to pay an additional $6 million in taxes that could have been saved.[103] When shareholder plaintiffs brought suit seeking

[100] *Id.*
[101] *Aronson v. Lewis*, 473 A.2D 805, 812 (Del. 1984).
[102] *See, e.g.*, *Dodge v. Ford Motor Co.*, 204 MICH. 459, 500 (Mich. 1919) ("The discretion of the directors will not be interfered with by the courts unless there has been bad faith, wilful neglect, or abuse of discretion.").
[103] 86 MISC. 2D 809, 812 (N.Y. Sup. Ct. 1976).

damages for a breach of the duty of care, the court disposed of the action by applying the business judgment rule. In its opinion, the court held that "[i]t is not enough to allege, as plaintiffs do here, that the directors made an imprudent decision… [m]ore than imprudence or mistaken judgment must be shown."[104] Because the American Express directors considered the potential tax consequences of the decision, and because elements like fraud or conflicts were not present, the court deferred to the board's action even though It recognized that it might be "unwise" in hindsight.[105]

The upshot of operating with the presumption is that to proceed with lawsuits against a company board in Delaware, the plaintiff has the burden to prove that either directors breached their duty of care (were grossly negligent) or that directors breached their duty of loyalty (i.e., acted in a conflicted way).

Duty of Care & Duty of Loyalty

Delaware courts see the duty of care as tied to "concepts of gross negligence."[106] Directors under the duty of care are obligated "to inform themselves, before making a business decision, of all material information reasonably available to them."[107] As the following sections demonstrate, Delaware law does allow firms to protect directors from personal liability for breaches of the duty of care in many situations. However, Delaware does not go so far as to completely exculpate liability for duty of care breaches, as directors who exhibit a "conscious disregard" for their duties[108] or engage in a conscious failure of oversight[109] can still face personal liability.

By contrast, Delaware courts and the state's relevant statutes approach the duty of loyalty differently in corporate law. The chief concern of the duty of loyalty is self-interest, which includes conflicted transactions and other forms of "self-dealing."[110] Self-dealing describes transactions or other corporate activities in which an officer, director, or controlling shareholder of a corporation is interested in the other side of a deal with that corporation—when an individual with fiduciary duties "stands on both sides of the transaction."[111]

Conflicts can arise in all sorts of corporate transactions. For example, a board member who provides consulting services to a company and is paid for these

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[104] *Id*. at 813.
[105] *Id.* (quoting *Pollitz v Wabash R.R. Co.*, 207 N.Y. 113, 124.).
[106] *Aronson v. Lewis*, 473 A.2D 805, 812 (Del. 1984).
[107] *Id*.
[108] *In re Walt Disney Derivative Litigation*, 907 A 2D 693 (2005).
[109] *See In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 970 (Del. Ch. 1996) ("A director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses.")
[110] *See Sinclair Oil Corp. v. Levien*, 280 A.2D 717, 720 (Del. 1971) ("Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.")
[111] *Kahn v. Lynch Communication Systems*, 638 A.2D 1110, 1117 (Del. 1994).

services is interested in receiving high pay. If she participates in the corporation's decision to hire her consulting services, that decision is affected by self-interest.[112] Another example might arise when a controlling shareholder wants the company he controls to buy another company he owns (a company in which he has a higher share).[113] In such a scenario, the controlling shareholder would be interested in receiving a higher price. A controlling shareholder who wants to take the company she controls private would face a similar conflict, except with interest being in the opposite direction — minimizing what she pays for the other outstanding shares to execute the transaction.[114]

While the approach has developed over time, Delaware courts have maintained their focus on protecting shareholders from breaches of the duty of loyalty. To review these forms of dealing, the courts have generally proceeded by application of the demanding entire fairness test. The test involves a far more scrutinizing level of review, assessing both "fair dealing and fair price" in the context of the challenged transactions.[115] This test is generally seen as the highest form of scrutiny that Delaware courts apply and starkly contrasts the highly deferential business judgment rule discussed above.

(b) Delaware's Exculpation Statute: D.G.C.L §102(b)(7)

A discussion of Delaware's approach to the duties of care and loyalty requires understanding how much personal liability directors actually face for breaching these duties. Today, Delaware allows directors to be exculpated from personal liability for duty of care breaches—a development that can largely be traced back to a single case. In *Smith v. Van Gorkom*, decided in 1985, the Delaware Supreme Court declined to give the directors of a target company business judgment deference, even though they had accepted a bid that delivered a premium of 60% to shareholders.[116] The court took issue with the directors' process regarding the deal, holding that they had not kept themselves adequately informed and that failure in process constituted a breach of the duty of care and thus defeated business judgment deference.[117]

The implication of the *Van Gorkom* decision exposed directors to potential personal liability even after accepting valuable bids on behalf of company shareholders. The holding was met with fierce criticism from the business and academic community. Director and officer insurance rates in Delaware shot up at

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[112] *See, e.g.*, *In re Ezcorp Inc.*, C.A. No. 9962-VCL, 24 (Del. Ch. Jan. 25, 2016).
[113] *See, e.g.*, *In re Southern Peru Copper Corp.. S'holder Derivative Litig.*, 30 A.3D 60, 90 (Del. Ch. 2011) (describing "deficiencies in the substance of the special committee's negotiations" in finding an unfair transaction).
[114] *Kahn v. M&F Worldwide Corp.* (*MFW*), 88 A.3D 635, 647 (Del. 2014).
[115] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (1983).
[116] 488 A.2d 858 (Del. 1985).
[117] *Id.*

this new prospect of risk.[118] One well-regarded corporate law scholar even called *Van Gorkom* "surely one of the worst decisions in the history of corporate law."[119]

The reaction and correction from Delaware lawmakers was swift: it adopted D.G.C.L §102(b)(7), which allowed Delaware firms to exculpate directors from personal liability for breaches of the duty of care, with shareholder approval.[120] In the decades since, most firms have adopted such a provision.[121] More recently, in 2022, Delaware amended §102(b)(7) again to extend its optional exculpation provisions to senior officers.[122]

Delaware's intent with this provision was, in part, to cultivate an environment where directors would not be deterred from serving on the boards of Delaware corporations. Furthermore, allowing personal liability to attach to risky business calls would incentivize directors to prefer low-risk decisions, which would hurt the long-term returns of shareholders. Finally, it avoided the problem of allowing directors to constantly be judged by hindsight if decisions they made in good faith turned out to be wrong. Some also argue that the Delaware legislature's quick correction reacted to the pressure the business community and corporate bar put on them in the wake of *Van Gorkom*.[123]

In the decades since most Delaware firms have opted into the §102(b)(7) exculpation protections.[124] Delaware recently amended §102(b)(7) to include exculpation for senior officers, and firms have been similarly enthusiastic.[125] These devices can only enter a firm's charter with shareholder approval.

The other side of §102(b)(7) is also essential: it lists exceptions to which Delaware firms are prohibited from exculpating their directors from personal liability.[126] These include breaches of the duty of loyalty and the duty of good faith, intentional misconduct, and knowing violation of law.[127] These exceptions are understandable because the rationales that apply to the duty of care exculpation do not apply to them. Furthermore, judicial scrutiny is needed in these situations to guard against opportunistic self-serving behavior, which could harm firms and shareholders significantly.

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118 Daniel Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1440 (1985).
119 *Id.* at 1455.
120 *See* D.G.C.L § 102(b)(7).
121 Sean Sheely & Mark Reindheart, *Delaware's 102(b)(7) Exculpation of Senior Officers - One Year Later*, Jenner & Block (September 2023),
https://www.jenner.com/en/news-insights/publications/delawares-102b7-exculpation-of-senior-officers-one-year-later.
122 *Id.*
123 Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 113, 1143 (2006) ("As of late 1985, pressure was mounting on Delaware's legislature to intervene.")
124 Sheely & Reindheart, *supra* note 99.
125 *Id.*
126 D.G.C.L § 102(B)(7)(I)–(V).
127 *See* D.G.C.L §102(B)(7)(I)-(II)

When conflicts of interest arise, directors, controlling shareholders, or managers could extract private benefits, sometimes significant ones, that put their self-interests at odds with the company's interests.[128] Judicial deference could foster opportunistic behavior, potentially causing substantial harm to firms and shareholders. Because of that, Delaware law does not allow directors and officers to be exculpated from liability for self-dealing transactions (breaches of the duty of loyalty).[129] It also does not shield these transactions from judicial scrutiny through a consistent presumption of business judgment deference. Instead, Delaware courts apply an exceptionally high level of judicial review to these types of conflicted transactions - the Entire Fairness standard, which, as described above, assesses both fair dealing and fair price.[130]

(c) Nevada's Exculpation Statute: N.R.S. §78.138

Nevada is quite different. Its exculpation statute deviates sharply from the approach taken by Delaware. Nevada's intent with the design of its exculpation statute always has explicit differentiation from Delaware. As one lawmaker put it in 1987, when the legislature was considering NRS §78.138, the explicit goal of the bill was to "make Nevada the leading competitor in attracting corporations."[131]

In addition to breaches of the duty of care, Nevada also exculpates directors and officers for breaches of the duty of loyalty and duty of good faith. Under Nevada's exculpation statute, directors and officers are subject to personal liability only if their breach of a duty involves "intentional misconduct, fraud or a knowing violation of law."[132] Further, unlike the "opt-in" mechanism of the Delaware exculpation statute, which allows firms to adopt director and officer exculpation only with shareholder approval, Nevada's statutes operate as a default.[133] In other words, the standard provision governing exculpation for all Nevada corporations allows for personal liability of directors and officers only for acts that involve intentional misconduct, fraud, or a knowing violation of law.[134]

This difference is not merely a matter of statutory semantics. Notably, the "intentional" and "knowing" requirements of the Nevada exculpation statute have been interpreted by courts in the state to confer an extremely high degree of protection.

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[128] *See Kahn v. Lynch Communication Systems*, 638 A.2d 1110, 1117 (Del. 1994).

