Delaware's Global Competitiveness

William J. Moon[*]

ABSTRACT: For about a hundred years, Delaware has been the leading jurisdiction for corporate law in the United States. The state, which deliberately embarked on a mission to build a haven for corporate law in the early twentieth century, now supplies corporate charters to over two thirds of Fortune 500 companies and a growing share of closely held companies. But Delaware's domestic dominance masks the important and yet underexamined issue of whether Delaware maintains its competitive edge globally.

This Article examines Delaware's global competitiveness, documenting Delaware's surprising weakness competing in the emerging international market for corporate charters. It does so principally by studying the corporate law preferences of foreign firms listed in the United States. While Delaware was once a popular jurisdiction for foreign corporations listing in American stock markets, it has dramatically fallen out of favor in recent years. This is particularly true among firms based in China that have recently made their debut to American investors. For instance, the Cayman Islands is now the juridical home to over half of Chinese companies listed in American stock markets, compared to Delaware's five percent.

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[*] Assistant Professor, University of Maryland Carey School of Law. I thank Afra Afsharipour, Drew Bernstein, Pam Bookman, Lea Brilmayer, Christopher Bruner, Chris Cho, Stephen Choi, Patrick Corrigan, Nakita Q. Cuttino, Jens Dammann, Iza (Yue) Ding, Ofer Eldar, Jessica Erickson, Martha Ertman, Jesse Fried, Mark Graber, Sue Guan, Scott Hirst, Camilla Hrdy, Jeffrey Javed, Akshaya Kamalnath, Vera Korzun, Peter Oh, Nizan Packin, James J. Park, Frank Pasquale, Fernán Restrepo, Roberta Romano, Darren Rosenblum, Stephen Shay, Omari Simmons, Max Stearns, Eric Talley, Randall Thomas, Joel Trachtman, Kevin Tu, Andrew Tuch, Fred Tung, Pierre-Hugues Verdier, David I. Walker, David Webber, Verity Winship, and Yueh-Ping Yang for helpful conversations and comments. I am grateful to participants of workshops at McGill University Faculty of Law, Pace Law School, Tulane Law School, University of Akron School of Law, University of Maryland Carey School of Law, University of Miami School of Law, Vanderbilt Law School, Washington University School of Law, and UCLA School of Law. I am particularly grateful to Afra Afsharipour and James J. Park for serving as commentators on an earlier draft at the 2020 AALS's New Voices in Business Law Session in Washington D.C. For excellent research and editorial assistance, I thank Karachi Achilihu, Qin Cao, Jordan Danso, Stuart Davis, Lydia Jines, Erick Marquina, Susan McCarty, and Valeriya Zavyalova. Nicholas DeMaris, Joseph Kaczmarski, Joel Mudd, and other editors of the *Iowa Law Review* provided exceptional editorial work. Finally, I am indebted to Roberta Romano, whose written comments to my related project inspired me to undertake this project.

By exploring the paradox of Delaware's domestic popularity and international unpopularity, this Article makes three contributions to the literature. First, it presents data indicating that Delaware's dominance of the corporate charter market may be a parochial, American phenomenon. Second, it develops a theory to explicate why foreign firms operating within vastly different market environments may be averse to Delaware's corporate governance paradigm. Finally, it adds to the corporate law convergence debate, counseling against blind exporting of Delaware corporate law to foreign nations.

I. INTRODUCTION

It would appear that Delaware has it all—at least to American corporate law junkies. Heralded "as the de facto national corporate law [maker],"[1] the state's renowned Delaware Court of Chancery is celebrated as "America's premier corporate court."[2] In recent years, Delaware has cemented its status as the leading jurisdiction for corporate law in the United States,[3] serving as juridical home to over two thirds of Fortune 500 companies.[4] Some have called the competition over, declaring that Delaware has won the race between states to supply corporate charters.[5] Others assess that Delaware is an effective "monopoly,"[6] with the state erecting an insurmountable barrier to entry for other states competing in the market for corporate law.

But legal scholars have principally studied Delaware's dominance in terms of the state's magnetic appeal to American corporations,[7] thereby neglecting to consider Delaware's global competitiveness.[8] In reality, a large number of corporations headquartered in foreign nations can choose to be

1. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1574 (2005).

2. Mark J. Roe, *Juries and the Political Economy of Legal Origin*, 35 J. COMPAR. ECON. 294, 294 (2007) [hereinafter Roe, *Juries*].

3. Corporate law is the law governing the relationship between the firm's shareholders (the technical owners of the firm) and managers (directors and officers who operate the firm on behalf of shareholders). *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1–3 (1993) [hereinafter ROMANO, GENIUS]. In the United States, this body of law has principally been left to the states, who compete to supply corporate charters to corporations that can effectively "shop" for corporate law by incorporating in any state. *Id.*

4. *See About the Division of Corporations*, DELEWARE.GOV, https://corp.delaware.gov/aboutagency [https://perma.cc/UC9C-QEZV]. Delaware has also become the jurisdiction of choice for closely-held companies. *See* Jens Dammann & Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations*, 27 J.L. ECON. & ORG. 79, 84 (2011); Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 91 ("[W]e find evidence that large LLCs, like large corporations, tend to form in Delaware, and that they do so for many of the same reasons—that is, for the quality of Delaware's legal system.").

5. *See, e.g.*, Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003) ("Delaware has 'won' that race, as most large American firms incorporate there.").

6. Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1214–15 (2001) [hereinafter Kahan & Kamar, *Price Discrimination*].

7. The prevailing literature typically studies corporations that are both publicly traded in American stock markets *and* incorporated in one of the constituent states of the United States. *See, e.g.*, Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 348 (2006).

8. *See* William J. Moon, *Delaware's New Competition*, 114 NW. U. L. REV. 1403, 1407 (2020) [hereinafter Moon, *Delaware's New Competition*]; Omari Scott Simmons, *Delaware's Global Threat*, 41 J. CORP. L. 217, 221 (2015) ("Although scholars have addressed the impact of globalization on securities regulation, the parallel impact on Delaware's role, as a de facto national regulator, remains largely underdeveloped.") [hereinafter Simmons, *Delaware's Global Threat*].

governed by Delaware corporate law, simply by incorporating in Delaware.[9] This is particularly true for a growing number of foreign companies raising capital in American stock markets, who have incentives to choose corporate law that is most palatable to American investors.[10] After all, a corporation's place of incorporation determines the applicable corporate law governing a range of important shareholder rights,[11] and thus choosing a jurisdiction that diminishes those rights is presumably punished by the market in the form of lowered stock prices.[12] But we know little about how important this market is, who Delaware is competing with, and whether Delaware also dominates this broader *international* market for corporate law.[13]

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9. To form a Delaware corporation, a firm need not maintain any physical operation in Delaware. Instead, it only needs to file paperwork, pay a franchise tax, and hire a registered agent who has "a physical street address in Delaware." *How to Form a New Business Entity*, DELEWARE.GOV, https://corp.delaware.gov/howtoform.shtml [https://perma.cc/XD6Q-D93G]. Of course, many jurisdictions around the world forbid local corporations from choosing foreign corporate law. But there are many major jurisdictions around the world—including Brazil, Canada, China, India, Israel, Japan, the United Kingdom, and the United States—that allow their corporations (formally or informally) to shop for corporate law of any jurisdiction. *See infra* Section II.B.

10. *See* Brian Broughman, Jesse M. Fried & Darian Ibrahim, *Delaware Law as Lingua Franca: Theory and Evidence*, 57 J.L. & ECON. 865, 866 (2014) (assessing that "a firm wishing to attract investors from around the country may choose Delaware merely to provide a law that can be 'spoken' by all of its investors"). When choosing to list in the New York Stock Exchange or NASDAQ, foreign corporations subject themselves to a host of rules mandated by federal securities law. *See* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 922 (1998) ("[U]nder the current U.S. regime, issuers can only gain access to capital in the United States by complying with the American securities regime."). But foreign companies (to the extent that their home countries enable them to do so) are at liberty to choose the corporate law of any American state or foreign nation. *See, e.g.*, Solaredge Techs., Inc., Annual Report (Form F-1) 1 (Feb. 19, 2021) (illustrating an Israeli firm incorporated in Delaware and listed in NASDAQ); Nio, Inc., Annual Report (Form 20-F) 1 (May 14, 2020) (illustrating a Chinese firm incorporated in the Cayman Islands and listed the New York Stock Exchange).

11. *See* Vincent S.J. Buccola, *Opportunism and Internal Affairs*, 93 TUL. L. REV. 339, 346 (2018).

12. *See* Ralph K. Winter, *Foreword* to ROMANO, GENIUS, *supra* note 3, at xi (1993) (assessing that corporations incorporating in a state that deliberately diminishes shareholders rights "must pay more for capital"); James J. Park, *The Limits of the Right to Sell and the Rise of Federal Corporate Law*, 70 OKLA. L. REV. 159, 160 (2017) ("Because public shareholders can easily sell their shares, the market will check poor corporate governance."); Stephen J. Choi, *Promoting Issuer Choice in Securities Regulation*, 41 VA. J. INT'L L. 815, 826 (2001) ("For companies whose securities trade in an efficient market, the value of adopted regulatory protections will be incorporated in the market price.").

13. Part of this gap stems from the standard account presupposing that corporate law matters little when foreign firms choose to list in American stock markets. *See* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 699 (1999) [hereinafter Coffee, *Future as History*] ("This Article has said little about state corporate law, because it believes that the critical restraints that most limit agency costs are today contained in the federal securities laws."). This Article will complicate this conventional account, showing that corporate law matters, and that foreign firms have acute preferences for corporate law. *See infra* Section II.B.

This Article begins to fill that gap by documenting Delaware's surprising weakness competing in the emerging international market for corporate law.[14] Contrary to what conventional wisdom would predict—that capital thirsty foreign corporations would choose to incorporate in Delaware when listing in American stock markets to attract American investors[15]—foreign corporations are choosing to incorporate in small offshore nations in the Caribbean. Thus, for instance, when Alibaba (widely regarded as the "Amazon" or "eBay" of China) listed in the New York Stock Exchange raising a record-breaking $25 billion in 2014,[16] the company chose to incorporate in the Cayman Islands, rather than Delaware. Alibaba is hardly an unusual story.[17] In 2018, PagSeguro, Brazil's iconic financial technology firm, raised the highest amount of capital for a Brazilian company listing in the United

14. This Article is part of a series of projects aimed at uncovering what I believe is an emerging international market for corporate charters. In a recent paper, I document how a handful of "offshore corporate law havens"—principally the Cayman Islands, Bermuda, and the British Virgin Islands—have started to attract publicly traded corporations that are principally headquartered in the United States. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1406. My broader hope is that these projects will help us better understand the global dimensions of corporate law akin to other fields of law. *See* Benedict Kingsbury, Nico Krisch & Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 15, 29 (2005); Tseming Yang & Robert V. Percival, *The Emergence of Global Environmental Law*, 36 ECOLOGY L.Q. 615, 649 (2009); Jennifer Prah Ruger, *Normative Foundations of Global Health Law*, 96 GEO. L.J. 423, 434 (2008); Lawrence O. Gostin, Matiangai V.S. Sirleaf & Eric A. Friedman, *Global Health Law: Legal Foundations for Social Justice in Public Health*, *in* FOUNDATIONS OF GLOBAL HEALTH & HUMAN RIGHTS 45, 47 (Lawrence O. Gostin & Benjamin Mason Meier eds., 2020); Michael P. Van Alstine, *Consensus, Dissensus, and Contractual Obligation Through the Prism of Uniform International Sales Law*, 37 VA. J. INT'L L. 1, 36–42 (1996).

15. This theory is most prominently associated with the bonding hypothesis, developed in Professor Jack Coffee's celebrated work. In broad strokes, the theory predicts that firms voluntarily bind themselves to higher disclosure regimes mandated by established capital markets like the United States in order to "enhance their share price and become able to raise additional equity at lower cost." John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1763 (2002) [hereinafter Coffee, *Racing Towards the Top*].

16. Liana B. Baker, Jessica Toonkel & Ryan Vlastelica, *Alibaba Surges 38 Percent on Massive Demand in Market Debut*, REUTERS (Sept. 19, 2014, 12:40 AM), https://www.reuters.com/article/us-alibaba-ipo/alibaba-surges-38-percent-on-massive-demand-in-market-debut-idUSKBNoHD2CO20140919 [https://perma.cc/RHF9-T2RN] ("The pricing of the IPO on Thursday initially raised $21.8 billion for Alibaba. Scott Cutler, head of the New York Stock Exchange's global listing business, told CNBC that underwriters would exercise their option for an additional 48 million shares, to bring the IPO's size to about $25 billion, making it the largest initial public offering in history.").

17. Because of their importance to the general trend, this Article focuses on Chinese companies listed in American stock markets. But there are a number of other examples where foreign corporations raising capital in the United States choose non-Delaware jurisdictions. For instance, Jumia, widely regarded as the "Amazon" of Africa, recently made its debut in the New York Stock Exchange incorporating in Germany. *See* Jumia Techs. AG, Registration Statement (Form F-1) 9 (Mar. 12, 2019) (identifying the place of incorporation as Berlin, Germany).

States—after incorporating *not* in Delaware or Brazil, but in the Cayman Islands.[18]

While Delaware was once a popular jurisdiction for foreign corporations listing in American stock markets, it has dramatically fallen out of favor in recent years.[19] This is particularly true among the army of giant corporations headquartered in China that have recently made their debut to American investors. As documented below, the Cayman Islands is now home to over 50 percent of Chinese companies listed in American stock markets, compared to Delaware's 4.9 percent.[20] This is no accident. In recent years, companies like Sohu.com and China Biologic Products have spent millions of dollars hiring elite American law firms to change its legal domicile from Delaware to the Cayman Islands.[21]

This trend is particularly perplexing given Delaware's preeminent status in the corporate law ecosystem.[22] In addition to being widely considered the gold standard among American legal scholars and practitioners alike, it has served as a model template for a number of foreign nations enacting corporate law reforms.[23] There is also a well-developed body of empirical research documenting why firms incorporate in Delaware. Professor Roberta Romano, for instance, has produced an extensive set of empirical evidence demonstrating that Delaware maintains a firm-value-enhancing set of corporate governance rules.[24]

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18. *Investor Relations*, PAGSAGURO, http://investors.pagseguro.com/ir-home [https://perma.cc/5DHU-X3LJ] (describing the company's initial public offering in the New York Stock Exchange in 2018 as the "[l]argest Brazilian IPO in the US, totaling 2.6bn dollars").

19. *See infra* Table 1 (showing that Delaware's market share of foreign firms listed in the United States has declined from 29.5 percent in 1985 to 11.2 percent in 2018).

20. *See infra* Table 2.

21. For instance, China Biologic Company, a major biopharmaceutical company specializing in blood plasma in China, hired Davis Polk to redomicile from Delaware to the Cayman Islands in 2017. *See China Biologic Products Redomicile from Delaware to the Cayman Islands*, DAVIS POLK (Aug. 1, 2017), https://www.davispolk.com/news/china-biologic-products-redomicile-delaware-cayman-islands [https://perma.cc/LQ37-GZY2] ("Davis Polk advised China Biologic Products, Inc., a NASDAQ-listed company, in connection with its change of domicile from Delaware to the Cayman Islands . . . .").

22. *See, e.g.*, Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 426 (2003) ("Delaware . . . is widely recognized as the most significant jurisdiction for corporate-law purposes . . . ."). *But see* Robert Anderson IV & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049, 1051 (2015) ("Corporate lawyers routinely embrace the widespread, yet unproven assumption that Delaware's corporate governance framework is better than that of other states and steer their clients towards Delaware.").

23. *See infra* Section IV.B. The Republic of the Marshall Islands, for instance, has statutorily adopted Delaware corporate law (including the state's judicial precedents) as the law of the Republic. *See* Business Corporations Act 1990, tit. 52, ch. 1, § 13, https://rmiparliament.org/cms/images/LEGISLATION/PRINCIPAL/1990/1990-0091/BusinessCorporationsAct1990_4.pdf [https://perma.cc/HSC4-RLU6] (Marshall Islands).

24. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 279 (1985) [hereinafter Romano, *Law as a Product*] ("Delaware is not only the choice of firms reincorporating to undertake transactions with increased litigation potential, but even

Of course, it is possible that foreign corporations are flocking to the Cayman Islands or the British Virgin Islands for tax reasons. These offshore jurisdictions, after all, have been identified in both popular media and various academic circles as some of the most notorious "tax havens" in the world.[25] Current federal tax code, indeed, subjects all foreign companies *incorporated* in the United States to federal tax, even if they physically operate entirely outside of the United States.[26] Perhaps the promised tax reduction is so great that foreign firms are willing to opt into "suboptimal" Cayman law, even though they would have preferred Delaware law.[27]

But tax is at best only a partial explanation.[28] If tax were the only reason (or even the principal reason), one would predict that firms incorporated offshore would *contractually* specify Delaware-type corporate governance rules in their corporate bylaws or corporate charters. After all, popular offshore jurisdictions like the Cayman Islands and the British Virgin Islands impose fewer mandatory rules than Delaware,[29] meaning that firms incorporated in those jurisdictions can choose to contractually provide higher (Delaware-level) protection for shareholders. And we know that corporate "[b]oards and shareholders [today] are increasingly using charter and bylaw provisions to

more important, the firms that migrated to Delaware perceived the difference in the laws of their origin and destination states to be a major factor in their decision to relocate."). Professor Robert Daines, moreover, has produced data indicating that Delaware corporate law not only improves firm value but also "facilitates the sale of public firms." Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 525 (2001); *see also id.* at 533 (illustrating that Delaware law enhances shareholder value by as much as five percent of the value of the firm). Of course, not everyone agrees that Delaware corporate law enhances firm value. *See* Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1777 (2002) ("[R]eported findings of a positive correlation between incorporation in Delaware and increased shareholder wealth are not robust and, furthermore, do not establish causation.").

25. *See, e.g.*, CHRISTOPHER M. BRUNER, RE-IMAGINING OFFSHORE FINANCE: MARKET-DOMINANT SMALL JURISDICTIONS IN A GLOBALIZING FINANCIAL WORLD 3–5 (2016); RONEN PALAN, RICHARD MURPHY & CHRISTIAN CHAVAGNEUX, TAX HAVENS: HOW GLOBALIZATION REALLY WORKS 27, 124 (2010); GABRIEL ZUCMAN, THE HIDDEN WEALTH OF NATIONS: THE SCOURGE OF TAX HAVENS 27–28 (Teresa Lavender Fagan trans., 2015).

26. Under Section 7874 of the U.S. Internal Revenue Code, corporations with no presence in the United States may be treated as U.S. corporations for U.S. federal income tax purposes by virtue of incorporating in the United States. *See* 26 U.S.C. § 7874 (2018); *see also* Douglas Chiu, Note, *Inversion Subversion: Corporate Inversions and the New Federal Laws Against Them*, 20 FORDHAM J. CORP. & FIN. L. 717, 723 (2015) ("[T]he corporation is considered domestic for taxation purposes so long as it is incorporated in or under the jurisdiction of the United States.").

27. *Cf.* Mitchell A. Kane & Edward B. Rock, *Corporate Taxation and International Charter Competition*, 106 MICH. L. REV. 1229, 1231 (2008) ("[C]orporate tax consequences of migration can make the cost of choosing the desired corporate law prohibitive. In this way, corporate tax can trap firms in a suboptimal jurisdiction from the standpoint of corporate law.").

28. *See infra* Section III.A.

29. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1444–49; *see also* E. EDWARD SIEMENS, OFFSHORE COMPANY LAW 9 (2009) (noting that the British Virgin Islands and the Cayman Islands are "preeminen[t] in the offshore world").

customize their corporate governance."[30] But this Article's extensive hand-collected study of Securities and Exchange Commission ("SEC") disclosures documented in Section III.A reveals that foreign firms listed in American stock markets are largely choosing to opt out of rules that are mandatory under Delaware law.[31]

In documenting Delaware's paradoxical position in the increasingly globalized market for corporate law, this Article develops a theory of *territorial market segmentation* to explain why firms operating in different market environments might prefer different types of corporate governance rules. This account, which builds on prevailing theories that assess that different types of corporations may have differentiated taste for corporate law,[32] explains why firms principally operating in certain foreign markets may be averse to Delaware corporate law. Thus, for instance, if a corporation operates predominantly in China—where self-dealing transactions are routine, tolerated by local authorities, and constitute an important strategy to compete in certain sectors[33]—that corporation would be averse to Delaware law, where self-dealing transactions would open the floodgate to costly shareholder litigation in the United States.[34]

The theory of territorial market segmentation offers a number of intellectual and practical payoffs. First, it adds to the debate on whether corporate law will globally converge. More specifically, it complicates Professors Henry Hansmann and Reinier Kraakman's provocative and widely-

30. Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 373 (2018) [hereinafter Fisch, *Corporate Bylaws*].

31. *See infra* Section III.A. It is also important to note that even if a particular firm's incorporation decision is purely motivated by tax, shareholders and managers of that company are opting into a legal regime that may have vast consequences for shareholder rights.

32. The idea that firms may have differentiated preferences for corporate law was originally hinted at by Judge Richard Posner and the late Professor Kenneth Scott in a book published four decades ago. *See* RICHARD A. POSNER & KENNETH E. SCOTT, ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION 111 (1980). The idea that firms shop for corporate law owes its intellectual debt to Professor Roberta Romano's influential works conceptualizing corporate law as "products." *See* Romano, *Law as a Product*, *supra* note 24, at 226–27. Since then, the concept of market segmentation has been expressly developed by Professor Michal Barzuza in her study of Nevada attracting firms that prefer manager-friendly corporate law. *See* Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 935–36 (2012) [hereinafter Barzuza, *Nevada*].

33. As further discussed in Section III.C, Chinese firms exhibit a vastly different organizational structure than their counterparts in the United States. According to Professors Raymond Fisman and Yongxiang Wang, "[m]ost large Chinese firms belong[] to a business group." Raymond Fisman & Yongxiang Wang, *Trading Favors Within Chinese Business Groups*, 100 AM. ECON. REV. 429, 430 (2010). The firms operating within large corporate groups, therefore, engage in intra-group transactions as a natural result of "operating as one enterprise in the form of a corporate group." Kon Sik Kim, *Related Party Transactions in East Asia*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 285, 304 (Luca Enriques & Tobias H. Tröger eds., 2019) [hereinafter Kim, *Related*].

34. *See* Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49, 86 (2011).

cited thesis that argues that corporate governance rules will globally converge to shareholder-centric governance rules.[35] To Hansmann and Kraakman, global convergence of corporate law to Delaware-style governance rules is almost assured by "recent dominance of a shareholder-centered ideology of corporate law among the business, government, and legal elites in key commercial jurisdictions."[36] But so long as regulatory laws and market environments impacting firms remain relatively heterogeneous across national borders, convergence may not be anywhere on the horizon.

Normatively, the theory of territorial market segmentation challenges conventional wisdom in some circles that effectively synonymizes "good" corporate governance rules with Delaware corporate law. Delaware's failure to attract foreign corporations raising capital in American stock markets is important—and underexploited—data indicating that corporate governance rules codified in Delaware may not be ideal in all market conditions. Thus, from a policy perspective, territorial market segmentation counsels against blindly exporting Delaware corporate law to foreign nations.

Several caveats warrant attention. First, Delaware's weakness in attracting foreign companies in recent years is not necessarily an indication that the quality of Delaware corporate law is on the decline. It is entirely plausible that the drop in Delaware's overall market share is largely due to the changing demographics of foreign firms listed in the United States, as opposed to shifting taste among existing firms. Indeed, the decline appears to be driven in large parts by the rapid growth in the number of Chinese firms listed in the United States in the past two decades that predominantly prefer to incorporate in the Cayman Islands over Delaware.[37] Second, this Article's findings should not be interpreted as an indication that tax or federal securities laws do not matter in incorporation choices of public companies.

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35. *See generally* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 468 (2001) (arguing that the "triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured"). This view is already contested, with leading scholars assessing that path dependency and local interest groups may hinder corporate law reform in many foreign nations. *See, e.g.*, Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 131 (1999) (explaining that corporate structures can provide certain groups with more power and influence, allowing them to adopt more favorable rules in the future); *see also* JEFFREY N. GORDON & MARK J. ROE, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 11 (Jeffrey N. Gordon & Mark J. Roe eds., 2004) ("[S]tructural imperatives help to explain why differences have persisted thus far, despite convergence in many economic areas."). This Article develops a complementary account, arguing that global convergence is unlikely to happen even as firms are increasingly able to shop for corporate charters transnationally. *See infra* Section IV.A.

36. Hansmann & Kraakman, *supra* note 35, at 439.

37. *See infra* Table 2. Relatedly, it supports the idea that firms may only need to provide *adequate* protection for investors in certain circumstances. That is, the minimal investor protection provided by federal securities law, coupled with the widespread perception that Chinese companies have explosive growth potential, may be enough for investors to overlook the possibility of self-dealing. These conditions may not universally hold for all foreign companies.

In some respects, imputing motives on the organizational behavior of juridical entities is an inherently imprecise task, and tax or federal securities laws may serve as important co-causal variables under many circumstances. The degrees of importance of these variables for firms operating in different market conditions is a subject that would benefit from further research.

The remainder of this Article proceeds in three Parts. Part I synthesizes the existing literature on the merits (and demerits) of Delaware corporate law and presents original data documenting Delaware's surprising weakness in attracting foreign corporations listed in American stock markets. After explaining why tax arbitrage opportunities or federal securities law cannot fully account for why foreign corporations listed in American stock markets are headed "offshore," Part II argues that the content of Delaware corporate law is responsible for foreign corporations actively avoiding Delaware. Part III develops a theory of territorial market segmentation, assessing that local regulations and market dynamics influence firm-level corporate law preferences. It then counsels against foreign nations blindly transplanting Delaware corporate law. A brief conclusion follows.

II. THE PARADOX OF DELAWARE'S DOMESTIC POPULARITY AND INTERNATIONAL UNPOPULARITY

American law school casebooks on corporate law are replete with cases from Delaware—and for good reason. Delaware has been the leading jurisdiction for corporate law in the United States for about a hundred years,[38] and Delaware courts have produced some of the most canonical and influential cases in corporate law.[39] Section II.A. synthesizes existing scholarship documenting Delaware's dominance of the American corporate law market, with leading scholars vigorously disagreeing about the normative merits of the state's influence. Section II.B. offers original data documenting Delaware's weakness competing in the emerging international market for corporate law.

A. DELAWARE'S POPULARITY

The central doctrinal bedrock to Delaware's corporate law empire is the internal affairs doctrine.[40] The doctrine, which is said to have a "quasi-

38. *See* Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 42 (2006); Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 271 (1976).

39. *See* James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 325 (2018) ("No student emerges from a law school's business organization class today without a deep familiarity with these Delaware precedents.").

40. *See* Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 542 (2005) ("While each state offers its own corporation law, states generally accept and apply the so-called internal affairs doctrine for their choice of law regarding a corporation's internal affairs—the relations among a firm's

constitutional" status under American law,[41] instructs that the firm's place of incorporation supplies the corporate law that governs the firm's shareholders and managers regardless of where the firm physically operates.[42] It is for this reason that a tiny state like Delaware can serve as the juridical home to over 66 percent of Fortune 500 companies and roughly half of all publicly traded companies in the United States.[43]

Corporate law is big business in Delaware. Delaware's state government derives approximately 17 percent of its government revenues from firms incorporated in the state.[44] Lawmakers in Delaware are not shy about pronouncing the importance of corporate franchise taxes to the state's economy.[45] According to an official state government publication, Delaware has "an uncommonly high share of the cost of government . . . actually paid

shareholders and managers."). According to the Supreme Court of the United States, "[t]he internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders." Edgar v. MITE Corp., 457 U.S. 624, 645 (1982). Today, the doctrine intellectually rests on the idea that corporate law is a nexus of contracts between voluntary actors coming together for commercial enterprises. Under this conception, jurisdictions are conceptualized as suppliers of corporate law "products," with firms exercising autonomy to incorporate in virtually any state or foreign nation in the world. *See* Romano, *Law as a Product*, *supra* note 24, at 226–27; Moon, *Delaware's New Competition*, *supra* note 8, at 1418–22 (synthesizing American conflict of laws jurisprudence enabling American firms to shop for the corporate law of any state or nation state).

41. *Compare* Richard M. Buxbaum, *Federalism and Company Law*, 82 MICH. L. REV. 1163, 1166–78 (1984) (questioning the internal affairs doctrine's constitutional pedigree), *with* Paul N. Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule—A Comment on* CTS Corporation, 13 J. CORP. L. 317, 349 (1988) ("[T]he internal affairs rule of choice of law may have a constitutional dimension.").

42. R. LEA BRILMAYER, JACK L. GOLDSMITH & ERIN O'HARA O'CONNOR, CONFLICT OF LAWS: CASES AND MATERIALS 114–15, 127–32 (2015).

43. *See* Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475, 512 (2011) ("Roughly half of all publicly traded U.S. corporations are chartered in their headquarters state; nearly all the rest are incorporated in Delaware."); *see also* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1572 (2002) (finding that nearly 95 percent of firms that incorporate outside of their home state choose Delaware).

44. Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 212 (2006) ("A substantial portion of Delaware's tax revenue—an average of 17% over the past several decades—is derived from incorporation fees.").

45. Franchise tax is an annual tax that states charge on firms for the privilege of incorporating in their states. As observed by Professor Barzuza, "[u]nlike some other taxes, the franchise tax is not a portion of income or revenues." Michal Barzuza, *Does the Structure of the Franchise Tax Matter?*, 96 VA. L. REV. BRIEF 27, 27 (2010).

by residents of other states,"[46] largely because of the state's "position as the preferred state of incorporation for corporate America."[47]

Delaware works hard to maintain its competitive advantage. The state's corporate code is a byproduct "of an unwritten compact between the bar and the state legislature."[48] It is no secret that Delaware lawmakers regularly rely "upon the expertise of the Corporation Law Section of the Delaware Bar Association to recommend, review and draft almost all amendments to the statute."[49] Its judiciary—particularly the Delaware Court of Chancery—is famous for being staffed with renowned business law judges who resolve disputes without juries.[50] The large number of corporations that choose to incorporate in Delaware, in turn, creates network effects: The unusually large number of corporate lawyers across the United States who are familiar with Delaware law and the extensive body of case law unavailable in other states encourage even more firms to incorporate in Delaware.[51]

The pursuit of corporate franchise taxes, which incentivizes state lawmakers to craft corporate codes that cater to private sector preferences, has been famously described as "the genius of American corporate law."[52] This is the influential "race to the top" account. As Professor Roberta Romano explains, competition between states results in a race to the top because it enables firms to "seek the state whose code best matches their needs so as to minimize their cost of doing business."[53]

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46. *See* DEP'T OF FIN., OFF. OF MGMT. & BUDGET, CONTROLLER GEN.'S OFF., DELAWARE'S GENERAL FUND REVENUE PORTFOLIO 22 (2008), https://financefiles.delaware.gov/docs/GP2008.pdf [https://perma.cc/Y26Q-WBRC].

47. *Id.* at 23. Franchise taxes constitute just one piece of the revenue flow. As the legal home to the largest share of the nation's corporations, Delaware also receives a substantial share of "'owner-unknown' and 'address unknown' property held by businesses incorporated in Delaware [which] must be remitted to Delaware after the dormancy period has run its course." *Id.* at 62.

48. LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 4 (2007).

49. *Id.* at 4. This group consists of 21 transactional and litigation attorneys representing small and large law firms in Wilmington, Delaware. *See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1755 (2006).

50. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 590 (1990) ("Delaware's governor, mindful of the value of corporate charters, often deliberately appoints judges with corporate experience."); Roe, *Juries*, *supra* note 2, at 294 ("[T]he usual view in legal circles is that the jury's absence (and the resulting decision-making by expert judges, not juries) is a strength of the court, not a weakness.").

51. Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 843–45 (1995); Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 586–87 (2002) [hereinafter Bebchuk & Hamdani, *Leisurely Walk*]. Closely related to this idea is that Delaware corporate law has become "a lingua franca" given that "some firms will domicile in Delaware simply to provide all of their investors with a language that each investor can understand." Broughman et al., *supra* note 10, at 867.

52. ROMANO, GENIUS, *supra* note 3, at 1.

53. *Id.*

Of course, Delaware's dominance of the American corporate law market has attracted its fair share of criticisms. In an infamous critique of Delaware corporate law, former SEC chair Bill Cary argued that competition between states to supply corporate charters induces states to "race for the bottom" by adopting laws that favor corporate insiders—namely directors and officers—over dispersed shareholders.[54] Modern writers also denounce Delaware as fattening the pockets of Delaware corporate lawyers, who purportedly are the main beneficiaries of Wilmington's corporate law empire.[55]

While the race for the bottom thesis continues to enjoy support among modern American corporate law scholars in various iterations,[56] the documented popularity of Delaware is difficult to explain away as a case of "managerial interest gone wild" scenario espoused by early race to the bottom theorists. For one, Delaware remains a fan favorite among institutional investors,[57] who now hold "over half the stock in most American corporations."[58] This sophisticated breed of shareholders—including BlackRock and the Vanguard Group—can presumably fend for their own interests.[59] There is also a well-developed body of empirical research documenting why firms incorporate in Delaware, particularly for large firms

54. *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 705 (1974) (describing American corporate law as encouraging a "race for the bottom"). This view built on Justice Brandeis's concern that a competition between states to produce laws for corporations would induce state laws to capitulate to private corporate interests over public interests. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548–65 (1933) (Brandeis, J., dissenting).

55. *See generally* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987) (exploring how an interest-group theory can help predict and explain legal rules of corporations chartered in Delaware that have left lawyers in a dominant position); Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85 (1990) (concurring with Professors Macey and Miller while expanding on the involved interest groups).

56. *See, e.g.*, Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2104 (2018); Lynn M. LoPucki, *Algorithmic Entities*, 95 WASH. U. L. REV. 887, 890 (2018); Bebchuk et al., *supra* note 24, at 1778; Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1797 (2002); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1169 (1999).

57. *See, e.g.*, Charles M. Elson, *Why Delaware Must Retain Its Corporate Dominance and Why It May Not*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 225, 228 (Stephen M. Bainbridge, Iman Anabtawi, Sung Hui Kim & James Park eds., 2018).

58. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 689 (2005); *see also* Scott Hirst, *The Case for Investor Ordering*, 8 HARV. BUS. L. REV. 227, 231 (2018) ("[T]he rise of institutional investors has transformed the ownership of U.S. corporations. Institutional investors, such as investment managers and pension funds, now invest the overwhelming majority of capital in U.S. corporations and have the capability to determine corporations' choice of arrangements." (footnote omitted)).

59. *See* Hirst, *supra* note 58, at 230–31.

that go public. Professor Roberta Romano, for instance, teaches us that Delaware produces a firm-value-enhancing set of corporate governance rules.[60] Professor Robert Daines, moreover, has produced empirical evidence showing that firms incorporated in Delaware have a higher Tobin's q (a widely used measure of management performance) than firms incorporated in other states.[61] It is for this reason that Delaware is almost always the chosen jurisdiction for corporations that change their legal residence from one state to another state.[62]

Unsurprisingly, judicial opinions issued by Delaware courts frequently serve as persuasive authority or even de facto precedential authority for state and federal judges across the United States.[63] Many state lawmakers have also enacted corporate codes heavily influenced by Delaware's approach, if not outright copying sections of Delaware's corporate code.[64]

But legal scholars have studied Delaware's dominance predominantly in terms of Delaware competing with other American states, thereby neglecting to consider Delaware's appeal to foreign corporations.[65] In reality, a significant cluster of firms that principally operate outside of the United

60. Romano, *Law as a Product*, *supra* note 24, at 279 ("I found statistically significant positive abnormal returns were experienced by firms reincorporating for mergers and acquisitions purposes.").

61. *See generally* Daines, *supra* note 24 (finding that Delaware law enhances shareholder value by as much as five percent of the value of the firm). *But see* Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32, 33 (2004) (assessing that "small Delaware firms . . . were worth more than small non-Delaware firms during the period 1991–1996, but not afterwards"); Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's q*, 73 VAND. L. REV. 353, 358–59 (2020) (critiquing the use of Tobin's q in modern corporate law scholarship assessing that "[a]s a general matter, Tobin's q, in any specification, is not a good measure of the value of corporations, either in theory or in practice").

62. POSNER & SCOTT, *supra* note 32, at 102 ("Of the total of 140 switching firms, 126 (90.0%) changed to Delaware and only 6 (4.3%) left Delaware for other states.").

63. Jens Dammann, Deference to Delaware Corporate Law Precedents and Shareholder Wealth: An Empirical Analysis 2 (June 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3384446 [https://perma.cc/P2PA-Q88Z].

64. *See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 57 (observing that "a few states have copied Delaware's law"); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2392 (1998) (observing that "the vast majority of states copied Delaware's approach, permitting charter amendments to eliminate liability").

65. There are some notable exceptions. Leading comparative corporate law scholars, for instance, have studied the influence of Delaware's corporate law jurisprudence in a number of foreign court proceedings, acknowledging the possibility of Delaware setting the global standard for foreign nations enacting corporate law reforms. *See, e.g.*, Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2175 (2005). However, legal scholars have largely left unaddressed Delaware's international competitiveness as measured by foreign firms choosing to incorporate in Delaware (as opposed to lobbying for local corporate law reforms, resulting in transplantation of Delaware's corporate governance rules). This untapped data is important because the corporate law preferences of foreign firms—particularly ones raising capital in the United States—are perhaps the best evidence we have of whether Delaware corporate law maintains its competitive edge internationally.

States can choose to be governed by Delaware corporate law—simply by incorporating in the state, in a process that is essentially "glorified paperwork."[66] Of particular note are the growing number of foreign corporations that raise capital in American stock markets, who have reasons to choose corporate law that is most desirable from the standpoint of American investors.

The prevailing literature unfortunately overlooks the importance of corporate law in examining the behavior of foreign firms listed in American stock markets.[67] Leading scholars have long assumed that federal *securities law* (which mandatorily kicks in when foreign corporations list in the United States) sufficiently displaces foreign firms' home *corporate law*.[68] Professor Jack Coffee, for instance, has observed that even if foreign corporate law governing foreign firms deviates from conventional features of American corporate law, those foreign firms "may be significantly constrained by federal securities regulation."[69] Instead, scholars have focused on examining why foreign corporations choose to list in American stock markets, despite the notoriously burdensome disclosure rules and compliance costs associated with federal securities law. This is the "bonding hypothesis" developed in Professor Coffee's influential pieces. According to Coffee, the simplest explanation for foreign firms listed in the United States "is that such a listing is a form of

66. *See* William J. Moon, *Tax Havens as Producers of Corporate Law*, 116 MICH. L. REV. 1081, 1095 (2018) [hereinafter Moon, *Tax Havens*].

67. To be sure, this omission was perhaps not as critical in the past as it is today. Several decades ago, relatively few foreign companies were listed in American stock markets, and these foreign firms had little reason to consider incorporating in the United States. Many foreign corporations listed in American stock markets were also either outright prohibited from incorporating outside of their "home" countries, or faced substantial costs to switch corporate law. But today, over 14 percent of corporations listed in American stock markets are incorporated in foreign nations. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1424–25. A substantial portion of these new foreign entrants to American stock markets are based in countries like China that allow their local firms to "shop" for corporate law.

