A Response to Professor Fox

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In this Comment, Professors Weiss and White respond to a critique by Professor Merritt Fox of their earlier article Of Econometrics and Indeterminacy: A Study of Investors’ Reactions to “Changes” in Corporate Law. In that article, the Authors conducted an econometric study of investors’ reactions to seven recent Delaware court decisions. The results of that study led them to reassess the seven decisions and to question arguments that have been advanced by “contract-oriented commentators.” Professor Fox has criticized this work, stating that the Authors’ primary evidence—absence of market fluctuations following the courts’ decisions—demonstrates only the inadequacy of market studies for this form of analysis. In this Comment, the Authors defend the use of market models and take exception to Fox’s characterization of their methodology and conclusions. They conclude, however, that notwithstanding its undue formalism, Professor Fox’s critique is not inconsistent with their own conclusions about the significance of their work for “contract-oriented commentators.”

INTRODUCTION

Professor Fox challenges the validity and usefulness of our study concerning investors’ reactions to seven major Delaware court decisions. Although these decisions appeared to make important, unanticipated changes in Delaware corporate law,¹ we found that investors failed to react significantly to any of the decisions.² This finding led us to conclude that “[i]nvestors [probably] do not believe that the Delaware courts’ decisions [in the seven cases] . . . cause meaningful changes in the value of the stock of Delaware companies”³ because “the doctrinal changes that the courts announced . . . do not foreshadow predictable differences in the outcomes of substantial numbers of future corporate

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² Id. at 593.
³ Id.

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governance cases."4 Fox also views the seven decisions as important and unanticipated, 5 but embraces what might be termed "the conventional view" of those decisions—that they are significant because they "have value for predicting future judicial behavior."6 He concludes that the Weiss-White study used "an inappropriate technique for evaluating the effects of such decisions."7

In this response, we reject Fox's criticisms. Part I reviews briefly our methodology and specific tests. Part II presents our disagreement with Fox's alternative explanation of our results as a fundamental inversion of standard social science methodology. Part II also elaborates on the shortcomings of his comments concerning our methodology. Part III elaborates on the implications of our study for corporate law scholarship and suggests that Fox's approach to reading cases is unduly formalistic.

I

THE WEISS-WHITE METHODOLOGY

We undertook to test the hypothesis that seven Delaware court decisions, which others had identified as important, represented unanticipated changes in Delaware corporate law that investors would consider significant. Two premises underlying this hypothesis were: First, changes in the legal rules regulating governance of a firm alter that firm's operations; and second, investors, anticipating operational changes, will react to changes in governance rules by reevaluating the stock of affected firms.8 Hence, significant positive or negative changes in stock prices following announcement of the seven decisions would constitute strong evidence that the decisions did indeed represent changes in Delaware corporate law that investors found significant. The absence of significant changes in stock prices would cast doubt on the hypothesis. In essence, we tested directly whether investors reacted significantly to the seven decisions and thereby tested indirectly whether the seven decisions changed Delaware corporate law in ways that were economically significant.9

4. Id. at 601.
6. Id. at 4.
7. Id.
8. This view has been stated most forcefully by Daniel Fischel. See Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporate Law, 76 Nw. U.L. Rev. 913 (1982), discussed in Weiss & White, supra note 1, at 558 nn. 25-26 and accompanying text.
9. Changes that are important to lawyers may not be important to investors. For example, lawyers may find important a decision altering disclosure requirements under Delaware law to bring them into line, more or less, with those imposed by federal law. Such a change might allow certain claims to be made in state law cases which formerly could be made only in cases brought under
To measure investors’ reactions, we used a standard methodology: an event study based on the market model. First, for each of the seven decisions, we collected daily stock return data for each of approximately 50 companies incorporated in Delaware. Next, we used ordinary least squares regression methods to determine the normal reaction of each stock’s daily returns relative to the movements of the overall market. Then we examined the relative movements of these stocks in the days immediately following each decision and measured their cumulative abnormal returns (CARs). We found no significant negative CARs and only for one decision (Unocal Corp. v. Mesa Petroleum Co.) did we find positive CARs.

Since much of “the market” that served as the basis for computing the CARs was composed of Delaware companies, which weakened the test, we repeated these procedures for the same seven decisions on samples of approximately 50 companies incorporated in other states. Again we did not find significant results, except for positive CARs following the Unocal decision. We then considered a third possibility, that there were differences in the average results for the portfolios of Delaware and non-Delaware companies. Again, we generally failed to find differences of statistical significance.