[129] DGCL § 102(B)(7). In fact the duty of loyatly and the duty of good faith are part of the few mandatory standards under Delaware law.

[130] *Weinberger v. UOP, Inc.*, 457 A.2D 701, 711 (1983).

[131] *Hearing on S.B. 46 Before the S. Comm. on Judiciary*, 1987 LEG., 64TH SESS. (Nev. 1987) (Testimony of Sec. of State Frankie Sue Del Papa).

[132] NRS 78.138(7)(B)(2).

[133] NRS 78.138(7).

[134] Firms who wish to have higher liability could opt out of this default; yet, since the status requires charter amendment for opting out, directors have a veto power that they can use to object to the default.

For example, *In re Zagg Inc., S'holder Derivative Action* involved a shareholder challenge to a CEO and chairman of the board who pledged company stock for a margin loan without disclosure, violating SEC rules.[135] The court decided that even though the directors knew about the margin loans, there was no proof that these three directors – two of whom were audit committee members - knew that SEC laws require disclosure of these loans. In affirming the lower court's dismissal of the complaint, the 10th Circuit engaged in an extended interpretation of the exceptionally high level of protection that NRS §78.138 offers to directors accused of wrongdoing:

> "The likelihood of liability is greatly reduced in Nevada by an "exculpatory" statute that limits the personal liability of corporate directors…The exculpatory statute's purpose is to limit corporate directors' liability. Under the narrower interpretations of intentional and knowing that does not require knowledge of wrongfulness, a director would not be protected if the director knew their actions—such as signing a document with knowledge of its contents. But that state of mind would be present for virtually any conduct that could lead to the director's liability to the corporation, its stockholders, or creditors. The exculpatory statute would be an empty gesture. To give the statute a realistic function, it must protect more than just directors (if any) who did not know their actions; it should protect directors who knew what they did but not that it was wrong."[136]

The court dismissed the case, deciding that the plaintiff did not show that directors who approved the margin loans knew that the lack of disclosure of these loans violated SEC rules,[137] and such knowledge is required under Nevada law.[138] Notably, adhering to the *Zagg* rationale, the Nevada Supreme Court, in a later case, adopted a similar interpretation of the exculpatory statute, holding that claimants "must establish that the director or officer knew that the alleged conduct was wrongful to show a "knowing violation of law" or "intentional misconduct" under NRS 78.138(7)(b)."[139]

Exculpation for breaches of the duty of loyalty results in critical differences between Nevada and Delaware law.[140] The duty of loyalty requires directors to operate "with a view to the interests of the corporation,"[141] and at least in theory, is challenged by forms of self-dealing. Nevada's exculpation for this kind of conflicted activity may have far-reaching implications, as the difference in how a challenge to an allegedly conflicted transaction might play out in Nevada courts versus Delaware courts is stark. Self-dealing is generally reviewed under the entire

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135 826 F.3d 1222, 1233 (10th Cir. 2016).
136 *Id*. (emphasis added).
137 *Id*. at 1234 ("We doubt that board members are expected to know the minutiae of SEC regulations.").
138 *Id*.
139 *Chur v. Eighth Judicial Dist. Court*, 458 P.3D 336, 342 (Nev. 2020)
140 NRS 78.138(7)(B)(2).
141 NRS 78.138(1).

fairness standard in Delaware, where the court looks to both process and price in determining fairness.[142] This standard of review is widely seen as the highest level of scrutiny that Delaware courts apply to corporate conduct.

On top of that, Delaware law does *not* allow firms to exculpate directors or officers for breaches of the duty of loyalty.[143] By contrast, directors and officers are much more protected from liability breaches of the duty of loyalty under Nevada law and, under Nevada's exculpation statute, avoid personal liability for such a breach by default, unless accompanied by an intentional and knowing violation of the law.[144] As such, a Delaware director faces a significantly stronger deterrent effect against potentially conflicted conduct than a Nevada director.

Finally, firms seeking to leave Delaware and reincorporate in Nevada have done so explicitly because they believe that Nevada law provides more excellent protection for their officers and directors. *Palkon v. Maffei* involved a shareholder challenge to a proposed redomestication of the company TripAdvisor to Nevada effectuated by Greg Maffei, the controlling shareholder of TripAdvisor's parent company.[145] As a part of the redomestication, the company was required to provide proxy materials ahead of the shareholder vote on the move. In explaining the rationale for the move to Nevada, the company stated that "[t]he Redomestication will result in the elimination of any liability of an officer or director for a breach of the duty of loyalty unless arising from intentional misconduct, fraud, or a knowing violation of the law." and expressed a belief that "in general, Nevada law provides greater protection to our directors, officers, and the Company than Delaware law."[146]

The exact scope and relevance of that "greater protection" as a matter of law are yet to be determined in the Delaware courts (and could eventually support a finding of a self-interested transaction). Nonetheless, the facts underlying the *Palkon* litigation suggest that Nevada has differentiated itself with its series of protections and that its law is materially so laxer that firms are sometimes willing to attempt high-profile and controversial domestication to end up under Nevada law.

As the discussion above shows, the significance of Nevada's exculpation statute can hardly be understated: it is materially more protective to directors and officers than Delaware's law. It is significantly lax in how it contemplates and polices the duty of loyalty and the duty of care.

2. Demand Futiity - Nevada's Hurdles to Derivative Litigation

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142 *Weinberger v. UOP, Inc.*, 457 A.2D 701, 711 (1983).
143 DGCL §102(B)(7).
144 NRS §78.138(7)(B)(2). *See also Guzman v. Johnson,* 137 NEV. ADV. OP. 13 (2021) ("NRS 78.138(7) supplies "the sole avenue to hold directors and officers individually liable for damages arising from official conduct."").
145 C.A. NO. 2023-0449-JTL (Del. Ch. Feb. 20, 2024).
146 *Id*. at 10.

Nevada's expansive approach to exculpating directors and officers poses an obstacle for plaintiffs at the earliest stages of litigation. As a part of a pleading, shareholder derivative lawsuits traditionally require establishing "demand futility," which effectively shows that a board of directors is compromised in some way to proceed with the lawsuit.[147] In Delaware, to adequately plead to demand futility, plaintiffs must plead with particularity that at least half of the board would not "be able to bring their impartial business judgment to bear on a litigation demand."[148] Importantly, exculpated claims under Delaware law do not satisfy this standard "because they do not expose directors to a substantial likelihood of liability."[149]

The process has the exact broad contours under Nevada law. Still, the state's broad exculpation statute makes this stage of litigation much more difficult for plaintiffs seeking to bring a derivative lawsuit.[150] As one observer has noted, the Nevada exculpation provisions "make it exceedingly difficult to convince judges that a substantial likelihood of personal liability exists for purposes of establishing demand futility."[151]

The Nevada Supreme Court clarified this standard in the 2006 case, *Shoen v. SAC Holding Corp*,[152], explaining what plaintiffs must show to successfully plead to demand futility in a derivative lawsuit against a Nevada corporation. The court held that in Nevada, "directors and officers may only be found personally liable for breaching their fiduciary duty of loyalty if that breach involves intentional misconduct, fraud, or a knowing violation of the law. Accordingly, interestedness through potential liability is a difficult threshold to meet."[153] An immediate effect of the *Shoen* holding was to curtail an essential pathway to pleading demand futility.

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[147] *United Food & Commercial Workers Union & Participating Food Indus. Employers Tri-State Pension Fund v. Zuckerberg*, 262 A.3D 1034, 1074 (Del. Sept. 23, 2021) ("The purpose of the demand- futility analysis is to assess whether the board should be deprived of its decision-making authority because there is reason to doubt that the directors would be able to bring their impartial business judgment to bear on a litigation demand. ").

[148] *Id.* In Zuckerberg, the court held that the following three questions should be asked of each director: "(i) whether the director received a material, personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand." Demand is to be excused if the answer to any of the questions is yes for at least half of the directors. *Id*. at 1075.

[149] *Id*. at 1039.

[150] *City of Warren Police & Fire Ret. Sys. v. Tenet Healthcare Corp.*, NO. 05-19-00260-CV, 10 (Tex. App. Sep. 28, 2020) (citing *Shoen v. SAC Holding Corp.*, 137 P.3D 1171, 1179–80 (Nev. 2006)) ("In analyzing demand futility, Nevada courts generally follow the approach and reasoning of Delaware law.").

[151] Kieth Bishop, *Nevada's Director Liability Standard Defeats Another Derivative Suit,* C.A. CORP. L. (Oct 26, 2020), https://shorturl.at/psALV.

[152] 122 NEV. 621, 137 P.3D 1171 (Nev. 2006).

[153] *Id.*

Similarly, in *Chur v. Eighth Judicial District Court*, the Commissioner of Insurance for the State of Nevada argued that directors of an insurance company did keep themselves sufficiently informed about the firm's status and that this lack of oversight contributed to the firm's eventual insolvency.[154] On appeal, the Nevada Supreme Court upheld the lower court's dismissal of the claim.[155] Because the Commissioner did not allege facts that constituted a breach that was not already exculpated by NRS 78.138(7), which "provides the sole avenue to hold directors and officers individually liable for damages arising from official conduct,"[156] the court held that demand futility had not been adequately pled.

In another case, the plaintiffs were the *City of Warren Police & Fire Ret. Sys. v. Tenet Healthcare Corp*. ran into a similar outcome in 2020.[157] Here, plaintiffs attempting to bring a derivative lawsuit against a board of directors alleged that board members had continued to violate the law through a "bribes-for-referrals scheme."[158] The case was litigated in Texas under Nevada law and again was dismissed for failure to plead demand futility properly.[159] The court relied heavily on *Shoen* in its decision.[160]

Demand futility is an integral part of shareholder derivative litigation. Nevada's exculpation statute provides many protections for officers and directors. As the cases above show, one way they do that is by preventing litigation from starting.