68. In order to reach the deep pockets of American investors, foreign companies listed in the United States surrender their home country's securities laws and are largely forced to abide by federal securities law. Modern federal securities law, in turn, directly impacts substantive areas traditionally considered to be in the domain of corporate law. *See* James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 126–31 (2017); Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649, 1652–53 (2015) [hereinafter Talley, *Inversions*] ("During the last fifteen years, a series of significant regulatory reforms—such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010—have suffused U.S. securities regulations with an unprecedented array of corporate governance mandates, ranging from board independence requirements to compensation reforms to internal financial controls to proxy access." (footnotes omitted)); MARC T. MOORE, CORPORATE GOVERNANCE IN THE SHADOW OF THE STATE 203 (2013) (describing how securities laws "affect corporate governance in ways beyond merely mandating ongoing corporate transparency"). Foreign corporations listed in American stock exchanges may claim some exemptions, but are unable to opt out of all of federal securities law once they choose to list in the United States. *See, e.g.*, Coffee, *Racing Towards the Top*, *supra* note 15, at 1821–22.

69. Coffee, *Future as History*, *supra* note 13, at 699.

bonding—a credible and binding commitment by the issuer not to exploit whatever discretion it enjoys under foreign law to overreach the minority investor."[70]

The bonding hypothesis has gained much traction and empirical support over the past two decades.[71] But the theory only further emboldens the paradox identified in this Article: If foreign firms bind themselves to federal securities law to raise capital from American investors, why do they not also bind themselves to Delaware corporate law? After all, American investors are most familiar with Delaware corporate law, and a robust body of empirical work indicates that incorporating in Delaware enhances firm value. Incorporating in Delaware also gives foreign corporations and their shareholders access to Delaware's judicial infrastructure,[72] which is said to be one of the pillars underlying Delaware's competitive advantage.[73] Contrary to what existing scholarship predicts, recent newspaper headlines suggest the opposite: Foreign companies, like Sohu.com, have re-incorporated out of Delaware to the Cayman Islands, often paying millions of dollars in legal fees to elite American law firms.[74]

There is a pressing need to examine this paradox. For one, the potential pool of foreign corporations that are eligible to shop for Delaware law have sharply increased over the years because a number of major foreign nations have relaxed legal restrictions that forced corporations to be bound by local

70. *Id.* at 691. The theory further predicts that "by voluntarily subjecting themselves to the United States's higher disclosure standards and greater threat of enforcement (both by public and private enforcers), they partially compensate for weak protection of minority investors under their own jurisdictions' laws and thereby achieve a higher market valuation." Coffee, *Racing Towards the Top*, *supra* note 15, at 1757.

71. *See generally* Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 (2003) (arguing that bonding theory is not supported by evidence versus the alternative avoiding hypothesis); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675 (2002) (arguing that mandatory disclosures create a mechanism to make a credible commitment device for tapping into U.S. capital markets); Ugur Lel & Darius P. Miller, *International Cross-Listing, Firm Performance, and Top Management Turnover: A Test of the Bonding Hypothesis*, 63 J. FIN. 1897 (2008) (examining the ability to improve cross-listed firms' corporate governance by identifying and eliminating poorly performing CEOs). Relatedly, the "reputational bonding hypothesis" explains that foreign firms choose to be governed by federal securities law as a reputation building mechanism. *See* Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. FIN. ECON. 319, 356 (2004).

72. Delaware courts exercise jurisdiction over corporate law disputes of any business entity incorporated in the state. *See* Papendick v. Bosch, 410 A.2d 148, 148 (Del. 1979).

73. *See, e.g.*, Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1017 (1997); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1064 (2000) [hereinafter Fisch, *Peculiar Role*] (attributing "Delaware's success in attracting corporate charters" to "the unique lawmaking function of the Delaware courts").

74. *See, e.g.*, Lulu Yilun Chen, *Sohu Proposal for Tax Haven Opposed by Prominent Proxy Adviser*, BLOOMBERG (May 23, 2018, 4:15 AM), https://www.bloomberg.com/news/articles/2018-05-23/sohu-proposal-for-tax-haven-opposed-by-prominent-proxy-adviser [https://perma.cc/J7H6-4MDV].

corporate law.[75] Today, a number of major jurisdictions around the world allow firms to shop for corporate law, including Brazil,[76] Canada,[77] China,[78] India,[79] Israel,[80] Japan,[81] the United Kingdom,[82] and the United States.[83] The number of foreign corporations listed in American stock markets has also grown by leaps and bounds in recent years,[84] and these firms have reason to choose corporate law that is appealing from the standpoint of American investors. Particularly noteworthy recent entrants are dozens of mega technology firms based in China that began tapping U.S. investors in the early

75. The legal restrictions turn on local conflict of laws rules. Doctrinally, restrictions on local firms opting out of local corporate law are often accomplished through the "real seat" doctrine, which assigns corporate governance rules based on where the corporation principally conducts its business. Werner F. Ebke, *The "Real Seat" Doctrine in the Conflict of Corporate Laws*, 36 INT'L L. 1015, 1016 (2002). Importantly, Europe has begun to abandon the "real seat" approach, although European Union law only requires member nations to allow local firms to incorporate in other member nations of the European Union. *See* Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475, 509 (2011) ("*Centros* allows a new corporation to incorporate in any EU state, and establish its business in any other EU state, even though the corporate governance system in the state of incorporation may impose fewer restrictions than the country in which the business is actually carried out.").

76. *See* André Antunes Soares de Camargo, *Three Essential Aspects of Corporate Law: A Brief Overview of Brazilian and American Approaches*, 9 SW. J.L. & TRADE AMS. 89, 99–100 (2003).

77. *See* Douglas J. Cumming & Jeffrey G. MacIntosh, *The Rationales Underlying Reincorporation and Implications for Canadian Corporations*, 22 INT'L REV. L. & ECON. 277, 279 (2001) ("There are no residency requirements associated with incorporating in a particular jurisdiction."); *id.* at 284 (studying Canadian firms reincorporating in foreign nations).

78. *See* Serena Y. Shi, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 FORDHAM INT'L L.J. 1265, 1266–67 (2014).

79. *See* Aditi Shrivastava, *Queue of Startups Rushing to Register Abroad Gets Longer*, ECON. TIMES (Feb. 12, 2020, 6:34 PM), https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/queue-of-startups-rushing-to-register-abroad-gets-longer/articleshow/74091926.cms [https://perma.cc/3NCP-L53M] ("More Indian startups are incorporating their businesses overseas. Singapore, the United States, the United Kingdom, the Netherlands and the United Arab Emirates are being preferred.").

80. *See* Yael T. Ben-Zion, *The Political Dynamics of Corporate Legislation: Lessons from Israel*, 11 FORDHAM J. CORP. & FIN. L. 185, 303 & n.642 (2006) (finding that "Israeli companies could incorporate in a foreign country" and continuing that "[t]he Israeli corporate law, like its American counterpart and as opposed to European corporate laws, applies the 'state of incorporation' doctrine and not the 'real seat' doctrine to the corporation's internal affairs").

81. *See* Tomotaka Fujita, *Regulation on Simplified and Foreign Companies in Japan*, 33 ARIZ. J. INT'L & COMP. L. 93, 103 (2016) ("[T]he definition of 'foreign company' under Japanese law is quite formal, and the law of the state of incorporation governs corporate internal affairs.").

82. Dan Prentice, *The Incorporation Theory—The United Kingdom*, 14 EUR. BUS. L. REV. 631, 633–34 (2003) ("It is the law of the domicile of the corporation—that is, the place of incorporation—that governs all aspects of the affairs of a company and this includes its creation, continued existence, internal management, and the creation of its share capital.").

83. ROMANO, GENIUS, *supra* note 3, at 1–3.

84. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1425.

2000s.[85] These firms are the talk of the town for any investment banker or transactional lawyer specializing in initial public offerings (IPO) on Wall Street these days. As reported in *The New York Times*, "Chinese firms accounted for four of the 10 largest [IPO] offerings in 2018 ranked by amount raised on American exchanges, the most of any country, including the United States."[86]

Understanding Delaware's weakness competing in the emerging international market for corporate law is also critical to map out the future of corporate law theory and policy. While the standard account has us believe that Delaware is the unquestioned gold standard for corporate law, if a large group of firms eligible to shop for corporate law do not choose Delaware law, it might shed light on whether Delaware corporate law is indeed ideal to begin with—or it might lend support to the idea that corporations might have differentiated taste for corporate law and that there may not be an ideal set of governance rules that work in all settings. It might also teach us lessons about the desirability (or perils) of exporting Delaware corporate law to foreign nations with vastly different market environments.

The next Section presents original data uncovering Delaware's global competitiveness, measured by the corporate law preferences of foreign companies listed in American stock markets.

B. DELAWARE'S UNPOPULARITY

This Section presents evidence that Delaware's dominance of the corporate charter market may be a parochial, American phenomenon. Foreign corporations raising capital in American stock markets—particularly those headquartered in China—have largely abandoned Delaware in recent years in favor of offshore jurisdictions including the Cayman Islands and the British Virgin Islands. This phenomenon is particularly perplexing, since existing theories would predict that these firms would prefer Delaware corporate law to make their shares more appealing to American investors.[87]

This study surveyed all publicly traded foreign corporations listed in American stock markets, principally made up of corporations listed in the

85. Jesse M. Fried & Matthew Schoenfeld, *The Risky Business of Investing in Chinese Tech Firms*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 4, 2019), https://corpgov.law.harvard.edu/2019/02/04/the-risky-business-of-investing-in-chinese-tech-firms [https://perma.cc/3834-PDTU] ("China's tech darlings began tapping U.S. investors in the early 2000s, when mainland capital markets were unsophisticated and the strict profitability requirements of PRC exchanges shut out most fast-growing tech firms.").

86. *See* Stephen Grocer, *Chinese Companies Flocked to U.S. Markets in 2018. The Trade War May Have Had a Role*, N.Y. TIMES (Jan. 2, 2019), https://www.nytimes.com/2019/01/02/business/dealbook/trade-war-china-ipos.html [https://perma.cc/XQ57-74AH].

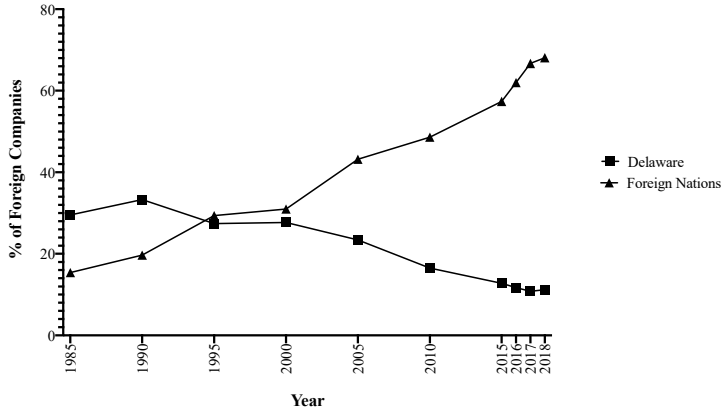
87. Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1420 (1989) ("The managers who pick the state of incorporation that is most desirable from the perspective of investors will attract the most money.").

New York Stock Exchange and the NASDAQ.[88] Using Standard & Poor's Compustat database (a compilation of public financial data for publicly traded corporations), I gathered 34 years of all publicly available data, from 1985–2018.[89] Table 1 and Figure 1 present a crude metric, examining the corporate law preferences of foreign firms listed in American stock markets that opt out of their home countries' corporate law—that is, the place of incorporation for foreign firms that are actively shopping for corporate law.[90]

Table 1. Place of Incorporation for Foreign Companies Shopping for Corporate Law

	1985	1990	1995	2000	2005	2010	2015	2016	2017	2018
Delaware	23 (29.5%)	44 (33.3%)	54 (27.4%)	86 (27.7%)	91 (23.4%)	92 (16.5%)	65 (12.8%)	61 (11.7%)	59 (10.8%)	56 (11.2%)
Foreign Nations	12 (15.4%)	26 (19.7%)	58 (29.4%)	96 (31%)	168 (43.2%)	270 (48.6%)	292 (57.4%)	324 (62%)	363 (66.7%)	342 (68.1%)
Total	78	132	197	310	389	556	509	523	544	502

Figure 1. Place for Incorporation for Foreign Companies Shopping for Corporate Law



88. Data is on file with author. NASDAQ and the New York Stock Exchange are the two biggest stock markets in the United States. Other stock markets included in the study are companies listed in the American Stock Exchange, OTC Bulletin Board, Boston Stock Exchange, Midwest Exchange, Pacific Exchange, and Philadelphia Exchange.

89. A few details on the methodology of data collection are worth mentioning. I aggregated the data using Wharton Research Data Service's Compustat. This aggregated dataset consisted a large number of duplicate inputs. I filtered out the duplicates using the statistics software, SPSS. Using SPSS, I also disaggregated the data by jurisdiction of incorporation. Using SPSS, I also eliminated firms that incorporate in their home jurisdictions.

90. *Cf.* Barzuza, *Nevada*, *supra* note 32, at 948 n.33 (illustrating a similar table on Nevada's corporate law shopping aggregated with Compustat).

While Delaware was by far the single most popular jurisdiction for foreign firms listing in the United States decades ago (attracting close to double the number of firms incorporating in foreign nations *combined*), it has dramatically declined in capturing the market share of foreign firms that actively shop for corporate law. In other words, a significant percentage of corporations that shop for corporate law appear uninterested in Delaware corporate law.

Several caveats warrant attention. First, the dataset excludes firms that incorporate in the jurisdiction where they maintain their headquarters. This is because a large number of foreign corporations raising capital in the United States are prohibited from opting out of their home countries' corporate law. Thus, for instance, South Korean law requires all firms headquartered in South Korea to be bound by South Korean corporate law, regardless of the place of incorporation.[91] Second, it is entirely plausible that Delaware's overall decline in attracting foreign firms might be largely due to the changing demographics of firms listed in the United States, as opposed to shifting taste among existing firms. More specifically, it might be driven in large parts by the explosive growth in the number of Chinese firms listed in the United States in the past two decades.

Indeed, the best evidence of Delaware's unpopularity among foreign firms comes from Chinese corporations that are listed in American stock markets.[92] For a variety of reasons, the vast majority of Chinese firms listed in the United States—including Baidu, Nio, Lufax, and Alibaba—are incorporated outside of China.[93] These corporations, in other words, actively

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91. Kyung-Hoon Chun, Kon-Sik Kim, Hyeok-Joon Rho & Ok-Rial Song, *General Introduction*, *in* CORPORATIONS AND PARTNERSHIPS IN SOUTH KOREA § 6.1 (3d ed. 2019) ("[I]f corporations incorporated in foreign countries have their principal business offices in Korea or transact their principal business in Korea, then such corporations shall be governed by the law of Korea."). Firms like LG Display (listed in NASDAQ) and Woori Bank (listed in the New York Stock Exchange) therefore cannot shop for corporate law. *See id.*; *see also* Rajeshni Naidu-Ghelani, *South Korea's 10 Biggest Companies*, CNBC (Sept. 13, 2013, 4:33 AM), https://www.cnbc.com/2012/07/23/South-Koreas-10-Biggest-Companies.html [https://perma.cc/3FFC-F4W9] (providing a list of South Korean companies which cannot shop for U.S. corporate law). Interestingly, South Korean e-commerce giant Coupang recently listed in the New York State Exchange as a Delaware entity. Even so, Coupang's SEC filings make clear that the company is largely bound by South Korean corporate law. *See, e.g.*, Coupang, Inc., Registration Statement (Form S-1) 50 (Feb. 12, 2021) ("Under applicable Korean law, directors of a Korean company, such as Coupang Corp., owe a fiduciary duty to the company itself rather than to its stockholders. This fiduciary duty obligates directors of a Korean company to perform their duties faithfully for the good of the company as a whole.").

92. While there are a few noteworthy exceptions, these corporations principally operate exclusively in China and all of their directors and officers reside in China. *See, e.g.*, ZST Digit. Networks, Inc., Registration Statement (Amend. 1 on Form S-1/A) (Jan. 14, 2010).

93. One central reason is the regulatory burdens imposed by the Chinese government on firms incorporated in China. Chinese corporations use legal loopholes and intermediate entities formed in foreign nations to gain access to American capital markets. *See* Wayne Duggan, *The Chinese Corporate Structure That Terrifies American Investors*, U.S. NEWS & WORLD REP. (Jan. 26, 2017,

shop for corporate law.[94] While some of these corporations choose to incorporate in one of the constituent states of the United States, Chinese corporations listed in American stock markets overwhelmingly choose to incorporate offshore (in the Cayman Islands in particular).

10:13 AM), https://money.usnews.com/investing/articles/2017-01-26/the-chinese-corporate-structure-that-terrifies-american-investors [https://perma.cc/338A-TC8R]. More specifically, Chinese companies listing in American stock markets typically employ a variable interest entity (VIE) structure. VIE is a corporate architecture that "is usually composed of an intermediary wholly foreign-owned entity (WFOE), which is a shell company registered in offshore jurisdictions, and multiple operating entities registered in China." Lianrui Jia, *Going Public and Going Global: Chinese Internet Companies and Global Finance Networks*, 13 WESTMINSTER PAPERS COMMC'N & CULTURE 17, 25 (2018). Through a series of contractual agreements detailing the level of control and cash flow, the intermediary is linked to the operating entity in China. *Id.* Foreign investors, under this structure, do not directly own shares in the operating entities in China, but instead in the intermediary. *See* Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control* 14 (Eur. Corp. Governance Inst., L. Working Paper No. 533/2020, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3644019 [https://perma.cc/NNQ6-2CVY]. The Chinese government thus enables firms based in China to shop for corporate law by "tolerating" the widely used VIE structure.

94. *Cf.* Barzuza, *Nevada*, *supra* note 32, at 948 n.33 (describing firms that incorporate outside of their home states as "firms that shop for law"). The fact that Chinese corporations are opting out of Chinese corporate law—said to be restrictive and underdeveloped—is not particularly surprising. This is especially true for the corporations that have chosen to list in American stock markets, abandoning China's relatively undeveloped capital markets. After all, leading scholars have previously documented problems associated with China's relatively new corporate and securities laws. *See generally* Donald C. Clarke, *The Independent Director in Chinese Corporate Governance*, 31 DEL. J. CORP. L. 125 (2006) [hereinafter Clarke, *Independent Director*] (assessing that proponents independent directors in China misconceive the nature of the corporate governance problem in China); Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494 (2003) [hereinafter Clarke, *Corporate Governance in China*] (discussing how a primary problem of Chinese corporate governance law stems from the state policy of maintaining a full or controlling ownership interest in enterprises in several sectors). But the fact that the Chinese corporations are actively shopping for corporate law, yet rejecting Delaware—and its purportedly value-enhancing law—demands further explanation.

