



Episode 1 Transcript: "'DExit' or Just Drama? The Future of Delaware and 'Y'all Street'"

Scott: Welcome to the Akin podcast series: The Business Court Benches: Delaware and Texas Compared. I'm your host, Scott Barnard, a litigation partner in the Dallas Office of Akin, specializing in fiduciary and securities litigation.

Stephanie: And I'm Stephanie Lindemuth, a business litigation partner in New York. Welcome to episode one: DExit or Just Drama? The Future of Delaware and Y'All Street.

Today we're exploring the specialized business courts of Delaware and Texas, examining how their unique approaches to corporate law can impact companies crucial decisions about where to incorporate.

Scott: Stephanie and I have been trying cases in the Delaware Court of Chancery for years, but with the recent advent of the Texas business courts, we thought that this would be the perfect time to discuss the similarities, the differences, and the relatively recent competition between Delaware and Texas to get companies to incorporate within their borders.

Stephanie: Yes, that competition really sets the stage for our whole discussion today.

Scott: I think that's right Stephanie. So before we start talking about the ins and outs of the courts themselves, what is it that even prompted this whole debate on where to incorporate? I mean, for decades, wasn't Delaware always just a foregone conclusion? It was essentially the gold standard?

Stephanie: That's right. Delaware has been the primary hub for incorporation in the US for a long time.

Many US states have dedicated business courts, but the world's preeminent legal hub is the Delaware Court of Chancery. It was founded way back in 1792 and the court began issuing written opinions over 100 years ago, forming the backbone of US commercial law, and it's also successfully built statutory corporate law alongside decades of common law corporate jurisprudence developed through the Delaware Court of Chancery.

This history is why Delaware has earned that gold standard designation.

Scott: I totally agree that Delaware gets the gold standard on business courts, but there are some recently who have said that that standing may have been shaken a little bit. Isn't that right?

Stephanie: Yes. There has been a shift stemming from the ever conflicting and evolving dichotomy between shareholder rights on the one hand, and rights and protections afforded to corporate fiduciaries like officers, directors, and controlling shareholders on the other. That dichotomy is really at the heart of the re domestication debate here.

Scott: Well, okay, I get that. But how is that like playing out in the Delaware courts?



Stephanie: Well recently some key decisions coming out of the Delaware courts are leaning more heavily toward the minority shareholder interest as opposed to the interests of the fiduciaries.

The corporate world is watching this closely leading many companies to consider whether Delaware is still the right place.

Scott: But if Delaware's not the right place, where should they be looking, or where are they looking right now?

Stephanie: Well, companies are looking to seek refuge in states like Nevada and Texas, which may seem to be moving away from the direction Delaware courts appear to be taking.

But I should stress that Delaware still maintains a high level of respect for its business acumen. And while questions are circling, we haven't seen a massive exodus just yet.

Scott: That's right. But I do think that there are questions out there, that are, maybe, louder than they have been in the past, and there's a few high profile cases that have really spawned this debate.

Probably most notably the tornado versus Musk case that involved Tesla.

Stephanie: That's right. That case is front and center.

And as a result of the Delaware Chancery's Tornetta decisions, Elon Musk vowed to move Tesla's incorporation from Delaware to Texas.

The first of these decisions issued in January 2024 was pretty significant. The court ordered rescission of a 10 year equity compensation plan for Elon Musk with an estimated value of \$56 billion.

Scott: That's a lot of money. And I'm sure just the figure alone is drawing a lot of attention.

Stephanie: Oh, yes.

Scott: But the decision, wasn't it kind of surprising in part because Delaware courts are typically highly deferential to executive compensation and that they look at that as something that's typically covered by the business judgment rule.

Stephanie: Exactly. but the Delaware Court of Chancery struck down the plan using the more stringent entire fairness standard. The crucial finding was that even though Musk did not hold a majority of Tesla's shares, he was still deemed a controlling shareholder due to the significant influence he exerted over the board.