3. Inspection Rights - Books and Records

Another critical difference between Nevada and Delaware concerns shareholders' rights to inspect corporate books and records. This right is essential to a shareholder's broader litigation rights. Potential plaintiffs can access materials that could help them bring a case in the face of suspected or potential wrongdoing by directors or management.

D.G.C.L. § 220 covers inspection rights in Delaware. After shareholders have made a procedurally proper demand for records, the burden shifts to the corporation to "establish that the inspection such stockholder seeks is for an improper purpose."[161] The statute allows the court to amend the stockholder request for records as needed.[162]

Shareholders must articulate a "proper purpose" under § 220 to get inspection rights; a shareholder seeking to investigate misconduct must show a "credible

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[154] *Chur v. Eighth Judicial Dist. Court*, 458 P.3D 336 (Nev. 2020).
[155] *Id.*
[156] *Id.*
[157] Texas App. LEXIS 7792 (2020).
[158] Bishop, *supra* note 111.
[159] *Id*.
[160] See *supra* note 118 and accompanying text.
[161] DGCL § 220(C)(3).
[162] *Id.*

basis" for a court to infer such wrongdoing.[163] The Delaware Supreme Court has called the credible basis standard in the preliminary § 220 analysis the "lowest possible burden of proof."[164] In short, the barrier to receiving books and records for Delaware shareholders looking into potential wrongdoing is relatively low.[165]

Nevada turns this posture of permissiveness on its head. It does offer its provision covering the rights of stockholders to inspect company records, which includes procedural requirements[166] for the request and a roughly analogous provision to Delaware, suggestive of a "purpose" requirement.[167] However, the Nevada provision also contains a powerful catch-all:

> [T]he provisions of [NRS 78.257] do not apply to any corporation that furnishes to its stockholders a detailed, annual financial statement or any corporation that has filed during the preceding 12 months all reports required to be filed under section 13 or section 15(d) of the Securities Exchange Act of 1934.[168]

This provision, added to the inspection law 1997, excuses publicly traded Nevada corporations from respecting stockholder inspection demands. In other words, so long as the firm furnishes its shareholders with the bare minimum required by federal law, it cannot be forced to share other corporate records. This allows firms to withhold one trove of vital information—board minutes and communication—from stockholders, even when there may be suspected wrongdoing. This enormously protective policy is almost the polar opposite of Delaware's rather expansive approach, and it presents yet another barrier to shareholders of Nevada firms who might otherwise seek to exercise their litigation rights in court.

4. Illustration: Steve Wynn and Wynn Resorts

Steve Wynn has been a fixture in the Nevada gambling industry for decades. Wynn long held a strong reputation in Las Vegas, and many credit his "visionary" status as primarily responsible for much of the growth in profile of the city that took place in the latter half of the 20th century.[169]

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[163] *Amerisourcebergen Corp. v. Lebanon County Emps.' Retirement Fund*, 243 A.3D 417, 425 (Del. 2020).
[164] *Id.*
[165] *See also*, Gail Weinstein, *Section 220 Decisions Amplify Stockholders' Rights to Inspect Books and Records*, HARV. L. SCH. FORUM CORP. GOV. (Oct. 3, 2022), https://shorturl.at/hsL02 (exploring recent § 220 holdings in Delaware and how they reflect a more permissive approach to books and records demands).
[166] NRS 78.257(1).
[167] NRS 78.257(2) (requiring that the stockholder submit an "affidavit to the corporation stating that the inspection… is not desired for any purpose not related to his or her interest as a stockholder.").
[168] NRS 78.257(7).
[169] Megan Messerly, Michelle Rindels & Jackie Valley, *The complicated legacy of Steve Wynn, a gaming visionary toppled by sexual misconduct allegations*, Nev. Ind. (Feb. 11, 2018).

Wynn's legacy, however, also included a long history of poor corporate governance practices and a negative culture, which contributed to and facilitated the systemic sexual harassment at Wynn Resorts. Through discussing Wynn's conduct over the years, this part will show how Nevada's lax corporate law—particularly the broad exculpation statute and the high hurdles to demand futility that plaintiffs face - contributed to these severe misconducts.

(a) Mirage Resorts

Wynn opened the Mirage Resort in Las Vegas in 1989.[170] To many, Mirage marked the beginning of "an era of mega-resorts on the Las Vegas Strip."[171] Yet, after taking the firm public, Wynn continued managing it as if it was his firm rather than a firm many public shareholders own. For instance, Wynn was leasing his art collection to the Las Vegas Bellagio Hotel for around $4M a year, which Wynn Resorts and its shareholders were paying.[172] When Wynn's stock declined, he had the board reprice his stock options.

When shareholders got frustrated with his high compensation, the maintenance costs of the art collection, and the self-dealing transactions, the Wynn stock price declined, and more so relative to its peers. MGM offered to acquire Mirage when identifying the undervalued stock as an opportunity. Wynn initially directed the board to reject the offer, and the board adopted a poison pill with a 10% trigger. Yet, as Mirage continued to raise its offer, the pressure mounted, and Wynn agreed to sell.

MGM Grand anticipated reduced costs from detaching from the art collection and some cash flow from selling private jets and a New York apartment that Mirage was paying for.[173] But Mr. Wynn was far from done. His lesson from this experience was maintaining control of his next company, Wynn Resorts. Together with his wife, they held around 20% of Wynn Resorts.

(b) Wynn Resorts - Different Company, Similar Problems

Steve Wynn has brought his blessings and curses to Wynn Resorts. Wynn's self-dealing practices did not subside. The company was paying the maintenance

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https://thenevadaindependent.com/article/the-complicated-legacy-of-steve-wynn-a-gaming-visionary-toppled-by-sexual-misconduct-allegations.

170 Zee Kallab, *The Mirage turns 33 years old, facing uncertain future amid Hard Rock takeover*, KTNV.com (Nov. 22, 2022), https://shorturl.at/aJMT3

171 *Id.*

172 Graef Crystal, *Steve Wynn Wins for Losing*, Courtesy of Kirk Kerkoria, BLOOMBERG (March 6, 2000).
https://shorturl.at/dCK79

173 Andrew Pollack, *MGM Grand to Acquire Mirage Resorts for $4.4 Billion*, N.Y. TIMES (March 7, 2000) ("MGM Grand is also likely to sell assets, like Mirage's airplanes and an apartment in New York.") https://shorturl.at/iozOR

costs of his art collection - insurance and taxes.[174] Most board members had a significant relationship with Steve Wynn or the firm.

Proxy advisory firms ISS and Glass Lewis routinely criticized Wynn Resort's governance, or lack thereof, excessive self-dealing transactions and lack of independence of its board members. In 2013, ISS gave Wynn the lowest governance risk ranking in a report detailing the company's numerous self-dealing transactions with Steve Wynn and several company directors.[175] The board voted only three times against Steve Wynn in over a decade.[176]

Shareholders also voted in large proportion against the firm's compensation packages. However, the self-dealing transactions and the compensation were not followed by shareholder lawsuits, probably due to Nevada's exculpation statute and shareholders' limited inspection rights. Yet, eventually, inside board fights opened the door to a derivative lawsuit.

(c) Shareholder Lawsuit - Louisiana Municipal Employees Retirement System v. Wynn

Recurrent self-dealing transactions, excessive compensation, and conflicted board members did not provide a viable shareholder claim under Nevada law. It was a donation made by the Wynn subsidiary, which finally opened a crack in the door for a non-exculpated breach of fiduciary duty claim against the board - one based on "knowing violation of law." The suit centered on a $135 million donation to the Macau Development Foundation by the subsidiary, which shareholders alleged was a bribe.[177]

1. Demand Futility - Knowing Violation of Law

The 2016 decision by the 9th Circuit in *Louisiana Municipal Employees Retirement System v. Wynn* further illustrates Nevada's high bar for shareholder litigation.[178] The district court dismissed the case because the plaintiffs had not adequately pleaded to demand futility.[179] Part of the proper demand futility

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174 Wynn Resorts Limited Proxy Statement (Schedule 14A) (2014), available at https://shorturl.at/mrzHL ("Artwork. Since June 2006, WYNN LAS VEGAS, LLC has leased certain fine art pieces from Mr. Wynn for an annual fee of one dollar ($1). WynnLas Vegas is responsible for all expenses incurred in exhibiting and safeguarding those works that it exhibits under the lease, including the cost of insurance and taxes.").

175 Christopher Palmeri & Jeff Green, *Harassment Claims Add to History of Issues With Wynn Board*, BLOOMBERG (Jan. 28, 2018), https://shorturl.at/ADNP3 ("The 10-member Wynn board includes Clark Randt, who received a $600,000 consulting agreement in 2015 before his appointment to the board, and J. Edward Virtue, who managed money for the Wynn family prior to 2012, Glass Lewis noted.").

176 *Id.* ("Wynn Resorts' board was widely viewed as compliant with the CEO's wishes. The board had voted against Wynn only three times since 2002.").

177 *Id.*

178 829 F.3D 1048 (9th Cir. 2016).

179 *Id.*

pleading required a showing that the directors' impartiality regarding the demand was compromised because they "face[d] a substantial likelihood of personal liability for any wrongdoing."[180] Upon appeal, the 9th Circuit affirmed the dismissal, emphasizing again that Nevada requires knowledge that the act is illegal:

> "Nevada law requires knowledge or intent before director liability attaches…[and] even assuming that the Macau donation did violate the [Foreign Corrupt Practices Act], the allegations do not create a reasonable inference that any of the individual directors intended or knew that it would do so, as Nevada law would require."[181]

The particularity of the pleading requirement required here—a showing that directors knew and intended to violate a law—is difficult for plaintiffs to meet and correspondingly makes it difficult for litigation to get off the starting blocks. Mainly since, on top of that, as explained below, Nevada shareholder inspection rights are significantly weaker than in Delaware.[182]

It did not matter that the plaintiff alleged that the board "voted in favor of the donation to the Foundation without any evidence that this donation was compliant with the law and the Company's policies."[183]

2. Demand Futility – The majority of the board is beholden to Steve Wynn.

The court also discussed and rejected the second basis for demand futility - that directors have self-interest or are beholden to a person with self-interest. The district court determined that Steve Wynn had a self-interest in the redemption of Okada stock, as it made him the largest Wynn resort shareholder.[184] The plaintiffs argued that a majority of the board is beholden to Steve Wynn and thus needs to be more capable of impartially considering the demand.[185] To that end, the plaintiff was burdened to show that at least two other directors were beholden to Steve Wynn.