Table 2. Place of Incorporation for Chinese Corporations Listed in American Stock Markets

	1985	1990	1995	2000	2005	2010	2015	2016	2017	2018
Delaware	4 (40%)	6 (40%)	8 (29.6%)	14 (26.4%)	32 (21.8%)	40 (13.9%)	12 (5.7%)	11 (4.8%)	12 (4.6%)	12 (4.9%)
Nevada	2 (20%)	3 (20%)	4 (14.8%)	9 (17.0%)	23 (21.7%)	66 (22.9%)	39 (18.6%)	34 (14.8%)	30 (11.5%)	27 (11.1%)
Other U.S. States and D.C.	3 (30%)	4 (26.7%)	6 (22.2%)	8 (15.1%)	12 (8.2%)	25 (8.7%)	13 (6.2%)	11 (4.8%)	8 (3.1%)	7 (2.9%)
Cayman Islands	1 (10%)	1 (6.7%)	1 (3.7%)	4 (7.5%)	53 (36.1%)	118 (41%)	106 (50.5%)	126 (54.8%)	160 (61.3%)	151 (62.1%)
British Virgin Islands	0 (0%)	1 (6.7%)	2 (7.4%)	6 (11.3%)	12 (8.2%)	24 (8.3%)	25 (11.9%)	34 (14.8%)	36 (13.8%)	31 (12.8%)
Hong Kong	0 (0%)	0 (0%)	0 (0%)	0 (0%)	2 (1.4%)	1 (0.3%)	1 (0.5%)	1 (0.4%)	2 (0.8%)	2 (0.8%)
Marshall Islands	0 (0%)	0 (0%)	0 (0%)	0 (0%)	0 (0%)	0 (0%)	1 (0.5%)	1 (0.4%)	1 (0.4%)	1 (0.4%)
Antigua and Barbuda	0 (0%)	0 (0%)	0 (0%)	1 (1.9%)	1 (0.7%)	1 (0.3%)	1 (0.5%)	1 (0.4%)	1 (0.4%)	1 (0.4%)
China	0 (0%)	0 (0%)	6 (22.2%)	11 (20.8%)	12 (8.2%)	13 (4.5%)	12 (5.7%)	11 (4.8%)	11 (4.2%)	11 (4.5%)
Total	10	15	27	53	147	288	210	230	261	243

Figure 2. Place of Incorporation for Chinese Corporations Listed in American Stock Markets[95]

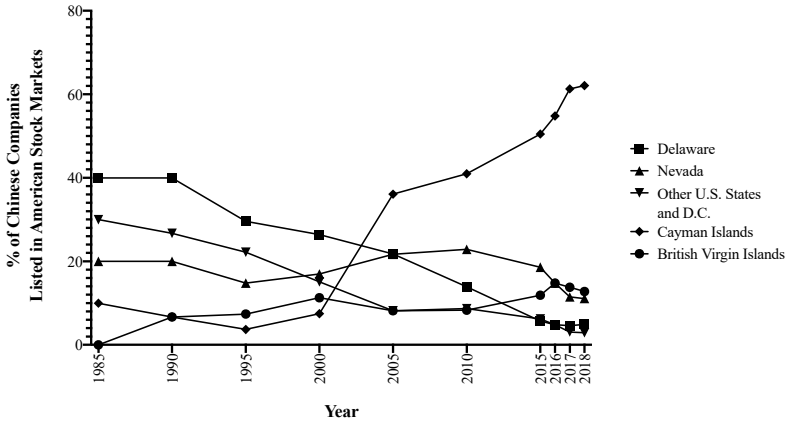

Table 2 and Figure 2 show that this is a stark difference from decades ago. In 1985, only ten Chinese corporations listed in American stock markets. Nine out of the ten corporations incorporated in an American state, with four out the nine choosing Delaware. Perhaps Chinese companies did not really

95. Figure 2 is constructed with data from Table 2. Note that the Marshall Islands, Antigua and Barbuda, and Hong Kong are excluded in Figure 2 for optimal data visualization.

shop for corporate law. "When in America, you go to Delaware," they may have been counseled. But times have changed. In the past two decades, there has been a dramatic uptick in the number of Chinese corporations listing in American stock markets, and they have attracted an army of American investors looking to profit from China's explosive growth. These firms have collectively raised hundreds of billions of dollars from American investors —largely without incorporating in Delaware.

While Delaware and Nevada continue to account for almost all Chinese entities choosing to incorporate in the United States[96] their collective market shares have drastically declined with the growing popularity of offshore jurisdictions. Similarly, while firms like PetroChina and China Eastern Airlines are incorporated in China (thus governed by Chinese corporate law),[97] a solid majority of Chinese firms listed in the United States today are incorporated in the Cayman Islands.

It is not for Delaware's lack of trying. Foreign corporations incorporated in Delaware can generate up to $200,000 per company annually for the state's government coffers.[98] That is no small change for a state that has faced a series of budget deficits in recent years.[99] Indeed, official state government publications are not shy about touting the advantages of Delaware corporate law to foreign corporations.[100] Dozens of incorporation service websites also advertise Delaware corporate law targeting foreign clients.[101] The Chinese, however, apparently fail to appreciate these purported benefits.

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96. This fact is important because it undermines the possibility that Chinese firms are choosing the place of incorporation randomly. Nevada's sustained popularity among Chinese firms over the past several decades is not a coincidence. Similar to the Cayman Islands and the British Virgin Islands, Nevada offers lax corporate governance rules favorable to corporate managers. Professor Barzuza describes Nevada corporate law as a near "liability-free jurisdiction." Barzuza, *Nevada*, *supra* note 32, at 947.

97. *See, e.g.*, PetroChina Co. Ltd., Annual Report (Form 20-F) 1 (Apr. 29, 2019).

98. DEL. CODE ANN. tit. 8, § 503(c) (2021); *see also Delaware Franchise Tax FAQ*, DELAWAREINC.COM, https://www.delawareinc.com/delaware-franchise-tax [https://perma.cc/D9LT-GQ35] (explaining that the Delaware Franchise Tax could range from $175 to $200,000 calculated based on a company's authorized shares).

99. *See* Matthew Albright, *Delaware's Budget Hole Deepens by $35.6 Million*, DEL. ONLINE (Mar. 20, 2017, 5:51 PM), https://www.delawareonline.com/story/news/politics/2017/03/20/budget-gap-grows/99423566 [https://perma.cc/Z29L-H5W4].

100. *See Beyond the Borders: Delaware's Benefits for International Business*, DELAWARE.GOV, https://corplaw.delaware.gov/delawares-benefits-international-business [https://perma.cc/5E9U-JXCN] ("Delaware's business statutes generally provide a number of advantages to international businesses. Delaware law also permits and provides efficient procedures for business combinations and other transactions, including mergers, transfers, and conversions.").

101. One website, for instance, describes corporate attorneys across the United States being "well-versed in Delaware law" and the Delaware Court of Chancery judges' "extensive knowledge of Delaware business laws" as some of the advantages of incorporating in Delaware. *See e.g.*, *Why Incorporate in Delaware?*, USA CORP. SERVS. INC., https://www.usa-corporate.com/new-business-resources/incorporate-in-delaware [https://perma.cc/4HCE-8GBT].

Hundreds of foreign companies abandoning Delaware as their preferred jurisdiction for incorporation could be bad news for those who celebrate the merits of Delaware corporate law.[102] It might be an indication that Delaware corporate law was never ideal, and the lack of serious competition from other *states* in the United States allowed Wilmington's corporate law empire to sustain itself. This account is supported by a number of leading scholars who have called the *inter-state* charter competition metaphor a "myth"[103] or at best "a leisurely walk" based on the observation that no other state besides Delaware appears to care about collecting corporate franchise taxes.[104] As observed by Marcel Kahan and Ehud Kamar, "[o]ther than Delaware, no state is engaged in significant efforts to attract incorporations of public companies."[105]

Delaware also contends with several entrenched interest groups that may make offshore jurisdictions seem more attractive.[106] Existing literature documents how these interest groups' rent-seeking behavior may have collectively eroded the state's competitiveness. In addition to a cottage industry of businesses that specialize in incorporation services,[107] the state's local corporate lawyers benefit from the state's notoriously vague corporate code that generates a garden variety of corporate law disputes.[108] It is for this

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102. It could also support the hypothesis that the complex web of mandatory federal securities laws that kick in when foreign firms list in American stock markets puts American states at a competitive disadvantage in attracting foreign firms. *See* Simmons, *Delaware's Global Threat*, *supra* note 8, at 222. After all, a number of disclosures mandated by federal securities laws may be avoided by foreign corporations simply by declining to incorporate in the United States, thereby being classified as foreign private issuers. I explore this possibility further in Section III.B, but remain skeptical that federal securities laws can fully account for the foreign aversion to Delaware law.

103. Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684 (2002) [hereinafter Kahan & Kamar, *Myth*].

104. Bebchuk & Hamdani, *Leisurely Walk*, *supra* note 51, at 556.

105. Kahan & Kamar, *Myth*, *supra* note 103, at 684. This point is contested. For instance, Roberta Romano maintains that "given Delaware's dominance, most other states engage in defensive competition, acting to retain domestic corporations, rather than seeking to lure corporations away from Delaware and unseat it as the market leader." Roberta Romano, *Market for Corporate Law Redux*, *in* THE OXFORD HANDBOOK OF LAW AND ECONOMICS: VOLUME 2: PRIVATE AND COMMERCIAL LAW 358, 363 (Francesco Parisi ed., 2017) [hereinafter Romano, *Corporate Law Redux*]. Others have argued that "[a]t least two states—Delaware and Nevada—are vigorously attempting to attract out-of-state incorporations." Barzuza, *Nevada*, *supra* note 32, at 994.

106. Popular offshore jurisdictions like the Cayman Islands and the British Virgin Islands, unlike most American states, are small enough to rely on corporate franchise taxes for government revenue. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1429. This reliance enables them to credibly commit to maintaining corporate governance rules that more or less reflect private sector preferences. *Id.* at 1436.

107. *See, e.g.*, *Delaware Mail Forwarding and Virtual Office Services*, DELAWAREINC.COM, https://www.delawareinc.com/ourservices/mail-forwarding [https://perma.cc/9WUC-QZMK].

108. Macey & Miller, *supra* note 55, at 486; Jonathan Macey, *Delaware: Home of the World's Most Expensive Raincoat*, 33 HOFSTRA L. REV. 1131, 1132 (2005) ("The Delaware judiciary has created

reason that Delaware lawyers are, on average, the highest paid lawyers in the United States.[109] The private sector's firm grip over the corporate lawmaking process in Delaware is hardly a secret.[110] Delaware judges may also have a role—with a prominent scholar recently assessing that Delaware judges principally serve to maximize their reputation.[111] Together, these interest groups may have taken too big of a bite out of Delaware's success, rendering the regime unduly expensive for foreign clients.[112]

Delaware's corporate law empire may be challenged if hundreds of Chinese corporations help popular offshore jurisdictions like the Cayman Islands build large bodies of case law and reputable dispute resolution mechanisms.[113] After all, a significant competitive advantage enjoyed by Delaware is network externalities: the fact that a large number of companies are already incorporated there, generating an impressive body of case law and an unusually large number of lawyers familiar with Delaware corporate law.[114]

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an environment in which lawsuits are plentiful, legal fees are high, and attorneys' fees generously awarded . . . .").

109. Kahan & Kamar, *Myth*, *supra* note 103, at 695 ("[T]he average income of Delaware lawyers is higher than that of lawyers in any other state, or even any city, in the country.").

110. The Delaware legislature regularly "responds to the bar's pulling the 'fire alarm' by enacting the proposed initiatives." Romano, *Corporate Law Redux*, *supra* note 105, at 364. Of course, corporate law is hardly the only field subject to interest group pressures. *See e.g.*, MAXWELL L. STEARNS & TODD J. ZYWICKI, PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW 358 (2009); Michael Pappas & Victor B. Flatt, *The Costs of Creating Environmental Markets: A Commodification Primer*, 9 U.C. IRVINE L. REV. 731, 739 (2019).

111. Stephen M. Bainbridge, *Interest Group Analysis of Delaware Law: The Corporate Opportunity Doctrine as a Case Study*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW, *supra* note 57, at 120, 122 ("[T]he most plausible explanation for the behavior of the Delaware courts in this context appears to be their interest in maximizing their reputation."). Law professors, including myself, should not be immune to an interest group analysis. Legal academics with expertise on Delaware corporate law are often paid handsomely for producing expert opinions used in high stakes litigation in the Delaware Court of Chancery.

112. It is also worth noting that Delaware, exploiting its market-dominant position, charges higher fees than other states. As explained by Marcel Kahan and Ehud Kamar, "Delaware is the only state that imposes substantial franchise taxes unrelated to the amount of business that firms conduct in the state." Kahan & Kamar, *Price Discrimination*, *supra* note 6, at 1218.

113. *See* Alyssa S. King, *Global Civil Procedure*, HARV. INT'L L.J. (forthcoming 2021) (manuscript at 29), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3652731 [https://perma.cc/35FS-4SGM] ("For common law jurisdictions like Delaware or Bermuda, deciding more cases also enriches local corporate law, so that competing for litigants can be part of a larger strategy of competing for corporate [charter] registration."). To a certain extent, prominent offshore jurisdictions have already established sophisticated legal infrastructures necessary to compete globally. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1437–39. Professor Pam Bookman describes these offshore business courts as "arbitral courts" that replicate features of international commercial arbitration. *See* Pamela K. Bookman, *Arbitral Courts*, VA. J. INT'L L. (forthcoming 2021) (manuscript at 3), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3691254 [https://perma.cc/SR2T-UMK4] [hereinafter Bookman, *Arbitral Courts*].

114. The concept of network externalities refers to the benefits of incorporating in a jurisdiction where a large number of other firms have incorporated. *See* Klausner, *supra* note 51, at 843–45. These benefits include: (1) a robust body of case law enhancing the predictability of

Thus, offshore corporate law havens' increasing network effects, jet-fueled by the Chinese, may accelerate the pace of firms incorporating away from Delaware.

We are already seeing signs of popular offshore jurisdictions becoming important players in the emerging global market for corporate charters. Dozens of publicly-traded corporations physically headquartered in the United States—including Accenture Consulting, Helen of Troy, Hudson Group, Vantage Drilling Company, Lazard, Herbalife, and Fruit of the Loom—are already incorporated offshore, principally to the Cayman Islands, Bermuda, and the British Virgin Islands.[115] These three jurisdictions have also launched specialized business courts in recent years, offering expert business law jurists resolving complex corporate law disputes.[116]

It is thus urgently important to understand Delaware's unpopularity among foreign corporations and to properly diagnose it, because it could point to larger defects in the content of Delaware corporate law. It could also have important implications concerning the desirability of foreign nations importing Delaware corporate law.

The next Part takes up this task, extrapolating causal variables that account for Delaware's surprising unpopularity in the emerging international market for corporate law.

III. ACCOUNTING FOR DELAWARE'S WEAKNESS COMPETING IN THE GLOBAL MARKET FOR CORPORATE LAW

This Part explains Delaware's unpopularity among foreign corporations raising capital in American stock markets. Section III.A examines whether tax reduction strategies may account for why foreign corporations are averse to Delaware law. Because tax and corporate law are bundled in the United

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the law; and (2) a large group of lawyers who can efficiently provide legal services by the virtue of their extensive practice experience in one jurisdiction. *See* Bebchuk & Hamdani, *Leisurely Walk*, *supra* note 51, at 586–87. Network effects, of course, are not just limited to corporate law. For an excellent recent work on the network effects of financial benchmarks, see Sue S. Guan, *Benchmark Competition*, 80 MD. L. REV. 1, 25–27 (2020).

115. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1406; Christopher M. Bruner, *Leveraging Corporate Law: A Broader Account of Delaware's Competition*, 80 MD. L. REV. 72, 78 (2020) (discussing the significant role played by "British Overseas Territories" including "Bermuda, the British Virgin Islands, and the Cayman Islands"); Darren Rosenblum, *The Futility of Walls: How Traveling Corporations Threaten State Sovereignty*, 93 TUL. L. REV. 645, 661–62 (2019) (discussing how Helen of Troy completed an "inversion transaction through which it became the subsidiary of a Bermuda shell corporation").

116. *See* Simmons, *Delaware's Global Threat*, *supra* note 8, at 243 ("[F]oreign jurisdictions desiring to attract foreign capital investment or prevent corporate migration may model or adopt Delaware-style adjudicative features and legal precedents to both create value for business litigants and enhance their reputations as business hubs."); Moon, *Delaware's New Competition*, *supra* note 8, at 1423 (documenting the emergence of "specialized business courts in offshore jurisdictions that supply the judicial infrastructure necessary to handle complex corporate law disputes"); Bookman, *Arbitral Courts*, *supra* note 113, at 17.

States,[117] tax could in theory incentivize foreign corporations to incorporate offshore, even if they may have preferred Delaware strictly from a corporate law standpoint. After dismissing tax avoidance as the sole reason for Delaware's unpopularity, Section III.B weighs the possibility that federal securities law may be undermining Delaware's competitiveness. After all, foreign firms incorporating in Delaware (as opposed to the Cayman Islands) would lose their "foreign issuer" status under federal securities law, and thereby subject themselves to heightened disclosure standards governing a typical American corporation listed in the United States. Concluding that neither tax nor federal securities law can offer a full descriptive account, Section II.C provides a corporate law explanation for Delaware's weakness competing in the emerging international market for corporate law: Delaware is losing to offshore foreign nations largely because of the content of its corporate law.

A. ALL ABOUT TAX REDUCTION?

It is no secret that corporations from Apple to Uber use offshore "tax havens" to evade or avoid domestic tax liability.[118] Corporate tax reduction strategies are, indeed, alive and well even after the recent federal tax legislation enacted in 2017.[119] Tax incentives are said to be responsible for the wave of corporate inversions, where American companies incorporate in offshore jurisdictions like Bermuda to reduce domestic tax liability.[120]

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117. Kane & Rock, *supra* note 27, at 1230; Rosenblum, *supra* note 115, at 669.

118. *See* Moon, *Tax Havens*, *supra* note 66, at 1081–83. A rich body of tax law scholarship explains how federal tax law is incentivizing American corporations to change their legal residency into small offshore "tax havens" to reduce domestic tax liability. *See, e.g.*, Andrew Blair-Stanek, *Intellectual Property Law Solutions to Tax Avoidance*, 62 UCLA L. REV. 2, 14 (2015); Daniel Shaviro, *The Rising Tax-Electivity of U.S. Corporate Residence*, 64 TAX L. REV. 377, 378 (2011).

119. MATTHEW GARDNER, STEVE WAMHOFF, MARY MARTELLOTTA & LORENA ROQUE, INST. ON TAX'N & ECON. POL'Y, CORPORATE TAX AVOIDANCE REMAINS RAMPANT UNDER NEW TAX LAW 1 (2019), https://itep.sfo2.digitaloceanspaces.com/04119-Corporate-Tax-Avoidance-Remains-Rampant-Under-New-Tax-Law_ITEP.pdf [https://perma.cc/36MU-9KSY]; *see also* Lynnley Browning & Eric Newcomer, *Uber Created a $6.1 Billion Dutch Weapon to Avoid Paying Taxes*, BLOOMBERG (Aug. 8, 2019, 3:36 PM), https://www.bloomberg.com/news/articles/2019-08-08/uber-created-a-6-1-billion-dutch-weapon-to-avoid-paying-taxes [https://perma.cc/GG8C-VP9C] ("Uber's moves signal how the Republican tax law, which cut the corporate rate to 21% from 35%, failed to encourage companies to bring IP and profits back to the US, because companies can still pay lower taxes by keeping certain entities overseas.").

120. The place of incorporation rule is responsible for enabling tax arbitrage opportunities. This rule determines the corporation's legal location based on the entity's place of incorporation, "permitting firms headquartered or managed in the United States to avoid U.S. taxpayer status by reincorporating in foreign jurisdictions." William J. Moon, *Regulating Offshore Finance*, 72 VAND. L. REV. 1, 11 (2019) [hereinafter Moon, *Regulating Offshore Finance*]. While the new federal tax bill enacted in 2017 attempted to abandon important aspects of the incorporation rule, it is at best a "hybrid" model that inevitably turns on the place of incorporation as a factor in assessing corporate tax. Reuven Avi-Yonah, *The Tax Act Actually Promotes Off-Shore Tax Tricks*, AM. PROSPECT (June 28, 2018), https://prospect.org/power/tax-act-actually-promotes-off-shore-tax-tricks [https://perma.cc/GMY2-5E4W]. Legal scholars have only begun to assess the tax

Legal scholars, accordingly, have diagnosed the American corporate inversion movement as a byproduct of tax reduction strategies. Professors Mitchell Kane and Ed Rock, for instance, describe U.S.-based corporate inversions as "unabashedly all about tax reduction,"[121] assessing that tax forces American firms to incorporate in jurisdictions that supply suboptimal corporate law.[122]

It may seem reasonable at first glance, thus, to attribute foreign corporations' abandonment of Delaware to tax incentives. Indeed, the current Federal Tax Code subjects foreign companies merely incorporated in the United States to federal tax, even if they operate entirely outside of the United States.[123] This includes potential U.S. corporate income tax as well as "levies on rents, royalties, interest and gains from the disposal of investments."[124] Perhaps the expected corporate tax reduction is so great that foreign corporations are willing to opt into "suboptimal" Cayman law, even though they would have preferred Delaware law.[125] Just like American corporations such as Helen of Troy and Fruit of the Loom that have gone offshore, Chinese corporations like Baidu or Weibo presumably also want to minimize global tax liability.[126]

Indeed, several executives of prominent Chinese corporations listed in the United States have openly declared tax savings as the reason for leaving Delaware. Consider the case of Sohu.com, a major on-line multiplayer gaming

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implications of the new tax bill, with initial accounts assessing it as a modest improvement. *See* David Kamin, David Gamage, Ari Glogower, Rebecca Kysar, Darien Shanske, Reuven Avi-Yonah, Lily Batchelder, J. Clifton Fleming, Daniel Hemel, Mitchell Kane, David Miller, Daniel Shaviro & Manoj Viswanathan, *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1488 (2019) ("[T]he old system of U.S. international tax rules, prior to the new tax legislation, was also the subject of considerable tax gaming and inefficiency. As measured against the baseline of old law, some of the new rules represent modest improvements.").