That controlling shareholder status triggered the entire fairness review instead of the more deferential business judgment rule.

Scott: And Stephanie, there wasn't just one decision, there were two decisions, right? Wasn't there a Tornetta too? Yes.



Stephanie: That came later in December of 2024. Tesla's stockholders who were not affiliated with Musk approved the plan again after receiving additional disclosures about it. Yet the Chancery court refused to revise its prior decision.

The whole scenario, especially the ruling on the breadth of what constitutes a controlling shareholder, has been perceived by some commentators as evidence of potential judicial bias an unfair departure, if you will, from traditional deference.

Scott: I think another thing that's pretty interesting about that case and just kind of adds to the drama is the original plaintiff in that case only owned nine shares of Tesla when he filed the suit back in 2018.

That's out of 3.3 billion shares. Billion with a B. So think about that for a minute. I think the combination of those factors, plus the visibility of Elon Musk led to some sort of backlash.

Stephanie: Mm-hmm. Exactly. Just after the first ruling on January 20th, 2024, Musk famously tweeted, quote, never incorporate your company in the state of Delaware, end quote. Shortly after SpaceX, his other company, officially changed its state of incorporation from Delaware to Texas on Valentine's Day of 2024.

Scott: And there's many that look at this and say, this is kind of what launched, what's being called the DExit movement, kind of a play on Brexit, um, where companies are theoretically leaving Delaware. Although, as you mentioned earlier, we haven't seen a lot of that yet. But shareholder requests for reincorporation are on the rise.

And while there's not a massive shift beyond Tesla and SpaceX reincorporating in Texas, Dillard's has made some noise about possibly reincorporating in Texas. And there's some media reports out there that Meta was reportedly in talks to do the same. There's also other companies like Oracle and Chevron and McKesson, Caterpillar, they've moved their physical headquarters to Texas. But that doesn't necessarily mean that they've changed their state of incorporation, although it's certainly in the mix.

Stephanie: Yes, that's right. The most commonly cited reasons for these re incorporations include reducing director liability and litigation risk, and finding a jurisdiction with more predictable corporation laws. Some argue that statutory law, like that in Texas, which has recently moved toward the codification of the business judgment rule, might be more predictable than judicial interpretations, which rely heavily on common law standards.

Scott: We should probably also note that while there's a lot of press recently about Texas being a new contender to Delaware, Nevada is another state that's out there, and that sees a lot of reincorporation activity, including recent reincorporation activity, because it picked up companies like Dropbox, TripAdvisor and Roblox.

Stephanie: Yes. TripAdvisor's move was actually the subject of some recent Delaware court decisions, in which the company and its fiduciaries were accused of seeking to reduce their potential liability and litigation risks. Beyond that case and Tornetta, there have been a growing number of cases with unexpected results, particularly in the M&A context that have further fueled the DExit phenomenon.



Scott: Like what examples do you have, Stephanie?

Stephanie: Well, one example is the Columbia Pipeline Group case. The Chancery court imposed a 199 million aiding and abetting verdict against the acquirer based on the buyer's constructive knowledge of fiduciary breaches by the seller's management.

Scott: That was a pretty unexpected expansion of potential liability for buyers, but ultimately, the Delaware Supreme Court reversed that decision on appeal and clarified that aiding and abetting a fiduciary duty requires actual knowledge of the underlying misconduct, which helped restore some predictability for the buyers.

Stephanie: Right, but, in a different case, Match Group Inc. derivative litigation in 2024, the Delaware Supreme Court reversed a lower ruling, expanding the application of entire fairness review to cover all conflicted controller transactions. This tightening of standards was viewed as increasing risk for controlling stockholders and boards involved in complex affiliated deals.

Scott: There's some commentators out there that are claiming that this pattern contributes to the perception of an increasingly suspicious or negative tone towards corporate boards and management from the Delaware courts. I'm not sure that that's a fair criticism, but I...there is quite a bit of press about that recently, especially out of the Musk decision we talked about earlier, and especially concerning controlling shareholder transactions.