The plaintiffs argued that Miller, a long-time member of the Wynn board, is interested in several reasons. First, he is a partner in a company that sells rose nectar to Wynn and is a director at another company that provides services to

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180 *Id.* at 1057.
181 *Id.*
182 *See supra* Part IV.B.3.
183 *Id.* The court also relied on the fact that Nevada authorities eventually ceased the investigation after filing the complaint.
184 *La. Mun. Police Emps. Ret. Sys. v. Wynn*, 2:12-CV-509 JCM (GWF) (D. Nev. Mar. 13, 2014)("...plaintiffs have met their burden under the heightened pleading standard of Rule 23.1 that Wynn was interested in the redemption of Okada's shares, at least to the extent that the redemption resulted in Okada no longer holding the position of the company's largest shareholder.").
185 *Id.*

Wynn. Steve Wynn donated $70,000 to his political campaign to win reelection as Nevada governor. He also donated to Miller's son when he ran for Nevada secretary of state from 2006 to 2012. Miller, in turn, testified on behalf of Steve Wynn in a libel suit that he brought against an author. In his testimony, he described himself as a "23-year-old friend of Wynn's" [186] The court found these ties insufficient to argue that Miller is beholden to Steve Wynn since the facts fail to allege the materiality of these personal and financial connections to Miller.[187]

The plaintiffs argued that another director, Wayson, is interested for the following reasons.[188] First, his father and Wynn's father were partners during the 50s. Second, his brother and sisters worked with Steve Wynn. Third, Wayson worked in other entities that Wynn controlled and received "substantial monetary compensation" from these entities. Fourth, he currently has business activities with Steve Wynn. Yet, the court decided that the forgoing was insufficient to plead a lack of independence since these economic ties were not material.[189] Thus, despite these board members' numerous financial and personal connections to Steve Wynn, the court found that the plaintiff did not argue with particularized facts that the board members are beholden to Wynn.

(d) Shareholder Lawsuit and Settlement in Sexual Harassment Litigation

In early 2018, the *Wall Street Journal* reported that dozens of people, among them employees, recounted patterns of sexual harassment and misconduct by Steve Wynn over several decades. In response to the article,[190] Wynn Resort's stock declined more than ten percent in one day and continued to fall in the following days.[191] Less than two weeks after the report, Steve Wynn resigned as CEO and Chairman of the board of Wynn Resorts.[192]

On February 22, 2018, the New York State Comptroller, Thomas Dinapoli, on behalf of the New York state's retirement funds, submitted a derivative shareholder lawsuit against Wynn Resorts' board of directors.[193] The complaint alleged that the board learned about these allegations in March 2016 (if not before),

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[186] *Id.*
[187] *Id.* ("[T]he Delaware Supreme Court "has rejected the suggestion that the correct standard for materiality is a 'reasonable person' standard; rather, it is necessary to look to the financial circumstances of the director in question to determine materiality.")
[188] *Id*. at 1060.
[189] *Id.*
[190] Alexandra Berzon, Chris Kirkham, Elizabeth Bernstein &Kate O'Keeffe, *Dozens of People Recount Pattern of Sexual Misconduct by Las Vegas Mogul Steve Wynn*, WALL ST. J. (Jan. 27, 2018), https://www.wsj.com/articles/dozens-of-people-recount-pattern-of-sexual-misconduct-by-las-vegas-mogul-steve-wynn-1516985953.
[191] Lucinda Shen, *Wynn Resorts Loses $3.5 Billion After Sexual Harassment Allegations Surface About Steve Wynn*, FORTUNe (Jan. 29, 2018), https://fortune.com/2018/01/29/steve-wynn-stock-net-worth-sexual-misconduct/.
[192] Maggie Astor & Jullie Creswell, *Steve Wynn Resigns From Company Amid Sexual Misconduct Allegations*, N.Y. TIMES (Feb. 6, 2018), https://shorturl.at/mouAS.
[193] *Id*.

detailed in a lawsuit submitted by Elaine Wynn, Wynn's ex-wife and a former board member.[194] The board did not act on these allegations or even cover them until they were exposed in the 2018 article.

The board defendants moved to dismiss the case, arguing that "the complaint failed to meet the standards under Nevada law to show that demand would be futile because the Amended Complaint failed to plausibly allege that a majority of the Board engaged in intentional misconduct, fraud or a knowing violation of the law."[195] On September 6, 2018, the Court denied the defendant's motion to dismiss, finding that the lead plaintiffs pleaded sufficient facts to show that a majority of the board faces substantial likelihood for the personal liability of two non-exculpated claims - knowing violation of law and insider trading. [196]

The judge found that plaintiffs had shown with particular facts that the board knew about the allegations and that the firm was obligated to report these conduct to its shareholders and gaming regulators. The plaintiff pointed to a press release by the company on March 28, 2016, in response to the allegations, which reveals this knowledge. As the press release states:

> "[a]s a leader in a highly regulated industry, Wynn Resorts prides itself on transparency and full disclosure to regulators and shareholders. Allegations made by Ms. Wynn that the company would hide any relevant activities from our regulators are patently false."[197]

Second, the judge found that the plaintiff brought other circumstantial evidence supporting the board's knowledge of the allegations against Wynn, including a lawsuit that Steve Wynn's victims filed with the EEOC against him and the board and evidence that the Wynn Resorts' General Counsel and several other executives knew about the allegations.

Concerning the second basis for liability, insider trading, the plaintiffs alleged that five Wynn directors sold over 58,000 shares at a value of more than $6 million right after the company statement on March 28, 2016, in suspiciously high-volume shares.[198] Due to the majority of the board's suspicious trading activity, demand was held to be futile based on the substantial likelihood of liability for insider trading by a majority of the board.[199]

5. Standards of Review Applied to Management's Use of Defensive Tactics

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[194] *Wynn Resorts, Ltd. Derivative Litigation*, Past Cases, Cohen Milstein (2021), https://shorturl.at/ACDP2.

[195] *Id.*

[196] *Thomas P. DiNapoli. v. Stephen A. Wynn, et al.*, CASE NO. A-18-770013-B, (Nev. Dist. Ct. 2018).

[197] *Id.* at 5.

[198] *Id.*, at 7.

[199] *Id.*

(a) Delaware: Intermediate Standards of Scrutiny Apply to Managers' Use of Defensive Tactics

Delaware courts apply an intermediate standard of review to managers' use of defensive tactics in the face of takeovers. This has long been a challenging area of conduct to adjudicate: as Professors Ronald J. Gilson and Reinier Kraakman wrote in 1989:

> "The courts have long struggled with a standard for reviewing management's efforts to deter or defeat hostile takeovers… Because evaluating a sale of the company is a complex business decision, management's response to a takeover bid resembles the normal business decisions that the business judgment rule largely insulates from judicial review. At the same time, however, a hostile takeover creates a potential conflict of interest, no matter what response it evokes from management."[200]

Over time, Delaware courts have developed three enhanced standards of scrutiny to review different kinds of corporate conduct resulting from defensive, antitakeover tactics.

In *Unocal v. Mesa Petroleum Co.*, the Delaware Supreme Court held that directors can take defensive actions in the case of a threatened takeover if "they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the defensive measures taken by the board were "reasonable in relation to the threat posed."[201] The *Unocal* standard aimed to balance a tradition of deference for business decisions and the dangers inherent in conflicted decision-making: as the court described, the approach was "designed to ensure that a defensive measure to thwart or impede a takeover is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders."[202] Another critical concern often discussed by courts here is the concept of "entrenchment:" the idea that boards would take steps to entrench themselves in their positions at the expense of shareholders or the company itself. *Unocal* is still good law and applies where directors attempt to fend off hostile takeovers and threats from activist investors.[203]

Next, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court held that, in situations where a company's sale or dissolution becomes inevitable, directors are charged with getting the best price possible for

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[200] Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review*, 44 BUS. L. 247, 247 (1989).
[201] *Id*. at 955, 949.
[202] *Id*. at 955.
[203] *See, e.g.*, *In re Ebix, Inc. Stockholder Litigation*, C.A. No. 8526-VCN, 2016 WL 208402 (Del. Ch. Jan. 15, 2016) (holding that *Unocal* enhanced scrutiny applies to a board that adopted certain defensive bylaw amendments in the face of a threat from an activist investor).

shareholders.[204] As the court described, once a change of control was guaranteed, the board's role shifts "from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[205] Where *Unocal* applies to boards that still have the opportunity to maintain control, courts apply *Revlon* to review the conduct of boards that engage in the sale process. *Revlon* explicitly contemplates the dangers of boards "playing favorites" in the auction or sale process as the chief danger the test is trying to defend against.[206]

Finally, in *Blasius Indus. v. Atlas Corp.*, the Court of Chancery held that boards must demonstrate a "compelling justification" for any acts interfering with shareholder votes.[207] Protecting the shareholder vote was the critical focus of *Blasius*: as the court held, "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[208] Delaware courts' particular sensitivity to intrusions on the shareholder franchise has drawn out a test for enhanced scrutiny that deals with these inclusions. Indeed, it applies both in the takeover context and outside of it.[209] *Blasius* is important enough that the Delaware Supreme Court has held that it is distinguished from the stringent entire fairness standard for what it protects, describing *Blasius* as a "different and necessary [type] of judicial review."[210]

These three cases—*Unocal*, *Revlon*, and *Blasius*—form the basis for "enhanced scrutiny" of director and manager actions taken in the face of threats to corporate control. None of them adopt strict, per se rules as standards. However, they allow courts in Delaware to balance the business judgment decisions of boards and officers while holding up some protection for shareholders.