121. Kane & Rock, *supra* note 27, at 1230.

122. *Id.* at 1233 ("[T]ax-motivated corporate locational decisions can lead to an efficiency cost to the extent that corporations are steered into suboptimal legal regimes from a corporate law standpoint.").

123. Under § 7874 of the U.S. Internal Revenue Code of 1986, corporations with no operations in the United States may be treated as a U.S. corporation for U.S. federal income tax purposes by the virtue of incorporating in the United States. *See* 26 U.S.C. § 7874 (2018); *see also* Susan C. Morse, *Startup Ltd.: Tax Planning and Initial Incorporation Location*, 14 FLA. TAX REV. 319, 322 (2013) ("A firm incorporated in Delaware that lacks any corporate functions in the United States must still pay US corporate income tax.").

124. Chen, *supra* note 74.

125. Kane & Rock, *supra* note 27, at 1231 ("[C]orporate tax consequences of migration can make the cost of choosing the desired corporate law prohibitive. In this way, corporate tax can trap firms in a suboptimal jurisdiction from the standpoint of corporate law.").

126. Indeed, the Chinese are no newcomers to the offshore world. "Round tripping" is a technique widely used by the Chinese in forming closely-held business entities, accounting for why the British Virgin Islands is the second largest foreign direct investor into mainland China. *See* Ken Davies, *While Global FDI Falls, China's Outward FDI Doubles*, 1 TRANSNAT'L CORPS. REV. 20, 21 (2009).

company based in Beijing. In attempting to garner support from shareholders to re-domicile the company from Delaware to the Cayman Islands in 2018, MIT-educated scientist and founder Charles Zhang offered the following explanation: "We have zero operations in the U.S. . . . . For U.S. taxes, by re-domiciling we can avoid taxes that we shouldn't pay."[127]

But tax is, at best, only a partial explanation. For one, at least some of the foreign companies that re-domicile out of Delaware may still be subject to federal income tax. For instance, China Biologic Products, which left Delaware for the Cayman Islands in 2017, reports in its SEC disclosures that the firm "will continue to be treated as a U.S. corporation for U.S. federal income tax purposes."[128]

Perhaps more importantly, if tax were the main reason, one would predict that foreign firms would *contractually* specify Delaware-type corporate rules in their corporate bylaws or corporate charters.[129] After all, popular "offshore corporate law havens" like the Cayman Islands impose fewer mandatory rules than Delaware,[130] meaning that corporations can choose to contractually provide higher (Delaware-level) protection for shareholders. It also bears noting that institutional investors are substantial shareholders of foreign firms listed in American stock markets,[131] who would have presumably demanded Delaware (or at least Delaware-like) corporate governance rules, should they feel that it is necessary.[132] Foreign firms understand that they

127. Chen, *supra* note 74 (quoting Charles Zhang).

128. China Biologic Prods., Inc., Proxy Statement (Form 14A) 9 (May 19, 2017). It is also worth noting that Chinese corporations that have gone offshore are not choosing jurisdictions randomly. For instance, while American corporations incorporating in foreign nations have frequently chosen Bermuda as their place of incorporation (a jurisdiction that offers virtually equivalent corporate and capital gains tax as the Cayman Islands or the British Virgin Islands), no Chinese company listed in the United States has chosen to incorporate in Bermuda. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1426 n.106. This data gives further support to the idea that there is more than tax at play.

129. Corporate laws of prominent offshore jurisdictions like the Cayman Islands and the British Virgin Islands are predominantly made up of default rules, meaning that corporations can choose to deviate from them by contractual specifications. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1148–49. Different jurisdictions maintain different formal mechanisms to contractually customize corporate governance rules that deviate from the default rules.

130. Moon, *Delaware's New Competition*, *supra* note 8, at 1142.

131. *See* Zhang Shidong, *US Investors Holding US$1 Trillion of Chinese Stocks in a Spot of Bother as Trump's Investment Ban Nears*, S. CHINA MORNING POST (Jan. 7, 2021, 9:00 PM), https://www.scmp.com/business/markets/article/3116795/us-investors-holding-us1-trillion-chinese-stocks-spot-bother [https://perma.cc/D9DM-DBMM] ("[I]nstitutional investors account for 86 per cent of the exposure to Chinese equities, according to Goldman Sachs.").

132. One might make the case that Delaware corporate law may not be as effective absent Delaware's legal infrastructure—namely, access to Delaware courts. *See* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law,"* 63 EMORY L.J. 1383, 1418–1419 (2014). However, the Cayman Islands and the British Virgin Islands have relatively-effective business courts that can adjudicate complex corporate law disputes, and there appears little reason why firms would not include Delaware-like rules if they want to appease American investors.

could easily impose stricter, Delaware-style governance rules, but affirmatively decide against it.

In order to test this hypothesis, I hand-collected and analyzed SEC disclosures of all Chinese corporations listed in the New York Stock Exchange and NASDAQ that are incorporated in the Cayman Islands.[133] As shown in Table 3, Chinese corporations that have gone to the Cayman Islands have largely opted out of governance rules that are mandatory in Delaware, choosing instead to adopt default rules offered by the Cayman Islands (or "middle ground" rules forbidden under Delaware law).[134] The fact that firms are intentionally opting out of Delaware law suggests that corporate law is the main driver of foreign firms going offshore.

133. I rely on the U.S.-China Economic and Security Review Commission's tracking of Chinese companies listed in American stock markets. "As of October 2, 2020, there were 217 Chinese firms listed [in an American exchange]." *Chinese Companies Listed on Major U.S. Stock Exchanges*, U.S.-CHINA ECON. & SEC. REV. COMM'N (Oct. 2, 2020), https://www.uscc.gov/chinese-companies-listed-major-us-stock-exchanges [https://perma.cc/WDR3-GXDR].

134. By "middle ground" rules, I mean rules that provide higher levels of protection for shareholders than the default Cayman law, but nevertheless do not reach the protection mandated under Delaware law. In many cases, Chinese firms incorporated in the Cayman Islands do provide higher levels of protection than what is required under Cayman law. Consider Sohu.com—the company's prospectus states: "Sohu's commitment to good corporate governance has not changed and will not change after we are domiciled in the Cayman Islands." *Sohu.com Inc. Chairman and CEO Issues Letter to Stockholders Regarding Special Meeting*, CISION (May 16, 2018, 8:00 AM), https://www.prnewswire.com/news-releases/sohucom-inc-chairman-and-ceo-issues-letter-to-stockholders-regarding-special-meeting-300649989.html [https://perma.cc/VJL6-UULW]. Yet, a detailed review of Sohu's SEC filings reveals that the company still elected to opt out of a number of rules mandated under Delaware law, including minority shareholder appraisal rights. *See* Sohu.com Ltd., Annual Report (Form 20-F) 153 (Mar. 28, 2019).

Table 3. Transnational Contractual Corporate Governance

Corporate Governance Rule Mandated by Delaware but not by Cayman Islands	Percentage of Chinese Corporations Listed in the United States that Contractually Adopt Delaware-Type Rules	Percentage of Chinese Corporations Listed in the United States that Contractually Adopt Cayman Islands Default or "Middle Ground" Rules
Annual Meeting[135]	16.3%	83.7%
Books and Records[136]	0%	100%
Appraisal Rights[137]	0%	100%

Consider, for instance, shareholder appraisal rights—an axiomatic feature of Delaware corporate law. Whenever a company is a target of takeover or merger, Delaware law gives shareholders "a statutory right to reject the terms of an approved sale in favor of a judicial determination of 'fair value' for their shares."[138] SEC disclosures reveal that Chinese

135. DEL. CODE ANN. tit. 8, § 211(c) (2020) ("If there be a failure to hold the annual meeting or to take action by written consent to elect directors in lieu of an annual meeting for a period of 30 days after the date designated for the annual meeting, or if no date has been designated, for a period of 13 months after the latest to occur of the organization of the corporation, its last annual meeting or the last action by written consent to elect directors in lieu of an annual meeting, the Court of Chancery may summarily order a meeting to be held upon the application of any stockholder or director.").

136. *Id.* § 220(b) ("Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right . . . to inspect for any proper purpose, and to make copies and extracts from . . . [t]he corporation's stock ledger, a list of its stockholders, and its other books and records . . . .").

137. *Id.* § 262(b) ("Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected.").

138. Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 34 J.L. ECON. & ORG. 543, 543 (2018). Shareholders of a Cayman Islands company do not have access to Delaware's appraisal rights regime, reportedly making it easier to "squeeze out" minority shareholders. *See* Gary Smith & Ramona Tudorancea, *Cayman Merger Take-Privates from NYSE and NASDAQ—2016 Year in Review*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 9, 2017), https://corpgov.law.harvard.edu/2017/04/09/cayman-merger-take-privates-from-nyse-and-nasdaq-2016-year-in-review [https://perma.cc/P8CP-F4CU]. Under Section 238 of Cayman Companies Law, dissenting shareholders of a Cayman Islands incorporated company can apply to have the fair value of their shares determined by the Grand Court. While Section 238 was modeled in part by Section 262 of the Delaware General Corporation Law, there are major points of differentiation. For instance, while Delaware entitles dissenters to their proportionate share of the firm's value, Cayman law permits minority discount. *See* Saniya Rao, *Amid Chinese ADR Delistings, the Role of Cayman's Valuation Process Examined*, CTFN (July 27, 2020), https://ctfn.news/news/jul-27-2020-bita-sina-sogo-wuba-276975 [https://perma.cc/3QEQ-7SL4]. Moreover, while the Cayman Islands Grand Court pays close attention to Delaware cases, it has made clear that it is not bound to follow Delaware's approach. *Id.* Given that the Cayman Islands case law is

corporations largely opt out of shareholder appraisal rights by opting into the default rules that operate in the Cayman Islands. YY Inc., China's largest video-based social network company, explains:

> Unlike many jurisdictions in the United States, Cayman Islands law does not generally provide for shareholder appraisal rights on an approved arrangement and reconstruction of a company. This may make it more difficult for you to assess the value of any consideration you may receive in a merger or consolidation.[139]

Relatedly, Table 3 also helps us understand that Chinese firms know how to contractually customize corporate governance rules,[140] undermining the possibility that they might have "accidentally" selected lax corporate governance rules. These firms appear to have acute preferences to avoid governance rules that are mandatory in Delaware.

At the very least, the assertion that federal tax law is to blame for Delaware's unpopularity needs to be tempered. This is particularly true given that Nevada has carved out a sizable niche market attracting Chinese firms. Since federal or state tax liability is not impacted whether a foreign corporation is incorporated in Nevada or Delaware,[141] it is unlikely that tax can fully account for their preferences.

B. IS FEDERAL SECURITIES LAW UNDERMINING DELAWARE'S COMPETITIVENESS?

Even setting tax aside, Delaware may not be entirely to blame for its global unpopularity. It may be because of the schizophrenic ways federal securities law applies to foreign companies listed in the United States.[142] Under current federal securities law, foreign firms trading in American stock markets are referred to as "foreign issuers," subject to less stringent disclosure and reporting requirements than their American counterparts.[143] But foreign

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in its nascent stages (at least relative to Delaware), it remains to be seen to whether and to what extent Cayman law will be hostile to minority shareholder rights.

139. YY Inc., Annual Report (Form 20-F) 49 (Apr. 26, 2019).

140. *Cf.* Fisch, *Corporate Bylaws*, *supra* note 30, at 373 (assessing that boards and shareholders are "are increasingly using charter and bylaw provisions to customize their corporate governance").

141. Moon, *Tax Havens*, *supra* note 66, at 1093 ("[I]ncorporation decisions in the domestic interstate context do not generally implicate a dramatic altering of the effective federal or state tax rate, notwithstanding the differences in state franchise tax fees. Federal income tax is unaffected because firms operating within the United States must pay federal taxes. State income tax is unaffected because corporations must establish physical presence within a state to be subject to that state's tax.").

142. *See* Steven M. Davidoff, *Paradigm Shift: Federal Securities Regulation in the New Millennium*, 2 BROOK. J. CORP. FIN. & COM. L. 339, 359 (2008).

143. Talley, *Inversions*, *supra* note 68, at 1653 n.8; *see also* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMPAR. L. 329, 349 (2001) ("[B]y listing on a U.S. stock exchange, the foreign company is obligated to register under Section 12(b) of the

firms will lose their foreign issuer status if they choose to incorporate in an American state. The heightened requirements include, for example, the obligation to disclose holders of more than five percent of its outstanding stock under Section 13(d) of the Securities Exchange Act of 1934.[144] Thus, by incorporating outside of the United States, Chinese companies can retain their "foreign issuer" status, thereby bypassing some of the rules otherwise imposed by federal securities law.[145]

It is already very common for foreign firms raising capital in American stock markets to claim waivers using their foreign issuer status, and these waivers are routinely granted.[146] As Roberta Karmel explains, "[b]ecause the reporting and disclosure requirements for listed companies are much more onerous than those required by a foreign issuer's home country, it is very common for foreign issuers to seek waivers."[147] Thus, Chinese firms fearing loss of their foreign issuer status may be avoiding Delaware to opt out of at least some of the burdensome and costly requirements associated with exchange rules and federal securities law. Indeed, Chinese companies routinely claim foreign issuer exemptions, often claiming that their "home" country is the Cayman Islands or the British Virgin Islands. For instance,

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Securities Exchange Act of 1934, thereby voluntarily subjecting itself to a host of U.S. securities regulations that have corporate governance implications.").

144. *See* Gilson, *supra* note 143, at 350.

145. *Id.* ("[T]he SEC has allowed some exemptive relief for foreign issuers when the detail of a particular requirement is inconsistent with the law of a foreign company's home jurisdiction."). Closely related to the rules directly imposed by federal securities law are listing rules imposed by stock exchanges like the New York Stock Exchange and NASDAQ. When foreign firms list in a U.S.-based stock exchange, they must enter into a listing agreement with the New York Stock Exchange or NASDAQ in order to have their securities traded on such market, which all contain corporate governance provisions. *See* Coffee, *Future as History*, *supra* note 13, at 687. As explained by Professor Coffee, "the standard NYSE requirements specify that a listed company must (a) have at least two outside directors on its board, (b) establish and maintain an audit committee composed of independent directors, and (c) set an appropriate quorum requirement for shareholder meetings." *Id.* While technically not part of federal securities law, these listing rules are heavily driven by and sanctioned by the SEC. As Professor Robert Thompson explains, "the SEC has had an important role in each change in the listing standards as an initiator and as a driving force as to their substance, such that in some respects the listing standards appear a thinly veiled substitute for federal government regulation rather than an alternative to it." Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 977 (2003). Under an order approved by the SEC in 1987, exchanges may "waive or modify certain enumerated listing standards for foreign issuers on a case-by-case basis." Roberta S. Karmel, *The Future of Corporate Governance Listing Requirements*, 54 SMU L. REV. 325, 333 (2001). Thus, foreign firms listed in the United States may claim exception from a wide-range of rules that are mandatory for American firms, including: "(1) [q]uarterly reporting of interim earnings; (2) composition and election of the Board of Directors; (3) shareholder approval requirements and voting rights; and (4) quorum requirements for shareholder meetings." Order Approving Proposed Rule Changes by American Stock Exchange and NYSE Relating to the Exchanges' Listing Standards, 52 Fed. Reg. 24,230, 24,231 (June 29, 1987) (footnote omitted).

146. Karmel, *supra* note 145, at 334.

147. *Id.*

21Vianet Group, Inc., a leading data service provider based in Beijing, discloses in its annual report to the SEC: "Certain corporate governance practices in the Cayman Islands, which is our home country, are considerably different than the standards applied to U.S. domestic issuers. . . . We currently follow our home country practice . . . ."[148]

While accurately capturing a morsel of descriptive reality, federal securities law cannot fully account for the Chinese aversion to Delaware. Perhaps most significantly, it cannot account for why Nevada—famous for its lax rules for corporate managers[149]—has vastly outperformed Delaware in attracting Chinese corporations. As shown in Table 2, Nevada has attracted more than double the number of Chinese firms listed in American stock markets as Delaware. Because Chinese firms incorporated in Nevada would also be stripped of their foreign issuer status, it appears that there is more than federal securities law at play.

The next Section takes a deep dive into the corporate governance reasons that account for Delaware's unpopularity among these foreign companies.

C. THE ENDURING IMPORTANCE OF CORPORATE LAW

The foregoing analysis suggests that foreign corporations (and their shareholders, to a certain extent) actually prefer the laws of the Cayman Islands and the British Virgin Islands over Delaware law, even without tax or federal securities law in the equation.

Of course, foreign corporations raising capital in American stock markets are not monolithic entities. And we must carefully evaluate the corporate law preferences of firms based on a host of factors, including the geographic location of operations, type of industry, shareholder composition, and the culture of corporate management. But because of their importance to the general trend, this Section focuses on Chinese corporations raising capital in American stock markets that appear to be actively shopping for corporate law. While these firms would by no means constitute a representative survey of all foreign firms listed in the United States, I focus on Chinese companies for several reasons. First, they make up a crucially important segment of firms listed in American stock markets that has thus far escaped the scholarly scrutiny they deserve.[150] The number of (and the market capitalization of) Chinese companies listed in NASDAQ and the New York Stock Exchange has grown by leaps and bounds in recent decades,[151] and Chinese firms in recent

148. 21Vianet Grp., Inc., Annual Report (Form 20-F) 41 (Mar. 27, 2019).

149. Barzuza, *Nevada*, *supra* note 32, at 994.

150. Collectively, the behavior of these corporations constitutes a natural social science experiment that can be exploited to better understand firm choice of corporate law.

151. As noted by Tamar Groswald Ozery, Chinese companies currently traded on the U.S. stock markets represent a "total market capitalization of $2.2 trillion." Tamar Groswald Ozery, *Illiberal Governance and the Rise of China's Public Firms: An Oxymoron or China's Greatest Triumph?*, 42

years have dominated the American market for initial public offerings.[152] Second, firms that operate outside of the United States (particularly those that principally operate in East Asia, continental Europe, and Latin America) face certain aspects of market environments that are closer to China than the United States,[153] thus providing a glimpse of insight into what may be driving the overall foreign aversion to Delaware.

In doing so, this Section shows that corporate law matters a great deal,[154] and identifies the principle reasons that may account for Delaware's unpopularity among Chinese firms. Importantly, Delaware's elaborate legal regime policing "self-dealing" transactions clashes with China's contemporary market dynamics, where firms operating as corporate groups routinely engage in "self-dealing" transactions as part of normal business.[155]

1. Delaware's Elaborate Legal Regime Policing Self-Dealing Transactions

One of the central goals of corporate law is to remedy the agency problem endemic in modern corporations. The agency problem derives from

U. PA. J. INT'L L. (forthcoming 2021) (manuscript at 9), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3616513 [https://perma.cc/39PA-UNQJ].