Another important example is the 2024 Morales decision where the Chancery court struck down a stockholder agreement that granted a controlling stockholder veto rights over major corporate actions. In that case, the court emphasized that the primacy of the board's authority under Delaware law, finding that the agreement improperly restricted management's authority.

Stephanie: It's worth remembering that the legislature in Delaware has stepped in. They passed arguably reactive legislation to pause some of the DExit sentiment because the stakes are incredibly high.

Scott: Well, Stephanie, when you say the stakes are incredibly high, what do you mean?

Stephanie: Well, roughly 40% of Delaware state revenue comes from fees and taxes paid by incorporated companies, and the state is home to over 1.9 million business entities, including more than 68% of Fortune 500 companies.

Scott: And the Delaware legislature is not just sitting on its hands in response to the Morales decision. Delaware also passed an amendment to Section 1.22.8 of the DGCL in August of last year, which effectively nullified the decision by expressly allowing companies to enter into agreements with shareholders that limit the board authority. This grants more contractual freedom to controlling shareholders.

Stephanie: Yes, and this pushback is serious. And Delaware also passed Senate Bill 21, which provides more protection for directors and simplifies processes for shareholder approval.



Scott: What we're seeing though, is there's kind of this opening, I mean, Delaware had these opinions, they responded with the legislature passing new laws, but at the same time, Texas is trying to take advantage of this opening.

Texas is home to 52 of the Fortune 500 companies tied with New York and just behind California. In fact, the State's Office of Economic Development and Tourism reports that Texas is producing 9% of the US' GDP and 22% of all exports. And Texas' population just topped 30 million, and its economy clocks in as the eighth largest in the world, just behind France. This is all led to kind of a new effort that's being called Y'All Street.

Stephanie: My favorite.

Scott: Exactly. It's a play on Wall Street, uh, and it's an initiative that includes lots of kind of pro-business activity going on in The Lone Star State including the new business courts to handle complex cases, but also the establishment of the Texas Stock Exchange, which is a national securities exchange that'll be based in Texas, I think opening up next year, and an expansion of the New York Stock Exchange into the Southwest as well.

Stephanie: Mm-hmm. And you mentioned the new Texas business courts already that opened just over a year ago to handle the complex business cases. And as part of this broader legislative package meant to make Texas the headquarters of headquarters. And Scott, what are you seeing corporations doing? How are they reacting to this?

Scott: I think they're thankful for the new business courts, and they're thankful for the pro-business attitude that the state is adopting. In fact, Sandra Phillips the general counsel of Toyota North America, she said, quote, a dedicated court talking about the Texas business courts. A dedicated court says that it matters to Texas, that as a company you are here and this is a place where you can build your business.

Stephanie: Right. And so we have the support of the corporations and the legislature here, and isn't the governor also supportive as well in Texas?

Scott: Yeah. You could say he's driving this in many ways. The governor applauded recently House Bill 40's Passage, which was a bill that expanded and clarified the jurisdiction for these new business courts. And Governor Abbott said it strengthens the Texas business courts and helps keep Texas the number one state in the nation to do business.

In addition to these initiatives that we're talking about, Texas also passed a new bill called Senate Bill 29 to help clarify its corporate law in an effort to attract more corporations and actually kind of challenge Delaware's leading position.

And that's a wrap on Episode 1: DExit or Just Drama? The Future of Delaware and Y'All Street. Thanks again for joining us today. My name is Scott Barnard, a fiduciary and securities litigation partner in the Dallas office of Akin.

Stephanie: And I'm Stephanie Lindemuth, a business litigation partner in New York. Next time, we'll talk about both new bills in Texas and Delaware, look in detail at how the laws of Texas and Delaware are changing in direct competition and how the Texas business courts are structured to compete with Delaware's established standard.

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