(b) Nevada and NRS 78.139

Nevada has taken a sharply different approach to reviewing anti-takeover actions by directors and officers. In 1999, the legislature adopted NRS 78.139 concerning the duties, presumptions, and powers of officers and directors confronted with a potential change of control.[211] These provisions developed out of an intent to differentiate from Delaware: they were adopted two years after the decision in *Hilton Hotels Corp. v. ITT Corp.*, in which the District Court of Nevada held that Nevada law was governed by Delaware caselaw (namely, *Unocal* and

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[204] 506 A.2D 173, 182 (Del. 1986).
[205] *Id.*
[206] *Id*. at 184.
[207] 564 A.2D 651, 661 (Del. Ch. 1988).
[208] *Id.* at 659.
[209] *See, e.g.*, *Coster v. UIP Cos*., 2020 WL 429906 (Del. Ch. Jan. 28, 2020).
[210] Id. at *17. *See also Marion Coster v. UIP Companies, Inc.*, NO. 49, 2020 (Del. June 28, 2021); Jason M. Halper, Jared Stanisci & Victor Bieger, *Delaware Supreme Court's Response to Chancery for Turning Away Stockholder's Claims*, HARV. L. SCH. FORUM CORP. GOV (July 29, 2021), https://shorturl.at/rKWX3.
[211] NRS 78.139.

Blasius) in the antitakeover context.[212] In considering the 1999 change, Nevada legislators expressly contemplated the implications of the *Hilton Hotels* decision for their law: "The Executive Committee believes the [*Hilton Hotels*] decision contained language which could be interpreted too broadly and wish[es] to clarify Nevada law by changing NRS 78.138."[213]

NRS 78.139 effectuated several changes in Nevada law, which can be understood by referencing *Unocal*, *Revlon*, and *Blasius* in Delaware. First, it adopted the *Unocal* standard that was applied to the use of defensive tactics by boards in Delaware and was applied to interference in the shareholder franchise in Nevada. In other words, Nevada directors are permitted to impede shareholders' right to vote on corporate matters if they i) reasonably perceive a threat to corporate policy and ii) the imposition on the shareholder franchise is "reasonable in relation to the threat."[214] In other words, the Nevada legislature replaced the higher *Blasius* standard with the lower *Unocal* standard in situations where shareholders allege that their franchise has been impeded.

Moreover, the Nevada legislature replaced both the *Unocal* and *Revlon* enhanced standards of scrutiny with simple business judgment deference.[215] This means that directors who engage in defensive tactics receive deference from the court in Nevada, and the balancing analysis set out in *Unocal* for Delaware corporations is wholly set aside. Similarly, even when a sale is inevitable, Nevada directors will still receive business judgment deference, which abrogates any *Revlon*-style obligation to get the best price for shareholders in the state.

The effect of these changes is summarized in Table 1 below:

Table 1: Standards of Review for Use of Defensive Tactics[216]

	Delaware	Nevada
Use of DT to remain independent	Unocal	BJR
Use of DT when sale is inevitable	Revlon	BJR
Interfere with SH Franchise	Blasius	Unocal

[212] 9718 F. Supp. 1342 (D. Nev. 1997); *see also* Keith Paul Bishop, *Nevada Legislature Ponders Rejection Of Unocal And Revlon Standards*, C.A. CORP. LAW (March 23, 2017), https://shorturl.at/jxBCG.

[213] Memorandum from John P. Fowler, Chair, Exec. Comm., BUS. LAW SECTION, STATE BAR OF NEV. TO S. JUDICIARY COMM., STATE OF NEV. 5 (Feb. 3, 1999), available at https://shorturl.at/yzMW8.

[214] NRS 78.139(1)(a)–(b).

[215] *See* NRS 78.138(3) ("Except as otherwise provided in subsection 1 of NRS 78.139 [concerning board actions that impede the stockholder franchise], directors and officers, in deciding upon matters of business, are presumed to act in good faith, on an informed basis and with a view to the interests of the corporation.")

[216] NRS 78.139(1)(a)–(b).; *See also* Barzuza, *supra* note 8, at 957.

C. The Home States - Why Texas?

Delaware also faces increasing competition from other states. Facing hurdles in reincorporating Tesla into Nevada, Elon Musk has redirected Tesla from Nevada to Texas. Indeed, unlike Nevada, Texas hasn't positioned itself as a low-liability regime. Thus, reincorporating Tesla into Texas is likely more feasible than reincorporating Tesla into Nevada. To begin with, shareholders might oppose a reincorporation to Nevada's lax regime but less so to Texas. Second, Texas corporate law is not as different from Delaware law, and thus, a reincorporation to Texas is less likely to be considered a self-dealing transaction that triggers the entire fairness review in Delaware court. In that case, the board's approval to reincorporate will award the deference of the business judgment rule, and a majority vote of the shareholders, including votes of a controlling shareholder, would suffice to consummate the reincorporation.

Texas, however, is not just another state: it is where Tesla's headquarters are located, where Tesla hires employees, and where it pays state taxes. Even if Texas does not currently offer high litigation bars, Tesla's management will have political clout that it can leverage to lobby for changes in Texas law. Indeed, during the 1980s, when managers faced a wave of hostile takeovers, they lobbied their home states successfully to pass antitakeover statutes - statutes that empower them to block acquirers, including ones that offer shareholders a high premium above market price for their stock.[217] Due to this lobbying, 42 states passed at least one antitakeover statute, up to a maximum of five.[218]

The vast majority of firms that do not incorporate in Delaware incorporate in their respective home states, where their headquarters are located. Scholars have argued that even though they retain many of their firms, the home states do not actively compete with Delaware, have only weak incentives to attract incorporations, and would face significant barriers to entry if they did so.[219] Other than Delaware indeed, no state charges a considerable incorporation tax,[220] and even if they did charge an amount similar to Delaware, for most of the states that would not result in a significant change to their budget.[221] Most states did not establish specialist business courts; their courts decide cases with juries and frequently don't publish their cases.[222]

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[217] Roberta Romano, *The Political Economy of Antitakeover Statutes,* 73 VA L. REV. 111 (1987).
[218] *See* Lucian A. Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate,* 46 J. L. & Econ. 383, 407, TBL. 9 (2003).
[219] *See* Bebchuk & Hamdani, *supra* note 3, at 563–64.
[220] *See* Kahan & Kamar, *supra* note 2, at 687–92.
[221] Since Delaware is a small state, incorporation taxes constitute a considerable contribution to its annual budget. *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2429 TBL.1 (1998)
[222] *See* Kahan & Kamar, *supra* note 2, at 712–13.

Yet, in recent years, home states have become more active in assuming a role as a destination for incorporations. More than half of the states have established business courts, and some have amended corporate law.[223] Most notably, Texas has entered the market by proactively catering to firms, establishing a new system of business courts, and publicizing it. Texas lawmakers established its specialized system of business courts this year.[224] While they will begin operating in the fall, the business courts will have several key features that might make the state more attractive to incorporate: they will have both injunction power and the power to grant relief. They will have concurrent civil jurisdiction over matters in which the amount in controversy exceeds $5 million and relates to derivative proceedings, corporate governance actions, alleged self-dealing, and other corporate issues.[225]

The business courts must be staffed by judges with ten or more years of experience in complex commercial litigation.[226] To date, reports indicate that Governor Greg Abbott has faced headwinds in actually finding attorneys to appoint to this new court, as the Texas legislature has consistently failed to increase compensation for members of their state judiciary at large (the salary for judges in the new business court begins at $140,000).[227]

The business courts have yet to start hearing cases, so their success in bringing more firms to Texas awaits to be seen. However, personal involvement from Texas officials with Musk has served to heighten the competitive pressure on Delaware. After Musk's Tesla pay package was considered unfair in *Tornetta*, Musk sent out a "poll" to his 175 million followers on X. The poll asked whether Tesla should change its state of incorporation to Texas.[228] Of the 1.1 million respondents to the survey, over 87% voted "yes."[229] Governor Abbott responded to Musk's poll on X with a celebratory tone, writing, "Elon, it's over. The election desk is declaring a landslide victory for Texas."[230] The business court legislation and the public encouragement by the state's governor represent a new stage of Texas's attempt to become a more relevant state competitor. The home state threat will become even more significant in the coming years. As shown in the following Part, reincorporation to a firm's home state might be substantially easier than moving to Nevada.

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223 *See* Dimarie Alicea-Lozada, *Business Courts Expanding Across the States*, National Center for State Courts (August 9, 2023) https://shorturl.at/cikI4.
224 TEX. GOV'T CODE § 25A.
225 *Id.* at §25A.008(A)(4).
226 Ryan Autullo, *Low Pay Plagues Judicial Recruitment in New Texas Business Court*, BLOOMBERG LAW (Dec. 14, 2023), https://shorturl.at/hnBRW.
227 *Id.*
228 @elonmusk, X, (Jan. 30, 2024, 7:40 PM), https://shorturl.at/jQTV3.
229 Keep in mind that anyone with an account on X could reply to the poll — it was not limited to Tesla shareholders or even Musk's followers.
230 @GregAbbott_TX, X, (Jan. 30, 2024) https://shorturl.at/bJL05.

IV. Implications for Delaware Corporate Law

A. The Law of Reincorporation: Palkon v Maffei[231]

Reincorporation—the act of incorporating a firm in another jurisdiction—typically carried out via mergers, conversions, or redomestications. The following Section will discuss reincorporation under Delaware law and the implications of the preceding differences between Nevada and Delaware on the judicial scrutiny of reincorporations.

1. Background

TripAdvisor is one of the world's largest travel websites, with online visitors reaching into the hundreds of millions annually.[232] A Delaware corporation, it is owned and controlled by its Delaware parent company, Liberty TripAdvisor Holdings.[233] Liberty, in turn, is controlled by its CEO and Chairman, Gregory Maffei, who controls 43% of its voting power.[234] Maffei is thus the controlling shareholder of both Liberty and the TripAdvisor subsidiary.