152. *See* Grocer, *supra* note 86 ("Last year . . . offerings from Chinese firms dominated the United States market for initial public offerings. The three largest I.P.O.s by market value were Chinese companies. And Chinese firms accounted for four of the 10 largest such offerings in 2018 ranked by amount raised on American exchanges, the most of any country, including the United States, according to Dealogic.").

153. *See* OECD, RELATED PARTY TRANSACTIONS AND MINORITY SHAREHOLDER RIGHTS 9 (2012), https://www.oecd.org/daf/ca/50089215.pdf [https://perma.cc/JZ5Z-ARR9] ("Around the world, company groups and concentrated ownership are normal, the exceptions being in the United Kingdom, the United States and Australia. Under such conditions, RPTs are mainly with the controlling shareholders and/or with members of a company group.").

154. In doing so, it complicates the widely presupposed assessment that corporate law matters little when foreign firms raise capital in American stock markets because federal *securities law* sufficiently displaces foreign *corporate law* when foreign corporations list in American stock markets. *See* Coffee, *Future as History*, *supra* note 13, at 699 ("Even if some foreign jurisdictions do grant controlling shareholders the discretionary power to take self-interested actions, this discretion may be significantly constrained by federal securities regulation."). While federal securities law indeed matters a great deal for foreign firms listing in the United States, corporate law is of central importance to any foreign firm deciding to list in the United States because they must consider the risks (and costs) of potential shareholder lawsuits that can be brought in the United States.

155. While there are competing ways to define a corporate group, "[t]he key defining characteristic of a corporate group is typically common ownership." Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 886 (2012). The importance of corporate groups in China has been well-documented. *See, e.g.*, Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697, 706 (2013) ("[B]usiness groups fostered by the political regime and deeply entwined with Chinese Communist Party leadership may be central to the developmental success of the regime."). *See also generally* Lisa A. Keister, *Interfirm Relations in China: Group Structure and Firm Performance in Business Groups*, 52 AM. BEHAV. SCIENTIST 1709 (2009) (examining emergence of "interfirm lending and trade ties" in business groups within China).

the separation of ownership and control that famously define modern corporations: although shareholders technically "'own' the corporation, they have virtually no decisionmaking powers."[156] Instead, the power to control the firm is vested in the hands of the board of directors, who appoint officers responsible for day-to-day operations of the firm.[157]

In the United States, shareholder litigation is one of the principal ways for shareholders to hold both officers and directors accountable for managerial misconduct, thereby ameliorating the agency problem.[158] But the system comes at a hefty cost. While Delaware's judicial system has been celebrated as the crown jewel of Delaware corporate law,[159] it is by no means a flawless system. Frivolous suits abound, with some legal scholars assessing that the real winners of these suits are corporate lawyers in Delaware who benefit from generating a stable stream of shareholder suits.[160] Litigation risk is immense for any large firm incorporated in Delaware. But these risks can be especially endemic and prohibitively costly for firms that operate in certain foreign nations.

One such risk is shareholder suits over self-dealing transactions.[161] Teachers of American corporate law are intimately familiar with the concept

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156. STEPHEN M. BAINBRIDGE, CORPORATE LAW 3 (3d ed. 2015); *see also* Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CALIF. L. REV. 1359, 1365 (2014) ("The common core of American corporation statutes is a clear statement that all corporate power is placed in, or under the authority of, the board of directors.").

157. Edelman et al., *supra* note 156, at 1365.

158. *See* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1749 (2004) ("[W]e believe derivative suits continue to play an important role. . . . Public company suits continue to be filed and to make new law. . . . Moreover, derivative suits against private companies perform an important, if less heralded, role in policing conflict of interest transactions and duty of care violations."); Reinier Kraakman, Hyun Park & Steven Shavell, *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1733 (1994) ("Shareholder suits are the primary mechanism for enforcing the fiduciary duties of corporate managers."). Foreign firms incorporating in Delaware necessarily opt into Delaware's legal regime by availing themselves to shareholder suits in Delaware. *See* Papendick v. Bosch, 410 A.2d 148, 152 (Del. 1979) ("[Bosch] purposefully availed itself of the benefits and protections of the laws of the State of Delaware for financial gain in activities related to the cause of action. Therein lies the 'minimum contact' sufficient to sustain the jurisdiction of Delaware's courts over [Bosch].").

159. *See* Black, *supra* note 50, at 590; Fisch, *Peculiar Role*, *supra* note 73, at 1064 (attributing Delaware's success in attracting corporate charters to "the unique lawmaking function of the Delaware courts").

160. *See* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 55–56 (1991) ("Critics of the shareholder suit assert that most of the suits are frivolous and that the plaintiff's bar is the true beneficiary of the litigation . . . .").

161. Self-dealing transactions, also known as related-party transactions, are not easily definable. As Geeyoung Min assesses, there is no universal definition of related parties transactions. Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663, 674 ("The terms 'related party' and 'transaction' carry different meanings depending on the regulation. . . . SEC Regulation S-K and the common law of duty of

of self-dealing. Because directors and officers of corporations have superior information over shareholders, they can exploit their positions to extract wealth from the firm for private gain.[162] In addition to outright looting, self-dealing transactions can manifest in various forms, including "compensation agreements for directors, corporate opportunity cases and trading of company shares by directors using price-sensitive information."[163] The law governing self-dealing therefore attempts to put in place mechanisms to police this well-known ailment in corporate law.

Under Delaware law, self-dealing is not strictly prohibited,[164] but either must be: (1) disclosed and approved by disinterested directors,[165] (2) disclosed and approved in good faith by vote of the shareholders,[166] or (3) demonstrated to be "fair" to the corporation.[167] A challenged transaction approved by independent directors is subject to the business judgement rule under Delaware law, almost guaranteeing dismissal of claims.[168] However, a challenged transaction is subject to the "fairness" standard of review if a majority of the directors approving the challenged transaction were either interested in the transaction or not independent of a person with an interest in the transaction.[169] Under the "fairness" standard of review, self-dealing transactions must be demonstrated to be objectively fair to the corporation and the minority shareholders.[170] This will make it almost impossible to

loyalty cover much broader definitions of 'related party transaction' than Delaware General Corporate Law Section 144 does.").

162. It is for this reason that self-dealing shows up in some of the canonical early works on American corporate law. *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 230–32 (1932).

163. John H. Farrar & Susan Watson, *Self Dealing, Fair Dealing and Related Party Transactions—History, Policy and Reform*, 11 J. CORP. L. STUD. 495, 496 (2011).

164. *See* Clarke, *Independent Director*, *supra* note 94, at 165–66; Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939, 952–55 (2019) [hereinafter Tuch, *Reassessing Self-Dealing*].

165. *See* DEL. CODE ANN. tit. 8, § 144(a)(1) (2020).

166. *See id.* § 144(a)(2). As noted by Professor Tuch, courts have "understood section 144(a)(2) to require approval by disinterested shareholders." Tuch, *Reassessing Self-Dealing*, *supra* note 164, at 956 n.117 (citing Fliegler v. Lawrence, 361 A.2d 218, 221–22 (Del. 1976)).

167. *See* tit. 8, § 144(a)(3); Tuch, *Reassessing Self-Dealing*, *supra* note 164, at 955.

168. This is because under the business judgement rule, the court must presume that "directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

169. Tuch, *Reassessing Self-Dealing*, *supra* note 164, at 955. In the influential case of *Sinclair Oil Corp. v. Levien*, the Delaware Supreme Court held that the intrinsic fairness standard applies to parent-subsidiary dealings where "the parent . . . 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." Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

170. *Id.*

dismiss the lawsuit at the pleading stage, leading to costly litigation concerning whether the transaction was "fair."[171]

Notwithstanding the various critiques over this complex regime, this system yields reasonable results for American corporations,[172] where self-dealing transactions are relatively rare. To the extent that self-dealing transactions do take place, independent directors can help "cleanse" those transactions. Today, the vast majority of directors serving on the boards of publicly traded American corporations are independent from management, thus constituting a staple feature of the modern American corporate governance paradigm.[173]

2. Why Delaware's Legal Regime is a Misfit for Chinese Firms

Chinese firms avoid Delaware's elaborate system of policing self-dealing transactions for two distinct (but related) reasons: the volume of self-dealing transactions and the lack of independent directors that can police these transactions. More specifically, Chinese firms listed in the United States typically operate as part of corporate groups, and self-dealing transactions that occur routinely within corporate groups (referred to as "intra group transactions" or "related party transactions") would be subject to a floodgate of litigation if these firms were incorporated in Delaware. Delaware's corporate law paradigm, thus, is operationally incompatible for Chinese firms that principally operate outside of the United States.[174]

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171. *See* Orman v. Cullman, 794 A.2d 5, 20 n.36 (Del. Ch. 2002) (noting that a determination of fairness "normally will preclude dismissal of a complaint on a Rule 12(b)(6) motion to dismiss"); Kahn v. Household Acquisition Corp., 591 A.2d 166, 175 (Del. 1991) (recognizing that a dispute over value is "a battle of experts"); *see also* Goshen, *supra* note 22, at 419 ("Determining the objective value of a transaction is a complicated process that requires a high degree of competence from the courts since such valuations involve future projections of different variables, all of which can affect the actual price, and the use of complex financial models.").

172. Delaware's jurisprudence on self-dealing is complex and fact-specific, leading to reasonable guidelines policing of related party transactions. *See* Tuch, *Reassessing Self-Dealing*, *supra* note 164, at 950–54. This jurisprudence comports with the general spirit of Delaware corporate law, which is predominantly composed of standards rather than rules, leading to reasonably determinant guidelines. According to Ed Rock, "Delaware courts provide a supplemental source of gossip, criticism, and sanction for this set of actors who are beyond the reach of the firm's normal systems of social control." Rock, *supra* note 73, at 1013.

173. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1465 (2007) ("Between 1950 and 2005, the composition of large public company boards dramatically shifted towards independent directors, from approximately 20% independents to 75% independents."); Yaron Nili, *The Fallacy of Director Independence*, 2020 WIS. L. REV. 491, 493 ("[T]he composition of United States public firms' boards of directors has seen a dramatic shift. Boardrooms once controlled by company executives have been almost entirely replaced by independent directors, often leaving the CEO as the lone executive in the room." (footnote omitted)).

174. Of course, the desirability of corporate groups and self-dealing transactions from a societal standpoint is a separate question. After all, intra-group transactions can undermine competition and, therefore, be toxic to consumer welfare. Antitrust policies, thus, have immense consequences for firm behavior, including their preferred corporate governance structure. *See*

i. Ubiquity of Corporate Groups

Iconic global conglomerates including Samsung (South Korean), Daimler (German), and Mitsubishi (Japanese) operate not as standalone companies but as part of corporate groups: a group of legally independent firms under common ownership.[175] For instance, Samsung currently consists of 74 affiliated companies that collectively offer products and services ranging from Samsung Galaxy phones to Samsung hospital and Samsung food services.[176] Daimler not only consists of companies including Mercedes-Benz, Detroit Diesel, and Western Star, but also includes Mercedes-Benz Financial Services and Mercedes-Benz Bank.[177] While a relative rarity in the United States, corporate groups are ubiquitous around the world, particularly in East Asia, Latin America, and continental Europe.[178]

China is no exception, although Chinese corporate groups (unlike their counterparts in South Korea and Japan) tend to be "vertically integrated firms focused on a particular industry or sector, not diversified groups involved in a wide range of industries."[179] Indeed, recent headline-grabbing Chinese firms including Tencent, JD.com, Nio, and Baidu all operate as part of corporate groups.[180] This organizational structure accounts for why self-dealing transactions are pervasive in China. Because Chinese firms generally operate in group structures, related corporations engage in intra-group transactions as a natural result of "operating as one enterprise in the form of a corporate group."[181] In my hand-collected survey of SEC filings, over 95

Yong Lim & Geeyoung Min, *Competition and Corporate Governance: Teaming Up to Police Tunneling*, 36 NW. J. INT'L L. & BUS. 267, 270 (2016).

175. Heitor Almeida, Chang-Soo Kim & Hwanki Brian Kim, *Internal Capital Markets in Business Groups: Evidence from the Asian Financial Crisis*, 70 J. FIN. 2539, 2539 (2015). A corporate group, in its simplest form, involves two separate legal entities "placed under unified management." *See* Jens Dammann, *Related Party Transactions and Intragroup Transactions*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 218, 218 (Luca Enriques & Tobias H. Tröger eds., 2019) [hereinafter Dammann, *Related*].

176. *Services and Others*, SAMSUNG, https://www.samsung.com/levant/aboutsamsung1/samsung/affiliatedcompanies_05 [https://perma.cc/VYY4-7KFL].

177. *Daimler at a Glance*, DAIMLER, https://www.daimler.com/company/at-a-glance.html [https://perma.cc/7H6K-F53U] (selecting "Brands").

178. *See* OECD, *supra* note 153, at 9. According to the OECD, transactions with directors representing both sides of the transactions are fairly common, particularly in countries where corporate groups are ubiquitous. *Id.*

179. Lin & Milhaupt, *supra* note 155, at 711.

180. According to Raymond Fisman and Yongxiang Wang, "[m]ost large Chinese firms belong[] to a business group prior to listing [in an exchange]." Fisman & Wang, *supra* note 33, at 430.

181. Kim, *Related*, *supra* note 33, at 304; *see also* Yenpao Chen, Chien-Hsun Chen & Weiju Chen, *The Impact of Related Party Transactions on the Operational Performance of Listed Companies in China*, 12 J. ECON. POL'Y REFORM 285, 287 (2009) ("China's enterprise groups in particular tend to make extensive use of related party transactions for earnings management . . . .").

percent of Chinese firms listed in the United States but incorporated in the Cayman Islands engage in related-party transactions.[182]

Chinese firms have reasons to operate as part of corporate groups, as opposed to operating as standalone entities. This is because transactions between affiliated companies within corporate groups can be economically advantageous in nations with weak legal systems and less-developed capital markets.[183]

Corporate groups, for one, "can help overcome or attenuate various types of market failure[s]" that can naturally arise in the contractual relationships between firms.[184] As explained by Jens Dammann, "[i]f supplier and buyer are both legally and economically independent, the supplier may fear that once he has incurred substantial sunk costs, the buyer may use some pretext to lower the price or otherwise 'squeeze' the buyer."[185]

This opportunism, of course, can be curbed without necessarily setting up complicated corporate group structures. In the United States, such opportunism is typically curbed through contractual devices. Consider the doctrine of economic duress that is taught to virtually all first-year contracts students. In the famous case of *Austin Instrument, Inc. v. Loral Corp.*, a contractor was forced to buy precision gear components used to produce radar sets for the Navy at a gouged price, out of necessity to meet its own contractual obligation. The court concluded that the defendant's "threat—to stop deliveries unless the prices were increased—deprived [Plaintiff] of its free will."[186] The lesson there is that contract law fights against the tendency to squeeze the buyer.[187]

But a robust judicial infrastructure that can safeguard economic arrangements through contracts cannot be taken for granted. In China, a relatively weak judiciary makes it unlikely that courts will step in to police long-term contracts. As explained by Donald Clarke, "Chinese courts are not politically powerful and are hence reluctant to take cases involving large sums of money and powerful defendants."[188]

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182. Data on file with the author.

183. *See, e.g.*, Keister, *supra* note 155, at 1711.

184. Dammann, *Related*, *supra* note 175, at 218.

185. *Id.* at 219.

186. Austin Instrument, Inc. v. Loral Corp., 272 N.E.2d 533, 536 (N.Y. 1971).

187. Of course, there are many other factors that may also explain why corporate groups and intra-group transactions are relatively rare in the United States. U.S. tax laws governing intra-group dividends, for instance, encourage freestanding firms as opposed to corporate pyramid structures that are common outside of the United States. *See* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double Taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy*, 19 TAX POL'Y & ECON. 135, 135 (2005).

188. Clarke, *Corporate Governance in China*, *supra* note 94, at 503; *see also* Tamar Groswald Ozery, *Minority Public Shareholders in China's Concentrated Capital Markets—A New Paradigm?*, 30 COLUM. J. ASIAN L. 1, 19 (2016) ("[T]he relative weakness of the courts and other institutions and their pronounced reluctance to adjudicate or enforce in such cases, curtails the system's

It also bears noting that even if the judiciary gains political power in China, judges would still face difficulty policing related-party transactions. Services and parts involved in related-party transactions often have idiosyncratic features, meaning that "the relevant market price is often not available."[189] As on-the-ground practitioners explain, the chairperson of a Chinese company "often own[s] different entities across the supply chain, as well as real estate interests, that make it hard to determine if a transaction is truly [at] 'arms length.'"[190] This would make it almost impossible to assess with accuracy on whether the transaction was "fair."

Related-party transactions can also be critical to securing capital when local capital markets are weak or underdeveloped. As Zohar Goshen explains: "[A] corporation seeking credit may find that, in some circumstances, a loan taken from its controlling owners is the cheapest option."[191] This is the concept of "propping up," a term used to describe instances when a controlling shareholder uses private resources to boost one of the firms within her corporate group.[192] Propping up is fairly common among Chinese firms listed in the United States. Thus, for instance, Aurora Mobile Limited, a data solutions company based in Shenzhen, China, discloses:

> As of December 31, 2016 and 2017, we had amounts of RMB5.6 million and RMB5.6 million, respectively, due to Mr. Weidong Luo, our chief executive officer and chairman of our board of directors, representing the capital he contributed to fund our operations at the early stage of our development. Such amounts are interest free. We fully repaid the outstanding balance to Mr. Luo in April 2018.[193]

Propping up can especially make sense from the corporate group's perspective when funding a particular business helps the firm solidify its supply chain and potentially exploit its market power.[194]

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ability to restrain controlling shareholders or hold them accountable *ex post* as well."). Transactions between intra-group firms curb this opportunism, while also "avoid[ing] other common contracting problems resulting from informational asymmetries, long-term contracting and the like." Dammann, *Related*, *supra* note 175, at 219.

189. Kim, *Related*, *supra* note 33, at 292.

190. Drew Bernstein, Caryn G. Schechtman & Robert D. Weber, *When U.S. Law Collides with Chinese Reality*, LAW.COM: N.Y. L.J. (Mar. 14, 2016, 12:00 AM), https://www.law.com/newyorklawjournal/almID/1202751855447/when-us-law-collides-with-chinese-reality [https://perma.cc/RJB7-FRU2].

191. Goshen, *supra* note 22, at 400.

192. Eric Friedman, Simon Johnson & Todd Mitton, *Propping and Tunneling*, 31 J. COMPAR. ECON. 732, 732 (2003) ("[U]nder some conditions entrepreneurs prop up their firms, i.e., they use their private funds to benefit minority shareholders.").

193. Aurora Mobile Ltd., Annual Report (Form 20-F) 87 (Apr. 3, 2019).

194. Stephen Yan-Leung Cheung, Lihua Jing, Tong Lu, P. Raghavendra Rau & Aris Stouraitis, *Tunneling and Propping Up: An Analysis of Related Party Transactions by Chinese Listed Companies*, 17 PACIFIC-BASIN FIN. J. 372, 374 (2009). Unsurprisingly, loans among affiliated companies of Chinese firms listed in the United States are hardly unusual. For instance, Huami,

This is not to say that self-dealing transactions should be celebrated. The normative merits of self-dealing transactions are, at best, murky. After all, controlling shareholders can wield their power to expropriate minority shareholders by engaging in transactions that enrich themselves.[195] For example, a transaction between a listed firm and a wholly-owned subsidiary both controlled by an insider "could serve to transfer value to the controller by . . . setting favorable transfer prices or selling off the listed firm's assets cheaply."[196] In its most perverse form, self-dealing is the legalized looting of minority shareholders.