Late in 2022, TripAdvisor's management presented to its board about a potential redomestication from Delaware to Nevada.[235] The topic was revisited at several board meetings throughout 2023. At these meetings, several advantages of Nevada law were presented to the directors. Among the advantages discussed were the following: TripAdvisor's management believed that "Nevada law generally provides greater protection from liability to the Company and its D&Os than Delaware law," and also pointed to the fact that *Revlon* duties obligating boards to get the highest price available in a sale context did not exist in Nevada.[236] Also discussed was the extensive litigation that Maffei and Liberty had faced in Delaware in the preceding years, along with the "substantial time and expense" this litigation caused.[237]

In April 2023, the TripAdvisor board approved a final resolution to convert the company to a Nevada corporation.[238] TripAdvisor and its Liberty parent prepared proxy materials explaining the conversion to their respective shareholders. TripAdvisor's proxy materials stated, "We believe, in general, Nevada law generally provides greater protection from liability to the Company and its D&Os than Delaware law."[239] It also disclosed that "[t]he Redomestication

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231 *Palkon v. Maffei*, C.A. No. 2023-0449-JTL (Feb. 20, 2024).
232 TripAdvisor Inc., *Annual Report* (Form 10-K) (2023), U.S. SECURITIES AND EXCHANGE COMMISSION. (February 16, 2024).
233 *Palkon* at 7.
234 *Id.*
235 *Id.*
236 *Id.* at 10.
237 *Id.* at 9. Liberty has dealt with at least eight stockholder lawsuits in Delaware since 2012.
238 *Id.*
239 *Id.* at 10.

will result in the elimination of any liability of an officer or director for a breach of the duty of loyalty unless arising from intentional misconduct, fraud, or a knowing violation of law."[240] Liberty's proxy statements offered substantially the same reasoning and disclosure.

In June 2023, most of each group of stockholders approved the redomestications to Nevada. However, this result was likely driven by Maffei's control of Liberty and Liberty's control of TripAdvisor. Only about 5% of minority TripAdvisor shareholders (unaffiliated with Liberty) and about 30% of minority Liberty shareholders voted to approve the conversion.[241]

2. The Lawsuit

Shareholders filed suit in the Delaware Court of Chancery to challenge the conversion transaction, asserting that it was self-interested and failed to meet the scrutiny imposed by the entire fairness review.[242] The plaintiffs sought an injunction of the transaction and damages.[243] Focusing on the heightened protection afforded to directors, officers, and controlling shareholders by Nevada law, the complaint framed the central issue of the case as follows:

> *The core question, in this case, is whether fiduciaries of a Delaware corporation – still bound by Delaware law and the duty of loyalty – can use their control over the corporation to force the company and its minority investors to give up all of Delaware law's protections, with the sole purpose being to insulate the conflicted controller and insiders from accountability.*[244]

The plaintiffs asserted that "[i]t is unfair for a controller to unilaterally eliminate public stockholders' ability to sue the controller and their directors…The Conversions essentially deprive Plaintiffs and other public stockholders of that right without any fair process or providing the minority any consideration."[245] The plaintiffs characterized the transaction as impermissible self-dealing, arguing that Maffei in the board stood to receive a benefit in the form of increased protection from suit and liability from shareholders and that shareholders had not been compensated for giving up that right of the suit.

By contrast, the defendants argued in their reply brief that the complaint should be dismissed.[246] The defendants argued that they should be entitled to business judgment deference because they comply with DGCL §266,[247] and

[240] *Id.*
[241] *Id.* at 11.
[242] Complaint at 3, *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL (Feb. 20, 2024).
[243] *Id.* at 35.
[244] *Id.* at 7.
[245] *Id.* at 5.
[246] Opening Brief in Support of Defendants' Motion to Dismiss the Amended Complaint at 15, *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL (Feb. 20, 2024).
[247] D.G.C.L § 266 covers the rules surrounding corporate conversion in Delaware.

because the plaintiff failed to plead a self-interested transaction adequately.[248] They also disputed the materiality of the differences between Delaware and Nevada law, arguing that "Nevada's allegedly greater protection from litigation for Maffei and the other Directors" did not constitute a "unique benefit."[249]

Analysis in the Court of Chancery

After a hearing on the motion to dismiss, Vice Chancellor Travis Laster issued an opinion on *Palkon v. Maffei* in February 2024.[250] The opinion partially denied the defendant's motion to dismiss, rejecting the plaintiff's request for an injunction, effectively allowing the conversion to proceed.[251] The court held that, at a minimum, the plaintiff pleaded enough for the suit to get past the motion to dismiss—the procedural impact of the opinion, for now, is to allow the case to proceed as a dispute about potential damages flowing from the alleged breach of fiduciary duties.[252]

Despite the early procedural posture, the opinion contained several elements that shed some light on how Delaware courts might consider reincorporations to Nevada. The court engaged in an extended discussion of the broad relative differences between Nevada and Delaware law, the first of its kind in a Delaware court. It also hinted at how those differences may be material in Delaware courts. Because of the procedural posture, the court's analysis reflected what kinds of inferences might be supported about Nevada law. It did so chiefly by pointing to TripAdvisor's materials:

> *"The real question for determining the standard of review is whether a decision confers a material benefit on the fiduciaries who made it. It is reasonable to infer at the pleading stage that the conversions will confer a material benefit on the fiduciary defendants who approved them. The defendant directors focused on the ability of the conversions to reduce or eliminate litigation risk. The board materials discussed those issues and called out past cases. And the proxy statements told the stockholders that the directors recommended the conversions to reduce or eliminate litigation risk."*[253]

The court also framed "litigation rights" in relation to the other core rights that Delaware shareholders possess. It held that the "fundamental" rights to "sell, vote, and sue" are each tied to "a category of entitlements that stockholders possess: economic rights, governance rights, and litigation rights."[254] In concluding that a drawback on economic or governance rights would likely trigger an entire fairness

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[248] Opening Brief in Support of Defendants' Motion to Dismiss the Amended Complaint at 15, 20, *Palkon v. Maffei*, C.A. NO. 2023-0449-JTL (Feb. 20, 2024).
[249] *Id*. at 20.
[250] *Palkon v. Maffei*, C.A. No. 2023-0449-JTL (Feb. 20, 2024).
[251] *Id.* at *51*–52 ("The court will retain jurisdiction over the individual defendants even after the conversion is complete.")
[252] *Id.*
[253] *Id*. at 32.
[254] *Id*. at 44 (citing *Strougo v. Hollander* 111 A.3D 590, 595 N.21 (Del. Ch. 2015)).

review, the court held that "[t]he same should be true for litigation rights."[255] In making this holding, the court noted that these three categories of rights are necessarily bound up: "[e]conomic rights and governance rights remain meaningful only to the extent that litigation rights back them up. Without legal protection, an investor's capital becomes a gift."[256] The court concluded its discussion of litigation rights with a pronouncement that may have some bearing on future cases involving redomestication to Nevada: "[f]rom the perspective of equity, Delaware law should be just as concerned about transactions that reduce stockholders' litigation rights as it is about transactions that reduce their economic rights or governance rights."[257] While the exact materiality of the differing litigation rights offered by Nevada and Delaware are yet to be ruled on as a matter of law, this form of analysis is likely to feature prominently in later stages of the litigation.

Another focus of the *Palkon* opinion was whether the entire fairness standard should govern the court's dispute review. Regarding the entire fairness standard of review, the court detailed the standard's substantive and procedural fairness prongs.

The court first explained that substantive fairness is questioned because the stockholders will be left with something different from what they had before the conversion.[258] As the court held, "[a]fter the conversion, the unaffiliated stockholders will possess only the litigation rights provided by Nevada law… those litigation rights are invariably less than what Delaware provides."[259] Again, "inferably less" is the furthest the court could take this holding for now, given the early stage of litigation.

Regarding procedural fairness, the court also held that the plaintiffs had pleaded enough to defeat the motion to dismiss. The court stated that the "goal of procedural fairness is to replicate arm's length bargaining" and that the "defendants did not make any effort to replicate arm's length bargaining."[260] The court also relied on the shareholder vote results to support its holding: "The unaffiliated stockholders' voting pattern supports an inference of unfairness….[h]ere, [they] resoundingly rejected the conversions."[261] As noted above, a mere 5 percent of the minority TripAdvisor shareholders voted to approve the deal.[262]

One way that controllers can altogether *avoid* an entire fairness review of a conflicted transaction is through the use of the twin *MFW* protections.[263] In that case, the Delaware Supreme Court held that controllers can avoid entire fairness

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[255] *Id*. at 46.
[256] *Id*. at 46–47.
[257] *Id*. at 47 (citing *In re Fox Corp./Snap Inc.*, ___A.3d ___, 2024 WL 176575 (Del. Jan. 17, 2024)).
[258] *Id*. at 40–41.
[259] *Id*. at 41.
[260] *Id*.
[261] *Id*.
[262] *Id*. at 11.
[263] *Kahn v. M&F Worldwide Corp.* (*MFW*), 88 A.3D 635 (Del. 2014).

scrutiny if they condition a conflicted transaction on approval by a committee of independent directors and the majority of unaffiliated shareholders.[264] Here, the *Palkon* court made it clear that the defendants *could have* availed themselves of the *MFW* protections in this move to Nevada: "[i]f directors proposed a similar conversion for a corporation with a stockholder controller, and if they properly conditioned the transaction on the twin *MFW* protections, then the dual approvals would be dispositive… triggering an irrebuttable version of the business judgment rule."[265] However, in this case, there was no cleansing: neither party even suggested that "the conversions were cleansed in any way."[266]

3. Implications for Reincorporation to Nevada and Other States

Vice Chancellor Laster's opinion in *Palkon v. Maffei* was a ruling on a motion to dismiss. As such, the longer-term effects of its holdings are not yet apparent: litigation on the merits is still pending, and a mid-February announcement by TripAdvisor that it would seek an acquisition may curtail the proceedings altogether.[267]

The case demonstrates the challenges that Delaware faces in responding to rising competition. The vexing question faced by Delaware was when they were presented with a case involving a firm trying to *leave* the state. Delaware wants to avoid being seen as a locked "Hotel California" from which firms may never leave. At the same time, however, its courts also have a long tradition of responsibly protecting minority shareholders' rights, particularly when challenging forms of self-dealing. Perhaps the court's decision to dismiss the injunction and allow TripAdvisor to proceed with the conversion while simultaneously allowing the damages claim against Maffei to live on is the court's way of splitting the difference on this challenging issue.

Looking ahead, the opinion provides a window into how Delaware courts might structure their thinking about firms attempting to relocate to Nevada—or other states—in the future. Vice Chancellor Laster's discussion of "litigation rights" is likely to figure prominently in any such analysis to ground the differences in legal regimes in the two states.

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[264] *Palkon* at 41.

[265] *Id.* at 4.

[266] *Id.* While it was less directly relevant to the *Palkon* case, the court also outlined a second way a hypothetical company, lacking a controlling shareholder, could get business judgment deference on the move out of Delaware: "[i]f a board proposed a similar conversion for a corporation without a stockholder controller, and if the fiduciaries fully disclosed the consequences of the change in legal regimes, including the effect on stockholder litigation rights, then the stockholders' approval of the conversion would be dispositive, triggering an irrebuttable version of the business judgment rule." *Id.*

[267] *Id.* at 12; *See also* Press Release, *Tripadvisor Announces Formation Of A Special Committee Of Independent Members Of Its Board Of Directors*, TRIPADVISOR (Feb. 12, 2024). https://shorturl.at/cvHY0.

This Article analysis focuses on the question at the center of *Palkon v. Maffei*. As Vice Chancellor Laster explains, if Nevada law sufficiently deprives shareholders of the litigation rights they retain under Delaware law, this finding alone could be enough to characterize a reincorporation as self-dealing subject to an entire fairness review.[268] The court spoke directly to this issue being central to the case: "[a]t the pleading stage, it is reasonable to infer from the complaint's allegations that Nevada law provides greater protection to fiduciaries and confers a material benefit on the defendants. To the extent the defendants wish to show that Delaware law and Nevada law are equivalent, they can attempt to make that showing at a later phase of the case" for damages.[269] The findings offered by this article suggest that the finding should be made when all is said and done—the differences in shareholder rights and managerial insulation from suit are too vast to be immaterial.

As the court explained, if reincorporation to Nevada is indeed considered a self-dealing transaction, then reincorporation to Nevada would be subject to Delaware's highest level of scrutiny: the standard of entire fairness. The standard requires the defendant to prove the fairness of the process and the price.[270]

While this standard is difficult to meet, procedural mechanisms could shift the burden of proof to the plaintiff or even award the transaction with the high deference of the business judgment rule. Moreover, the Palkon opinion also appears to endorse a pathway by which even a controlled company could relocate from Delaware to Nevada insulated by business judgment review: by conditioning the move on MFW's twin protections. Under MFW, a controlling shareholder like Maffei can gain the protection of the business judgment rule by conditioning the transaction to meet two cleansing mechanisms: approval by a committee of independent directors and approval by the majority of unaffiliated shareholders.[271]

B. Easing CS Self-Dealing: In re Match Group Derivative Litigation

The *Match* litigation in the Delaware Supreme Court does not explicitly address any question relating to state competition. On its surface, the Court is clarifying the standard of review that applies to controlling shareholders who engage in conflicted transactions and potentially establishing a pathway for controllers to obtain business judgment deference through cleansing mechanisms.

However, given the broader context here, it is possible that Nevada's growing profile as a legitimate threat to Delaware's corporate law priority, combined with the vocal criticism of Delaware by influential shareholders, is lurking in the

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[268] *Id*. at 4.
[269] *Id*. at 32.
[270] *See Weinberger v. UOP, Inc*., 457 A.2D 701, 711 (1983).
[271] *Kahn v. M&F Worldwide Corp. (MFW)*, 88 A.3D 635 (Del. 2014).

background of the court's inclination to reduce judicial scrutiny on controlling shareholders' self-dealing transactions.

1. Background - Cleansing Mechanisms

The match decision focuses on the cleansing mechanism that is required to gain the protection of the business judgment rule for self-dealing transactions. In an entire fairness inquiry before a court, the defendant "may seek to lower the standard of review from entire fairness by showing that the controller did not stand on both sides of the transaction."[272] This is typically done by using one or two of the following procedural guards: (1) Approval of the transaction by a special committee of independent and disinterested directors that was empowered to hire outside experts, to negotiate effectively, and to say no, and conducted this process effectively ; (2) Approval by a vote of a majority of the disinterested shareholders - Majority of Minority (MOM) - who were duly informed of any material fact, including the conflicted parties in the transactions and their conflicts.

A controlling shareholder who used these cleansing mechanisms (one or both) would shift the burden of proof to the plaintiff to argue that the transaction did not meet the entire fairness test.[273] Notably, these cases operate differently in a related subset of conflicted transactions where *officers or directors* self-deal with the company they direct or manage.[274] If self-dealing by an officer or director is challenged in court, the officer or director who uses *either* (i) approval by a majority of independent directors or a special committee of independent directors *or* (ii) voting approval by a majority of the minority shareholders to affirm the transaction may be awarded deferential business judgment review, bypassing the mere burden shift that a controller might receive if they only used one of these cleansing devices.

This slight difference in this policy reflects Delaware's concern about the power of controlling shareholders generally. As Leo E. Strine Jr. put it, "Delaware is more suspicious when the fiduciary who is interested is a controlling stockholder." Controlling shareholders operate in a "uniquely advantageous" position to exert influence over the boards of companies they control, and in particular, the purported "independence" of independent directors making decisions in these situations is inevitably called into question.

MFW

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[272] *Id.*

[273] *Id.* ("The most that the controller can achieve is a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness.")

[274] *In re Wheelabrator Techs., Inc. S'holders Litig.*, 663 A.2d 1194, 1203 (Del. Ch. 1995).

There is one pathway, however, for controlling shareholders to receive deferential business judgment reviews in the context of going private transactions: adherence to *MFW* procedural safeguards. In 2014, the Delaware Supreme Court affirmed Vice Chancellor Strine's holding in *Kahn v. M&F Worldwide Corp.* ("*MFW*"), which modified the application of the entire fairness test in a subset of conflicted transactions: take-private mergers between a controlling stockholder and its subsidiary. The defendant controlling MFW stockholder bought out its subsidiary's remaining shares in a take-private deal, conditioning the agreement from the outset on negotiation and approval by a special committee of directors and approved by a majority of minority shareholders. The Court of Chancery applied the business judgment rule based on these conditions, and the Delaware Supreme Court upheld this on appeal, holding:

[I]n controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to select its advisors freely and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

In essence, *MFW* established a procedural pathway for controlled squeeze-out transactions that would allow controllers to avoid the more exacting "entire fairness" review and instead be subject to the more deferential business judgment rule if the proper, shareholder-protective procedures were followed. In other words, if *MFW*'s procedural boxes are checked, then "any fiduciary breaches by the controller or directors are 'cleansed'—with the result that any claims of breach of fiduciary duties are dismissed at the early pleading stage of litigation."

Post-MFW Doctrinal Development & Debate

In the decade since *MFW* was handed down, the holding's dual-process approach has been extended and used in conflicted controller transactions that do *not* involve a take-private deal. In the wake of this doctrinal drift, moderate judicial confusion and extensive academic debate have emerged about what these changes mean and what the law should be.

One side, captured by Professor Charles Elson's recent brief before the court, argues that *MFW*'s dual-process cleansing now has been applied to situations that would have otherwise been reviewed under a high-scrutiny entire fairness standard in court. The other side, encapsulated by a 2021 article by Lawrence Hamermesh, Jack B. Jacobs, and Leo E. Strine, Jr., suggests that the non-squeeze-out cases that *MFW* is applied to now should generally be allowed to be cleansed by any *one* of the traditional cleansing mechanisms.

The debate is difficult to reconcile in part because the doctrine's characterization is fundamentally different. Indeed, even the meaning of the term

"*MFW*-creep" is debated, and somewhat confusingly, it is used to mean different things in other contexts. This debate also frames the issue before the Delaware Supreme Court in *In re Match Group., Inc. Derivative Litigation.*

2. In re Match Group, Inc. Derivative Litigation

A case currently pending before the Delaware Supreme Court is positioned to answer whether controlling stockholder transactions that do not involve a freeze-out can receive a business judgment review if they use only one cleansing mechanism.[275] The case appears likely to clarify whether MFW's requirements are cabined to the controlling shareholder freeze-out context and whether controllers can get business judgment deference by using one cleansing mechanism in other conflicted transactions.

First heard in the Court of Chancery in 2022, *In re Match Group, Inc. Derivative Litigation* involves a reverse spin-off where the controlling shareholder received a non-ratable benefit.[276] In the case, defendant IAC (an internet media company focused on acquiring other businesses) spun off a subsidiary, Match Group, Inc., into a separate entity.[277] Shareholders challenged the transaction, contesting that the separation of Match operated to the detriment of the old entity's minority shareholders.[278] The defendants sought dismissal by arguing that they should receive business judgment deference because they met *MFW*'s requirements for controller transactions.[279] Ultimately, Vice Chancellor Zurn agreed with the defendants and dismissed the case, holding that the business judgment rule must be applied because the MFW procedures were satisfied in the spin-off.[280]

The dynamics of this case on appeal are somewhat unusual. Initially, the plaintiffs argued on appeal that "the Court of Chancery erred in applying *MFW* because the special committee lacked independence and the stockholder vote was not fully informed," pointing to facts that might indicate as much.[281] In response, the defendant-appellees (who had prevailed in Chancery) argued that they had met the *MFW* standard but also raised a new argument that they conceded they had not raised below. The defendants argued that "[i]n a controlling stockholder transaction not involving a freeze-out merger… business judgment review should still apply if any one of three procedural devices is employed as part of the transaction – approval by (a) a board with an independent director majority; (b) a special committee of independent directors; or (c) a majority of the minority

[275] Gail Weinstein, Important MFW Deveopments, HARV. L.SCH. FORUM CORP. GOV. (Oct. 17, 2023). https://shorturl.at/aetKT

[276] *In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ (Del. Ch. Sept. 1, 2022).