But the normative desirability of self-dealing transactions (at least from the standpoint of the firm and its shareholders) depends on the web of regulatory laws and market conditions. Indeed, self-dealing transactions under certain conditions can be used "as part of the vertical or horizontal integration within an enterprise group . . . to achieve performance goals by reducing transaction costs."[197]

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a biometric company specializing in smart wearable technology, discloses its elaborate credit agreements:

> We have invested in a number of companies as a strategy to expand our business partner network, and we extended loans to our investee companies from time to time to support their operations. We have provided loans to Hefei LianRui Microelectronics Technology Co., Ltd., or Hefei LianRui, Hangzhou Aqi Vision Technology Co., Ltd., or Hangzhou Aqi, Xi'an Haidao information Technology Co., Ltd., or Xi'an Haidao, Hefei Huaying Xingzhi Fund Partnership, or Hefei Huaying, and Hangzhou Yunyou Technology Co. Ltd., or Hangzhou Yunyou.

Huami Corp., Annual Report (Form 20-F) 85 (Apr. 12, 2019).

195. *See* Cheung et al., *supra* note 194, at 374.

196. Fisman & Wang, *supra* note 33, at 429.

197. Chen et al., *supra* note 181, at 287. In many respects, deliberate government policy further facilitates the existence of the corporate group structure. Li-Wen Lin and Curtis Milhaupt's account of networked hierarchy is particularly helpful to understand the extent to which the Chinese government is intertwined in China's contemporary state capitalism. As Lin and Milhaupt explain, "a chief characteristic of the Chinese scheme of industrial organization" is "vertically integrated corporate groups organized under SASAC, strategically linked to other business groups—as well as to governmental organs and state institutions, such as universities—enmeshed in a helical personnel-appointment process of rotations managed jointly by the Communist Party and SASAC." Lin & Milhaupt, *supra* note 155, at 707. Under this system, certain forms of collaboration that would raise obvious antitrust concerns "have thus far been virtually exempt from antitrust enforcement." *Id.* at 723. Indeed, Chinese antitrust authorities generally tolerate a host of industries being subject to an oligopolistic market structure, enabling firms to take advantage of lopsided market power. *See* Qiang Xiaoji, *Baidu, Tencent, Alibaba Forming Oligopoly on Chinese Internet*, CHINA DAILY (Feb. 18, 2011, 5:38 PM), http://www.chinadaily.com.cn/bizchina/2011-02/18/content_12042514.htm [https://perma.cc/LF7R-DNA3] (describing oligopolistic market structure of China's internet, where "Tencent took up 76.56 percent of the market share of instant messaging . . . Baidu took 72.3 percent of the market shares of search engines, while Alibaba took up 54.39 percent of the the [sic] B2B business").

ii. Inadequacy of Independent Directors

The mere frequency of self-dealing transactions, of course, does not necessarily render Delaware corporate law impracticable. Recall that self-dealing transactions can be "cleansed" under Delaware law if approved by independent directors.[198] But the availability of independent directors that can effectively police these transactions cannot be taken for granted.[199]

While independent directors were formally introduced to the Chinese legal system in 2001,[200] their efficacy is, at best, questionable. This is because Chinese firms are typically dominated by the firms' founders (who often are also the controlling shareholders), and thus directors are not truly independent.[201] To put it bluntly, "independent" directors in China are often thought to be "rubber stamps for controlling shareholders and corporate insiders."[202] Indeed, a recent study indicates that "independent directors in Chinese corporations issued only 0.9% of dissent opinions . . . in board meetings."[203] This should not surprise anyone working on the ground "[i]n China . . . , [where] many independent directors have social connections with corporate insiders, but . . . are not necessarily efficient monitors and advisors."[204] Given this reality, it is unlikely that Delaware courts will find appointed "independent" directors in China to be truly independent. This is particularly true under recent Delaware Supreme Court jurisprudence

198. Tuch, *Reassessing Self-Dealing*, *supra* note 164, at 955.

199. Under recent Delaware jurisprudence, directors must physically reside in the principal place of business of the firm, meaning that Chinese firms must rely on local independent directors in China even if they incorporate in Delaware. *See* Transcript of Oral Argument and Court's Ruling at 17–18, *In re* Puda Coal, Inc. S'holders Litig., (Del. Ch. Feb. 6, 2013) (C.A. No. 6476-CS) ("[I]f you're going to have a company domiciled for purposes of its relations with its investors in Delaware and the assets and operations of that company are situated in China that, in order for you to meet your obligation of good faith, you better have your physical body in China an awful lot. You better have in place a system of controls to make sure that you know that you actually own the assets. You better have the language skills to navigate the environment in which the company is operating."). Even within the United States, scholars have identified inadequacies in the current independent-director framework. *See, e.g.*, Nili, *supra* note 173, at 503; Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 453 (2008).

200. Clarke, *Independent Director*, *supra* note 94, at 125.

201. Bernstein et al., *supra* note 190; Clarke, *Independent Director*, *supra* note 94, at 169 (citing a study conducted by the Shanghai Securities Exchange identifying the "lack of independence (presumably from management) of the board of directors" as one major problem in Chinese corporate governance); Virginia Harper Ho, *Corporate Governance as Risk Regulation in China: A Comparative View of Risk Oversight, Risk Management, and Accountability*, 3 EUR. J. RISK REG. 463, 469 (2012) ("Notwithstanding reforms to introduce independent directors to corporate boards, boards do not always function as effective monitors, and controlling shareholders can structure decision making power so as to effectively usurp the role of the board of directors." (footnote omitted)).

202. Sang Yop Kang, *The Independent Director System in China: Weaknesses, Dilemmas, and Potential Silver Linings*, 9 TSINGHUA CHINA L. REV. 151, 154 (2017).

203. *Id.*

204. *Id.* at 168.

clarifying that social relationships bear directly on the question of director independence.[205] And, even if integrated into the corporate board of Chinese firms, it is unclear if "independent" directors will be able to effectively police harmful self-dealing transactions. For a typical Chinese corporation listed in the United States, opting into Delaware corporate law will yield protracted disputes over whether they qualify as "independent,"[206] and if not, costly litigation over the "fairness" of intra-group transactions.

There are also strategic reasons why independent directors may be undesirable for firms that principally operate in China. First, "independent directors—even if they are truly independent—often lack expertise, and face time constraints in understanding significant corporate business policies."[207] Second, business is often done through "social networks in China[, which] are cumulatively connected in a complicated matrix through regional, educational and other backgrounds."[208] Therefore, independent directors may be hostile to the very way business is customarily conducted in China.

This organizational structure helps explain why Chinese firms would prefer Cayman law over Delaware law. Under the Cayman Islands Companies Act, even an interested director may vote on self-dealing transactions so long as the conflict is disclosed to the board[209]—something prohibited under Section 144 of the Delaware General Corporation Law.[210] The legal divergence between the two jurisdictions is hardly a secret. As 21Vianet Group fully discloses in their SEC filings:

> Certain corporate governance practices in the Cayman Islands, which is our home country, are considerably different than the standards applied to U.S. domestic issuers. . . . We currently follow our home country practice that . . . does not restrict a company's transactions with directors, requiring only that directors exercise a

205. *See* Marchand v. Barnhill, 212 A.3d 805, 820 (Del. 2019) ("Although the fact that fellow directors are social acquaintances who occasionally have dinner or go to common events does not, in itself, raise a fair inference of non-independence, our law has recognized that deep and longstanding friendships are meaningful to human beings and that any realistic consideration of the question of independence must give weight to these important relationships and their natural effect on the ability of the parties to act impartially toward each other." (footnote omitted)).

206. Kang, *supra* note 202, at 154; *see also* Sandys v. Pincus, 152 A.3d 124, 130 (Del. 2016) (holding that co-ownership of an airplane with a corporate defendant "is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment").

207. Kang, *supra* note 202, at 153.

208. *Id.* at 154.

209. *See* Bradley Kruger, *Acting as a Director of a Cayman Islands Company*, OGIER (Apr. 12, 2020), https://www.ogier.com/publications/acting-as-a-director-of-a-cayman-islands-company [https://perma.cc/D2T7-42FR].

210. *See* DEL. CODE ANN. tit. 8, § 144(a)(1) (2020) (requiring interested transactions to be approved "by the affirmative votes of a majority of the disinterested directors").

> duty of care and owe certain fiduciary duties to the companies for which they serve . . . .[211]

Many Chinese firms listed in the United States have expressly memorialized this understanding in their Articles of Association.[212]

Firms like Baidu and JD.com thus avoid shareholder litigation over presumably "benign" self-dealing transactions by avoiding Delaware corporate law altogether. It is telling that three of the most popular jurisdictions for Chinese corporations listed in American stock markets—the Cayman Islands, the British Virgin Islands, and Nevada—practically immunize self-dealing transactions from challenge.[213] It is no wonder that Nevada—which protects directors and officers even for self-dealing transactions[214]—has vastly outperformed Delaware in attracting Chinese firms. Taking a step further than Nevada, the Cayman Islands and the British Virgin Islands make it exceedingly difficult to bring shareholder derivative suits altogether.[215]

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Corporations choosing to incorporate in jurisdictions offering lax corporate law may be a sign of a race for the bottom. In an infamous piece,

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211. 21 Vianet Grp., Inc., *supra* note 148, at 125.

212. As one prominent offshore law firm explains:

> [I]nvariably a company's articles of association will nowadays provide that, if a director discloses his or her interest to the board at or before the meeting at which a particular matter is to be considered, he or she may vote in respect of that matter, notwithstanding that he is interested in such matter.

Kruger, *supra* note 209. Thus, for instance, Baidu's Articles of Association spell out:

> No person shall be disqualified from the office of Director or alternate Director or prevented by such office from contracting with the Company, either as vendor, purchaser or otherwise, nor shall any such contract or any contract or transaction entered into by or on behalf of the Company in which any Director or alternate Director shall be in any way interested be or be liable to be avoided, nor shall any Director or alternate Director so contracting or being so interested be liable to account to the Company for any profit realised by any such contract or transaction by reason of such Director holding office or of the fiduciary relation thereby established. A Director (or his alternate Director in his absence) shall be at liberty to vote in respect of any contract or transaction in which he is so interested . . . .

BAIDU.COM, INC., AMENDED AND RESTATED MEMORANDUM OF ASSOCIATION 32 (2005), https://www.sec.gov/Archives/edgar/data/1329099/000119312505140785/dex31.htm [https://perma.cc/9Q7J-X8US].

213. Moon, *Delaware's New Competition*, *supra* note 8, at 1445–46, 1450 n.231.

214. *See* Barzuza, *Nevada*, *supra* note 32, at 951 ("[D]irectors and officers in Nevada are liable only for intentional misconduct, fraud, or a knowing violation of law. This may result in no liability for a number of important categories, including conflicts of interest, self-dealing with the company, personal benefits, and conscious disregard of duties.").

215. In both the Cayman Islands and the British Virgin Islands, derivative suits require permission from the court to proceed and the practical success rate is slim. *See* Moon, *Delaware's New Competition*, *supra* note 8, at 1145–46.

Bill Cary conceptualized competition between states to supply corporate charters as inducing a "race for the bottom."[216] Extending Cary's framework, competition between nation-states may enable the race to go further into jurisdictions offering liability-free regimes.[217] Both legal and finance professionals have warned that Chinese corporations can exploit American investors.[218] Recently, Matthew Schoenfeld and Professor Jesse Fried have assessed that investing in Chinese corporations listed in American stock markets is "extremely risky, at least for American investors."[219] Similarly, Professor Donald Clarke has assessed that "[i]nvestors should take seriously the disclosures in the risk factors section of the prospectuses of Chinese companies to the effect that it will be difficult to hold companies and their executives accountable under US law."[220]

To a certain extent, these accounts are backed up by recent newspaper headlines and SEC indictments against officers and directors of Chinese companies.[221] Consider ZST Digital Networks, Inc., a firm specializing in digital and optical network equipment in the Henan Province of China. In 2012, the company failed to comply with a default judgement in Delaware ordering the company to produce detailed financial and strategic information.[222] Vice Chancellor J. Travis Laster of the Delaware Court of Chancery held the company in contempt of court and went on to issue arrest warrants for the uncomplying Chinese executives.[223] Even Hollywood has jumped on the bandwagon, producing films including *The China Hustle*, depicting collusion between American bankers and Chinese companies to screw over U.S. investors.[224]

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216. Cary, *supra* note 54, at 666.

217. *See id.*; *see also* Moon, *Delaware's New Competition*, *supra* note 8, at 1450 n.231 (discussing the opportunity "to model the type of domestic companies that are incorporating in foreign nations").

218. *See, e.g.*, Jesse M. Fried & Ehud Kamar, *China and the Rise of Law-Proof Insiders* 2 (Eur. Corp. Governance Inst., L. Working Paper No. 557/2020, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3740223 [https://perma.cc/A42C-A6MN].

219. Fried & Schoenfeld, *supra* note 85.

220. Donald Clarke, *The Bonding Effect in Cross-Listed Chinese Companies: Is It Real?*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW: CHINA AND THE WORLD 88, 99 (Robin Hui Huang & Nicholas Calcina Howson eds., 2017).

221. *See, e.g.*, Pan Kwan Yuk, *Another Chinese Company Gets Charged with Fraud*, FIN. TIMES (June 20, 2013), https://www.ft.com/content/257ddfa3-a077-39a8-9c15-2907eb42f418 [https://perma.cc/8VDA-A9LV].

222. *See* Deutsch v. ZST Digit. Networks, Inc., C.A. No. 8014, 2018 WL 3005822, at *3 (Del. Ch. June 14, 2018).

223. *See* Matt Levine, *You Can't Hide from the Corporate Cops*, BLOOMBERG OP. (June 21, 2018, 9:56 AM), https://www.bloomberg.com/opinion/articles/2018-06-21/you-can-t-hide-from-the-corporate-cops [https://perma.cc/359L-476M].

224. Mark Hughes, *Review: 'The China Hustle' Is the Most Important Film of 2018*, FORBES (Mar. 30, 2018, 8:00 AM), https://www.forbes.com/sites/markhughes/2018/03/30/review-the-china-hustle/?sh=253ad9843357 [https://perma.cc/DQM8-9NU3].

But the question remains why anyone—particularly sophisticated institutional investors like BlackRock—would invest in Chinese companies only to be exploited. After all, we typically assume that investors can fend for themselves when it comes to buying shares of publicly traded corporations.[225]

While there are undoubtedly Chinese firms that go offshore because it makes it easier to defraud American investors, there are legitimate business reasons why a typical Chinese firm listed in the United States would avoid Delaware. Institutional investors in the United States thus far have not (successfully) demanded that Chinese firms incorporate in Delaware.[226] They also have not lobbied these firms to provide for enhanced contractual safeguards of shareholder rights via corporate charters or bylaws—indicating that the popularity of the Cayman Islands and the British Virgin Islands has more to do with corporate governance rules that comport with local market conditions rather than facilitating fraud.

The next Part turns normative, after collecting broader lessons to be drawn from Delaware's international unpopularity.

IV. LESSONS: TERRITORIAL MARKET SEGMENTATION AND THE PERILS OF EXPORTING DELAWARE CORPORATE LAW

This Part distills lessons from foreign corporations that appear to be unattracted to Delaware corporate law. Section IV.A develops a theoretical framework that explains how local regulations and market infrastructures impact the corporate-law preferences of firms. This Section, which builds on theories developed in the pure domestic context, brings legal theory up to date to account for the emerging international market for corporate law. Section IV.B lays out policy prescriptions and counsels against exporting Delaware corporate law to foreign nations that may have vastly different market environments than the United States.

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225. *Cf.* Winter, *supra* note 12, at 256 (assessing that, while corporate managers could technically choose any state's corporate law, if that choice was unfavorable to the shareholders' interest, they would be outperformed, putting the managers' employment in jeopardy); *see also* Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. REV. 1459, 1464 (2019) ("In the United States, institutional investors have opportunities annually, and often more frequently, to vote the shares they hold for their clients . . . . They often engage proxy advisors—firms such as ISS and Glass Lewis—that provide guidelines, recommendations, and other information to help investors vote their shares on the various proposals before them." (footnote omitted)).

226. To be sure, there have been some notable efforts to dissuade Chinese firms from leaving Delaware. For instance, Institutional Shareholder Services, a top shareholder advisory firm, unsuccessfully opposed Sohu's proposal to redomicile from Delaware to the Cayman Islands, assessing that "under Cayman Islands rules, director nominations and business proposals are limited to shareholders holding at least 5 percent of outstanding shares, which could diminish investor rights" and "[t]he company would also not be required to follow certain Nasdaq standards." Chen, *supra* note 74.

A. Territorial Market Segmentation: The Role of Local Regulations and Market Infrastructures on Incorporation Choice

A powerful explanation that accounts for Delaware's unpopularity in the emerging global market for corporate law is that Delaware corporate law may not be operationally compatible with foreign market environments, even if we view shareholder profit maximization as the sole goal of corporations.[227] This lesson has several implications for the future of corporate law theory and practice.

Territorial market segmentation is the term I offer to capture the whole swath of local regulations and market dynamics that impact the corporate law preferences of firms.[228] That is, local market environments—shaped by an array of factors including government policies, regulatory laws, capital markets, business culture, and judicial infrastructure—affect the corporate law preferences of firms.[229] This theory predicts that firms that operate in substantially different market environments will prefer different corporate governance rules, to the extent that firms can shop for corporate law.

This framework departs from the way we currently understand corporate law preferences of firms.[230] The idea that firms may have differentiated taste for corporate law was originally hinted at by Judge Richard Posner and the

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227. This is a contested notion. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 249 (1999); Afra Afsharipour, *Redefining Corporate Purpose: An International Perspective*, 40 SEATTLE U. L. REV. 465, 469 (2017); Kevin V. Tu, *Socially Conscious Corporations and Shareholder Profit*, 84 GEO. WASH. L. REV. 121, 126 (2016). For now, I leave some of the important normative questions aside, but the time will come to give this maxim the attention it deserves.

228. This framework builds on an extensive body of comparative corporate law literature that has shown that "successful forms of corporate capitalism do not have identical features around the world." Lin & Milhaupt, *supra* note 155, at 704. As explained by Lin and Milhaupt, "firms differ systematically in their ownership structures, sources of financing, and the surrounding set of national legal and market institutions in which they develop." *Id.*

229. While cross-border transactions have challenged territorially tethered regulatory laws, territoriality remains central to how national and sub-national regulatory laws are applied to firms. In the United States, for example, the presumption against extraterritoriality operates as a powerful canon that counsels against applying federal statutes to cases that principally involve transnational fact patterns. *See* William S. Dodge, *The New Presumption Against Extraterritoriality*, 133 HARV. L. REV. 1582, 1603–04 (2020); Pamela K. Bookman, *Litigation Isolationism*, 67 STAN. L. REV. 1081, 1097–99 (2015). For critiques of how modern courts have applied the presumption, see Lea Brilmayer, *The New Extraterritoriality:* Morrison v. National Australia Bank, *Legislative Supremacy, and the Presumption Against Extraterritorial Application of American Law*, 40 SW. L. REV. 655, 663–64 (2011); Aaron D. Simowitz, *The Extraterritoriality Formalisms*, 51 CONN. L. REV. 375, 389 (2019); Moon, *Regulating Offshore Finance*, *supra* note 120, at 4–5.