[277] *Id.*

[278] *Id.* at 3.

[279] *Id.* at 15.

[280] *Id.*

[281] Delaware Supreme Court, Order for Supplementary Briefing at 2 (May 30, 2023), *In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ.

stockholder vote."[282] This position closely mirrors the position taken by Hamermesh, Jacobs, and Strine in their 2021 article.[283]

After reviewing the briefs, the court here decided to order a briefing on a narrow question: "Whether the Court of Chancery judgment should be affirmed because the Transactions were approved by either of (a) the Separation Committee or (b) a majority of the minority stockholder vote."[284] To some observers, this was a surprising outcome, as the Delaware Supreme Court rarely entertains arguments that were not raised below. The court justified this order by recognizing that clarity on this point would "provide certainty to boards and their advisors who look to Delaware law to manage their business affairs" and that it would "provide certainty to the Court of Chancery, which has continued to address *MFW* outside the context of controlling stockholder freeze-out transactions in a manner that has evaded appellate review."[285]

3. The Analysis Implications for Match

The Delaware Supreme Court has thus decided to consider and potentially answer a question with significant implications on how much judicial scrutiny conflicted controller transactions outside of the freeze-out context should receive. If the appellees prevail in convincing the Court to award business judgment review to controlling shareholders who engage in conflicted transactions if they have used one traditional cleansing mechanism, the transactional planning environment for controlling shareholders in Delaware would likely become more hospitable, particularly for the controlling shareholders who may already wield outsized power over corporate affairs.

Such a holding would lower the barriers to effectuating conflicted transactions by requiring only one cleansing mechanism for controlling shareholders, which would be relatively easy for most of them to obtain. Simultaneously, it would also sharply raise the pleading standards for plaintiffs looking to challenge a transaction because proper cleansing under the new standard would automatically trigger business judgment deference for the defendant.

Such a holding would also bend against substantial Delaware precedent. As Professor Charles Elson describes in an amicus brief submitted as a part of the

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282 *Id.* (italics added).

283 Lawrence Hamermesh, Jack B. Jacobs, and Leo E. Strine, Jr., *Optimizing The World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead*, U of Penn. Inst for Law & Econ Research Paper No. 21-29, 18 (2021) https://ssrn.com/abstract=3954998 ("[I]f any of the traditional cleansing protections are employed to approve the [conflicted] transaction – i.e., i) approval by a board comprised of a majority of independent directors; ii) approval by a special committee of independent directors; or iii) approval by a majority of the disinterested stockholders – the business judgment rule standard should apply.").

284 Delaware Supreme Court, Order for Supplementary Briefing at 3 (May 30, 2023), *In re Match Group, Inc. Derivative Litig.,* C.A. NO. 2020-0505-MTZ.

285 *Id.,* at 2.

Match litigation, "[h]istorically, the baseline standard for review of conflicted-controller transactions has been entire fairness. As an incentive to encourage controllers to provide important protections, *MFW* created an exception to that rule if two cleansing devices were imposed from the beginning: an independent committee and a majority-of-the-minority vote."[286] In other words, in the non-going-private context, the most a controlling shareholder could hope for was historically not a business judgment review but rather simply a shift of the entire fairness burden to the plaintiff.[287] Delaware, considering bucking the run of cases like this, suggests that the external threat of Nevada may be behind it.

Beyond the substantial precedent, several policy reasons favor applying entire fairness to self-dealing transactions conducted by controlling shareholders. First, all self-dealing is, by definition, going to be a conflict-of-interest transaction. The examples of this are abound. If an officer, director, or controlling shareholder provides services to a company, they are interested in that company paying higher than the market price for these services. Suppose a controlling shareholder is pushing one company to purchase another company in which he has higher (or perhaps even 100%) ownership. In that case, he will be interested in the purchasing company paying above market price for the deal. Conversely, a controlling shareholder taking a company private has an incentive to pay as low a price as possible to minority stockholders for their stock.

It is easy to see why these apparent conflicts might require higher scrutiny from a court. The conflict of interest removes the transaction from pure business decisions. Accordingly, when challenged, it should no longer be awarded a highly deferential business judgment rule. It refers to a duty of loyalty, not only of care, which may prompt a different set of questions from a reviewing court. Moreover, this protection for shareholders offers other downstream benefits. For one thing, shareholders will pay a higher price for a stock with this entire fairness protection built in—this is a desirable dynamic ex-*ante* for the controlling shareholder. From a broader level, this protection will also promote market efficiency by preventing controlling shareholders from extracting outsize value via inefficient transactions motivated by self-interest.

Controlling shareholders also have uniquely strong incentives to self-deal. As one of the amici briefs before the Court in *Match* puts it, "Controllers themselves have a powerful incentive and power to impose agency costs by diverting value from minority stockholders."[288] As the brief notes, in the face of these twin dynamics, the typical "corporate governance mechanisms designed for widely held corporations are ill-equipped to confront controller agency costs."[289] Controlling shareholders dominate the ballot box by definition and can often

[286] Brief for Appellees at 6, *In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ.
[287] *See, e.g., Rosenblatt v. Getty Oil Co.*, 493 A.2D 929, 937 (Del. 1985); *Kahn v. Tremont Corp.* ("Tremont I"), 1996 WL 145452 (Del. Ch. 1996); *In re Ezcorp Inc.,* C.A. NO. 9962-VCL, 24 (Del. Ch. Jan. 25, 2016).
[288] Brief Supporting Appellants as Amici Curiae at 3, Mark Lebovitch & Gregory Varallo, *In re Match Group, Inc. Derivative Litig.*, C.A. NO. 2020-0505-MTZ.
[289] *Id.*, at 4.

unilaterally replace even "independent" directors.[290] The weakness of cleansing devices when controlling shareholders are present has also been borne out in actual cases.[291]

4. *Match* and the Competition in the Market for Corporate Law

The weight of the caselaw and underlying policy considerations suggests that entire fairness is the operative standard of review when a controlling shareholder engages in a conflicted transaction. Using a cleansing mechanism should only shift the burden to the plaintiff, not lower the standard of business judgment review. Thus, if the appellees prevail in convincing the Court to award business judgment review to controlling shareholders who engage in conflicted transactions so long as they have used one traditional cleansing mechanism, such a holding would represent a clear-cut deviation from both prior Delaware precedent and many of the settled policy goals of Delaware courts. Such a shift would have significant implications.

To take just one example of what this new regime would look like, in the 2011 *Southern Peru* case, Chancellor Strine awarded nearly $2 billion in damages to the plaintiffs after they challenged a conflicted transaction carried out by a controlling shareholder who used a special committee to negotiate the deal.[292] If the Court were to agree with the appellees in *Match*, however, it is likely that the holding in *Southern Peru* would have come out the other way: the use of a single cleansing mechanism through the special committee under the appellee's theory would have meant business judgment deference, leaving the court unable to protect minority stockholders' right under such a challenge materially.

All of this begs the question: what could this pressure from Nevada mean for Delaware law? Any moves by Delaware to bring its law more in line with that of Nevada have the potential of developing a "snowballing" effect toward degradation in general. The next Part discusses the implications of this effect in more detail.

5. The Risk of Snowballing to the Bottom

Should the Delaware courts go this route, the first-order effect will, of course, be to establish a much more hospitable environment for controlling shareholders to effect transactions. As the previous part explained, not only would this represent a marked shift in long-standing Delaware doctrine, but it could also significantly impact shareholders' economic rights. Put simply; shareholders

[290] *Id.*
[291] *See, e.g., In re Southern Peru Copper Corp.. S'holder Derivative Litig.*, 30 A.3d 60, 90 (Del. Ch. 2011) (describing "deficiencies in the substance of the special committee's negotiations" in finding an unfair transaction).
[292] *Id.*

would have less protection and recourse to challenge transactions effectuated by self-interested controlling shareholders.

Delaware, however, may also face second-order risks from this decision: such a holding could potentially create a "snowball effect" and make it *easier* for other Delaware firms to move to Nevada. If only one cleansing mechanism were required for the redomestication transaction, it could make it easier for a controlling shareholder to move firms they control to Nevada, as it would generally be easier to get business judgment deference for reincorporation. Relatedly, it would simultaneously make it more difficult for minority shareholders to challenge Nevada reincorporations *as* self-dealing because such an equilibrium would mean that the relevant differences between the two states (and the extent of the non-ratable benefit flowing to the controlling shareholder) would be significantly reduced. To illustrate, with the Match proposition, it would be enough for Maffei to establish a committee of independent directors to gain the protection of the business judgment despite the significant opposition of 95% of the minority shareholders.

Suppose Delaware finds itself in such a situation, with the barriers to reincorporation lowered and the risk of corporate exodus heightened. In that case, the incentives may align to degrade its corporate law in other ways further. Because Nevada offers a host of other less-discussed but still important protections to directors and controlling shareholders, Delaware might be pressured to incorporate similar changes in their corporate law. This sort of degradation could reduce the significance and importance of Delaware's judiciary; if, for example, the only way to attach liability to a director or officer is through intentional misconduct, the need for a bench with business-specific expertise is subsequently reduced. Another key benefit associated with Delaware, the fact that there are network benefits because most firms are incorporated there, would also be reduced the more firms moved to Nevada.

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