230. This framework is also distinct from the way existing scholarship has documented market segmentation occurring in global capital markets. *See, e.g.*, John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 231–32 (2007) ("In overview, high-intensity enforcement [in U.S. stock markets] may dissuade some issuers from entering the U.S. market and, thus, could be responsible for some of the asserted decline in the 'competitiveness' of the U.S. capital markets. But, at the same time, other firms are attracted to U.S. markets. In effect, there is a separating equilibrium as foreign issuers go both ways.").

late Professor Kenneth Scott in a well-known book published in 1980.[231] The idea that different bundles of corporate law may appeal to different firms was also a theoretical building block to Professor Roberta Romano's influential "law as a product" thesis advanced in the mid-1980s.[232] Since then, the concept of market segmentation has been expressly developed in Professor Michal Barzuza's study of how Nevada carved out a sizable niche of the American corporate law market.[233] Importantly, Nevada does not compete head-on with Delaware. Instead, Nevada competes by attempting to attract a different segment of the market—namely, corporations looking for lax rules friendlier for managers in what Professor Barzuza describes as a "liability free jurisdiction."[234] Others have extended her theory with a rich body of empirical research, suggesting that different types of shareholders also impact corporate law preferences. Professors Ofer Eldar and Lorenzo Magnolfi, for instance, assess that Nevada appeals to "small firms with low institutional shareholding."[235]

The theory of territorial market segmentation does not disagree with the market segmentation thesis, but assesses that it is incomplete. It posits that local market conditions also affect the firm-level preferences of corporate governance rules. That is, whether a firm principally operates in New York, California, or all 50 states, does not affect whether the Sherman Act or the Racketeer Influenced and Corrupt Organizations Act will govern. It also does not impact the local judicial infrastructure or capital markets that may incentivize firms to operate as standalone entities rather than as part of a corporate group. Whether a company principally operates in China or the United States, on the other hand, will vastly impact applicable regulatory laws and the surrounding market environment—and therefore the choice of corporate law.[236]

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231. *See* POSNER & SCOTT, *supra* note 32, at 111 ("Delaware has tailored its law to the needs of the large public corporation; if states are competing for charter business, wouldn't one expect some product specialization? In fact, in recent years, quite a few states have adopted special statutes or provisions to deal with the special needs of small, closely-held corporations.").

232. *See* Romano, *Law as a Product*, *supra* note 24, at 226–27; *see also* ROMANO, GENIUS, *supra* note 3, at 1 (arguing that charter competition between states enables firms to "seek the state whose code best matches their needs so as to minimize their cost of doing business").

233. Barzuza, *Nevada*, *supra* note 32, at 994. According to Professor Barzuza, "[m]arket segmentation is a multi-step process involving: (1) identification of heterogeneity among consumers; (2) division of the market into subgroups with similar preferences; and (3) creation of a product to meet a particular segment's demand." *Id.* at 959.

234. *Id.* at 947–49. After all, Delaware faces substantial pressure on the demand side to maintain shareholder-friendly laws, and Nevada does not attempt to emulate Delaware's substantive laws. *See id.* at 960.

235. Ofer Eldar & Lorenzo Magnolfi, *Regulatory Competition and the Market for Corporate Law*, 12 AM. ECON. J.: MICROECONOMICS 60, 62 (2020).

236. More cynically, it could also mean that these firms are trying to maximize the private benefits of control, rather than maximize firm value. As Professor Coffee explains, firms with concentrated ownership "often act[] to maximize the private benefits of control for their

Territorial market segmentation thus helps refine our understanding about firm preferences of corporate law. The theory takes seriously the idea that standard "shareholder centric" corporate governance rules espoused by Delaware may not be operationally compatible with local market conditions present in many foreign nations. For firms principally operating in markets like China, even shareholders—who are presumably seeking the highest returns on their investments—might prefer a set of rules that deviate from Delaware corporate law. It is thus unsurprising that Chinese firms have gravitated towards corporate law jurisdictions that more or less accommodate self-dealing transactions.[237]

The theory of territorial market segmentation has a number of payoffs. First, it undermines the idea that corporate law is on the path to global convergence. In their provocative and widely-cited piece, *The End of History for Corporate Law*, Professors Henry Hansmann and Reinier Kraakman argued two decades ago that "[t]he basic law of corporate governance . . . has achieved a high degree of uniformity . . . and continuing convergence toward a single, standard model is likely."[238] Professors Hansmann and Kraakman support this assertion by documenting "[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors."[239] Others, perhaps most prominently Professor Jack Coffee, have explored the possibility of global convergence taking place not through local legal reforms, but through contracts: Foreign corporations may "converge" to American-style corporate law without local reforms because they can list in an American stock market, thereby subjecting themselves to functionally similar corporate governance rules.[240]

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controlling shareholders," rather than "maximize their share price in the market." Coffee, *Racing Towards the Top*, *supra* note 15, at 1764. Relatedly, it is also possible that managers of these firms are trying to maximize growth, rather than shareholder wealth. As Professor Romano explains in the context of Japanese managers preferring objectives like maximization of growth, "[g]iven the corporate group setting, in which the most significant shareholders have dual roles as customers, suppliers, or lenders, such an attitude is also not surprising." Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021, 2032 (1993).

237. *See supra* Table 2.

238. Hansmann & Kraakman, *supra* note 35, at 439.

239. *Id.* at 468.

240. Coffee, *Future as History*, *supra* note 13, at 650 ("[L]egislation is not the only route to functional convergence. Although this Article agrees with the path dependency perspective that formal convergence faces too many obstacles to be predicted, it argues that functional convergence can be facilitated by a much more feasible and largely voluntary route. That route runs through the international securities markets and, in particular, involves the growing migration of foreign firms to the U.S. equity markets." (emphasis omitted) (footnote omitted)); *see also* Gilson, *supra* note 143, at 349 ("John Coffee has developed a second example of convergence by contract . . . . In this case, the contract is the listing agreement executed when a non-U.S. corporation lists its securities on a U.S. securities exchange, together with those U.S. securities laws to which the act of listing subjects a foreign corporation." (footnote omitted)). Professor Coffee's groundbreaking work remains important today, but this Article complicates

The "end of history" thesis, at least in its strong form, has already been challenged on a number of grounds. Perhaps the most robust line of scholarly attack has been on the grounds of path dependency: that is, initial patterns of local political and social institutions may hinder local corporate law reform. In their majestic work, Professors Mark Roe and Lucian Bebchuk argued that path dependency driven by the power that various interest groups have in the process of producing corporate rules will constrain and probably overcome the competitive forces pushing for corporate convergence.[241] Other notable scholars have extended this framework through rigorous case studies. Professor Afra Afsharipour, for instance, has studied corporate governance reform efforts in India to assess "that comprehensive convergence is limited and that the transmission of ideas from one system to another is highly complex and difficult, requiring political, social, and institutional changes that cannot be made easily."[242]

Territorial market segmentation provides an alternative (and complementary) explanation for why global convergence is unlikely to take place in the near future.[243] As long as regulatory laws and market dynamics impacting the firm remain relatively heterogeneous across national borders, corporate law preferences may be varied even in a purely Darwinian world of corporate law enabled by transnational corporate law shopping.[244] Corporate law differentiation, in other words, will likely persist—and for good reason.[245]

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the existing contractarian model by showing that firms have acute preferences for corporate law distinct from federal securities law.

241. *See* Bebchuk & Roe, *supra* note 35, at 131.

242. Afra Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 NW. J. INT'L L. & BUS. 335, 339 (2009).

243. The prevailing critiques against convergence tend to assess some form of an inability of systems to adapt and converge. My account supports the possibility of simple reluctance by foreign systems. This account is particularly important, as major jurisdictions increasingly allow firms to shop for the law of any nation. In turn, firms can choose their preferred shareholder-centric corporate law regime without reliance on local corporate law reform.

244. The dominant scholarly account adopts a Darwinian explanation to corporate law. *See* Clarke, *Independent Director*, *supra* note 94, at 175 ("In Western studies of corporate governance, the dominant explanation for the current corporate landscape is a Darwinian one: the structures and institutions we see are presumed to be the efficient ones that survived in the course of competition with less efficient forms, and the challenge is to explain the source of that efficiency."); *see also* Ruth V. Aguilera & Gregory Jackson, *Comparative and International Corporate Governance*, 4 ACAD. MGMT. ANNALS 485, 486 (2010) (assessing that "the current U.S. corporate governance system" is "frequently seen as the 'best practice' model").

245. This account finds support from an excellent forthcoming work by Tamar Groswald Ozery, who studies the way political institutions with corporate governance capacities have been deployed in China. Groswald Ozery develops a "politicized corporate governance" framework to conclude that "convergence is not inevitable even while development continues . . . thus suggesting that corporate capitalism is not a sole panacea for capital market development." Tamar Groswald Ozery, *The Politicization of Corporate Governance—A Viable Alternative?*, AM. J. COMPAR. L. (forthcoming 2021) (manuscript at 7–8), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3608727 [https://perma.cc/W5KH-JAXM].

The theory of territorial market segmentation holds some lessons about our own systems, too. For one, it pushes back against the assessment that Delaware's gravitational pull over American corporations is a byproduct of a collective lawyerly "delusion"[246] or is merely self-serving for corporate lawyers who practice in Delaware.[247] While both accounts may have captured morsels of descriptive reality, I am skeptical that the greed of corporate lawyers and other entrenched interest groups in Delaware have eroded Delaware's *domestic* competitiveness. Rather, the more plausible explanation is that corporate law preferences are not uniform for all firms, particularly if we account for firms that operate in markets that are vastly different from that of the United States. Delaware will likely remain a powerhouse for corporate law in the United States, but the state is equally unlikely to be attractive to firms internationally.

B. AGAINST A "ONE-SIZE-FITS-ALL" PARADIGM IN CORPORATE LAW

The theory of regulatory segmentation dispels, at its core, the idea that a singular system of corporate law is ideal in all settings. The idea that corporate governance rules deviating from Delaware corporate law is a sign of defective corporate governance breaks down under serious intellectual pressure.[248] As Professors Li-Wen Lin and Curtis J. Milhaupt remind us, "the business group, the form of corporate structure prevalent in 'bad' law jurisdictions around the world, has been the engine of development in countries pursuing a diverse range of economic strategies over the past half century."[249]

Wilmington's corporate law empire has been called a lot of things, but it might be the exact ingredients that made it popular in the United States that make it difficult for the state to attract foreign corporations.[250] The state's

246. *See generally* Anderson & Manns, *supra* note 22 (suggesting that Delaware's dominance is due to its past reputation rather than present benefits).

247. *See generally* Macey & Miller, *supra* note 55 (exploring how an interest-group theory can help predict and explain legal rules of corporations chartered in Delaware that have left lawyers in a dominant position).

248. As Professor Bainbridge observes, "the literature assumes that the U.S. model, towards which global systems are (or are not) converging, is one of shareholder primacy." Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW. 45, 45 (2002). A growing number of voices have challenged the orthodoxy that self-dealing transactions are evidence of defective corporate law. *See* Dan W. Puchniak & Umakanth Varottil, *Related Party Transactions in Commonwealth Asia: Complexity Revealed*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 327, 332 (Luca Enriques & Tobias H. Tröger eds., 2019) ("[T]he general assumption that [related party transactions] per se are evidence of defective corporate governance and that stricter regulation of [related party transactions] consequently equates to 'good law' is erroneous.").

249. *See* Lin & Milhaupt, *supra* note 155, at 749 (footnote omitted).

250. Relatedly, Professor Barzuza has assessed that Delaware's shareholder-friendly legal regime makes it difficult to attract American corporations that prefer laxer governance structure. Barzuza, *Nevada*, *supra* note 32, at 941–42. Because Delaware must retain its brand, it would be difficult for Delaware to offer similar types of "legal regimes" offered by Nevada, the Cayman

legal regime is costly, and its judicial precedents developed and applied in the American context may not be ideal for corporations operating abroad that compete in vastly different market conditions. This is particularly true because the United States is fairly unique in the world, in terms of the relative lack of self-dealing transactions and corporate groups.[251]

We therefore ought to rethink the way in which Delaware corporate law has been exported to foreign nations.[252] According to former Delaware Supreme Court Justice Randy Holland, Delaware's international influence is perhaps best summarized by the statements of Chief Justice In-Jaw Lai of Taiwan: "Use Delaware in the U.S. as the Model."[253] Particularly in the aftermaths of liberally exporting American-style free markets and democracy to developing countries,[254] Delaware corporate law has been marketed internationally in some circles as an important toolkit for economic development in emerging economies.[255]

The World Bank has been a leading international organization spearheading this movement recently. The international organization's influential Doing Business Report (DBR), published annually, "has [served as] a key platform for the American-driven dissemination of global norms of good corporate governance."[256] Integral to the DBR is the "extent of conflict of interest regulation index,"[257] which presupposes that "good law" places onerous restrictions on related-party transactions.[258] Thus, the report

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Islands, and the British Virgin Islands. *Cf.* Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1138–39 (2008) (conceptualizing Delaware's legal regime as a brand in the market for corporate charters).

251. *See* Dammann, *Related*, *supra* note 175, at 218.

252. Others have critiqued the fallacies of transplanting Delaware's substantive corporate code without America's discovery regime. *See* Gorga & Halberstam, *supra* note 132, at 1485–87.

253. *See* Randy J. Holland, *Delaware's Business Courts: Litigation Leadership*, 34 J. CORP. L. 771, 787 (2009) (quoting *In-Jaw Lai: Use Delaware in the U.S. as the Model*, COM. TIMES (Taiwan), Nov. 12, 2007).

254. *See* Amy L. Chua, *Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development*, 108 YALE L.J. 1, 4 (1998) ("Marketization and democratization each have been the site of massive Western legal intervention in the developing world.").

255. Gilson, *supra* note 143, at 331 ("The American system then became the apparent end point of corporate governance evolution, a consensus that appears clearly from the IMF and the World Bank's response to the 1997–1998 East Asian financial crisis. In addition to these agencies' traditional emphasis on macroeconomic matters like government deficit reduction, countries accepting financial assistance also had to commit to fundamental reform of their corporate governance system, in the direction of the American model.").

256. Puchniak & Varottil, *supra* note 248, at 328.

257. *See Protecting Minority Investors Methodology*, WORLD BANK, https://www.doingbusiness.org/en/methodology/protecting-minority-investors [https://perma.cc/3W3G-SZ23].

258. Puchniak & Varottil, *supra* note 248, at 328. The OECD's guidelines on good corporate governance have also drawn from Delaware's experience. While the non-binding OECD guide disavows the notion that there is a "single model of good corporate governance," the guideline draws heavily from the American (and in particular, Delaware's) experience. *See* OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE 10 (2015). As Shann Turnbull explains, "the US is seen as the prime role model for other market economies to emulate. . . . [T]he OECD

gives higher scores "for stricter disclosure requirements for related-party transactions, for example, in the area of protecting minority investors."[259]

These are not just academic exercises. The Republic of the Marshall Islands, for instance, has literally copied and pasted Delaware's corporate code wholesale into its domestic law, statutorily pegging its corporate law to be updated in accordance with Delaware's judicial precedents, as well.[260] Other nations, including Panama,[261] Israel,[262] Malaysia,[263] and Nevis[264] have enacted corporate law statutes modeled after Delaware. Still other nations,

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Corporate Governance Principles follow US practice." Shann Turnbull, *How US and UK Auditing Practices Became Muddled to Muddle Corporate Governance Principles* 6 (May 12, 2005) (working paper), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=608241 [https://perma.cc/CQC3-NWA3].

259. THE WORLD BANK, DOING BUSINESS 2019: TRAINING FOR REFORM 23 (2019), https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf [https://perma.cc/WFJ9-USFS].

260. Business Corporations Act 1990, tit. 52, ch. 1, § 13, https://rmiparliament.org/cms/images/LEGISLATION/PRINCIPAL/1990/19900091/BusinessCorporationsAct1990_4.pdf [https://perma.cc/HSC4-RLU6] (Marshall Islands) ("This Act shall be applied and construed to make the laws of the Republic, with respect to the subject matter hereof, uniform with the laws of the State of Delaware . . . with substantially similar legislative provisions . . . . [T]he non-statutory law of the State of Delaware . . . is hereby adopted as the law of the Republic . . . .").

261. Juan Pablo Fabrega Polleri, *Panama: Panamanian Corporations: Their Usefulness, Advantages and Benefits*, MONDAQ (Nov. 4, 2016), https://www.mondaq.com/wealth-asset-management/482182/panamanian-corporations-their-usefulness-advantages-and-benefits [https://perma.cc/DT57-W667] ("The law on Panamanian corporations, adopted in 1927, is a version of the corporation law of the State of Delaware, United States.").

262. Amir N. Licht, *Be Careful What You Wish for: How Progress Engendered Regression in Related Party Transaction Regulation in Israel*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 452, 468 (Luca Enriques & Tobias H. Tröger eds., 2019) ("The rise of American influence on Israeli company law may be attributed primarily to the enactment of the new Companies Law in 1999 . . . . The 1999 Law came in the wake of a long preparatory work conducted by Uriel Procaccia and a committee headed by Aharon Barak . . . . Procaccia's report was heavily influenced by mid-1980s views in the law and economics literature and by American corporate law.").

263. *See* Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp & Mark D. West, *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 801 tbl.1 (2002).

264. MARIO A. MATA, ASSET PROTECTION TECHNIQUES FOR REAL ESTATE OWNERS 605, 649 (2005) ("Nevis adopted its Limited Liability Company Ordinance in 1995. The Act is modeled after the Delaware Limited Liability Company Act and is considered by many practitioners as the most modern offshore limited liability legislation of its kind.").

including the Netherlands,[265] Canada,[266] and Japan[267] have relied on Delaware's judicial precedents to varying degrees.

While Delaware's century of dominating the American corporate law market may have taught us important lessons, territorial market segmentation counsels against foreign nations blindly importing Delaware corporate law. In many foreign nations, Delaware-style governance rules may be hostile to the very goals corporate law is designed to accomplish.

V. CONCLUSION

Delaware is celebrated as the crown jewel of American corporate law. Notwithstanding generations of academic commentators that have critiqued Delaware corporate law as epitomizing a race for the bottom, an abundant number of corporate law scholars and practitioners today celebrate Delaware corporate law as one of America's prized innovations. There is a degree of truth to this observation. Today, judges and lawmakers in virtually all other states look to Delaware for guidance on corporate law, and some foreign nations have outright copied Delaware's corporate code.

But this Article suggests that Delaware's celebrated corporate governance regime may not have the same type of appeal to foreign corporations operating in distinct markets and regulatory environments. In doing so, this Article calls into question the universality of "good" corporate governance rules espoused by Delaware that were largely developed and refined in the uniquely-American context. Foreign firms listed in American stock markets tell a story that corporate law cannot be "one-size-fits-all," and that even the most orthodox principles in American corporate law have space to be re-conceptualized.

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265. Danielle Quinn, Note, *Dutch Treat: Netherlands Judiciary Only Goes Halfway Towards Adopting Delaware Trilogy in Takeover Context*, 41 VAND. J. TRANSNAT'L L. 1211, 1234 (2008) ("Increasingly, the emerging Dutch judicial framework appears to mirror Delaware's common law doctrines on takeovers."); Huub Willems, *Other Aspects of the Companies and Business Court's Powers*, *in* THE COMPANIES AND BUSINESS COURT FROM A COMPARATIVE LAW PERSPECTIVE 193, 199 (Marius Josephus Jitta, Vino Timmerman, Guus Kemperink, Richard Norbruis, Anthony Driessen, Peter van der Zanden, & Huub Willems eds., 2004) (assessing that "in the Netherlands developments [in corporate law] will proceed similarly [as in Delaware]").

266. *See* Drew C. Broughton & Peter Amrhein, *Delaware Judge Finds Elusive MAC—Does It Change Anything?*, BENNET JONES (Oct. 9, 2018), https://www.bennettjones.com/Blogs-Section/Delaware-Judge-Finds-Elusive-MAC-Does-It-Change-Anything [https://perma.cc/NR65-4BH7] ("In a significant opinion issued on October 1, 2018 by Vice Chancellor Travis Laster of the Delaware Chancery Court . . . it was ruled that a purchaser could walk away from an acquisition due to factors which were found to constitute a 'material adverse change' ('MAC'). . . . While not a Canadian decision, there are similarities in the law in Canada and the U.S. as it relates to these types of M&A provisions, and courts in Canada have historically looked to the U.S. when interpreting MAC clauses. We expect that the analysis used in Laster's decision would be considered by a Canadian court, and should be taken into consideration when advising clients.").

267. Milhaupt, *supra* note 65, at 2175; *see also* Holland, *supra* note 253, at 786 ("Delaware law has significantly influenced recent developments in Japanese takeover law.").