Finally, we undertook a more detailed examination of the 50 Delaware CARs for the Singer v. Magnavox Co. decision. We sought to test whether the absence of significant results for the average of the sample might be masking the responsiveness of individual companies. Accordingly, we used ordinary least squares regression methods to regress the fifty CARs against a set of eight company-specific variables that we thought might be good measures of the companies’ likely sensitivity to Singer. Again, we found no significant pattern.

This repeated absence of statistically significant results formed the basis for our conclusions.

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federal law. Investors are likely to find this change to be of little import. See Weiss & White, supra note 1, at 591-92. Fox does not acknowledge this distinction. See infra notes 20-23 and accompanying text.

10. Weiss & White, supra note 1, at 579-580.
12. Weiss & White, supra note 1, at 582.
13. Id. at 580-83.
14. Id. Fox appears to accept that the design of our study was appropriate to test investors’ reactions to the seven decisions (assuming that event study methodology is appropriate for such a study) and that there was no consistent, statistically significant pattern of market reaction to any of the seven decisions.
15. 380 A.2d 969 (Del. 1977).
16. Weiss & White, supra note 1, at 584-86.
II
FOX'S CRITIQUE

A. Methodology

While our methodology involved the testing of hypotheses, by contrast, Fox starts with "the assumption that cases have predictive value." He rejects the possibility of testing his assumption directly and offers no direct or indirect empirical tests of the significance of the seven decisions. Instead, he attempts to validate his assumption by discussing "how one feels about the implications of the assumption being false."

We did not claim, nor do we believe, that decisions have no "predictive value" in one sense in which Fox uses that term—providing lawyers with guidance concerning how certain courts are likely to deal with certain claims. For example, Zapata Corp. v. Maldonado (one of the cases we studied) allows a lawyer to predict, in a case in which demand is excused, that a Delaware court may be prepared to exercise its own business judgment to override a special litigation committee's recommendation that a derivative suit be dismissed. By contrast, a New York court might be expected to follow Auerbach v. Bennett, and hence review only the independence of the litigation committee's members and the procedures that the committee followed.

The relevant question, however, from an investor's point of view, is not what standard the courts will use but whether a Delaware court, following Zapata, is likely to allow a suit similar to one that a New York court, following Auerbach, would dismiss. We explained why, despite the sharp differences in the courts' doctrinal pronouncements, "different outcomes [in cases involving similar facts] do not seem inevitable." Our conclusion then was that investors apparently had good reason not to consider Zapata—or the other decisions we studied—significant, even though these decisions may have "predictive value."

Second, to the extent that Fox addresses a relevant issue, we reject

17. Fox, supra note 5, at 1018 (emphasis added).
18. Id. We note that standard social sciences methodology does not test "assumptions" directly. Rather, one or more hypotheses are inferred from a set of assumptions and these hypotheses are then tested.
19. Id.
22. Weiss & White, supra note 1, at 599.
23. A recent review by the reporter for the ALI Corporate Governance Project of courts' decisions to accept or reject litigation committee recommendations suggests, at least as to Zapata, that investors were correct. It makes clear that one can more easily reconcile those decisions by reference to the nature of the claims involved in the underlying derivative suits than by reference to the standard of review that the courts use. See AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, § 7.08, (Tent. Draft No. 8, Reporter's Notes 4-6 1988.)
his approach because it turns standard social science methodology on its head. One cannot learn about the empirical validity of a proposition by simply assuming that the proposition is valid. If this were the way to proceed, all the empirical branches of the social sciences could cease their efforts; only the writings of moral philosophers would be relevant.

We do not suggest that it is inappropriate for Fox to criticize the specifics of our empirical tests. Such criticism, however, should leave one agnostic and eager to evaluate alternative tests. To merely assume the validity of an alternative proposition is not a viable substitute.\textsuperscript{24}

\section*{B. The Weiss-White Tests}

\subsection*{1. Narrow versus Broad Events}

Fox begins his critique of our tests by claiming that judicial decisions of the type we chose to study are not suitable for market model tests. He states that earlier market model studies focused on events that would be "expected to affect the share prices of one, or at most a handful, of firms"\textsuperscript{25} and points out that, in contrast, "the announcement by a Delaware court of a corporate law decision . . . potentially affects all firms incorporated in Delaware."\textsuperscript{26} Fox then argues that these wide-reaching events are likely to have a relatively small effect on any individual company (though the aggregate effect may be large) and that transaction costs and a lack of consensus as to the direction of likely effect will result in changes in share prices that are either small and difficult to measure or nonexistent.\textsuperscript{27}

This set of criticisms is deeply flawed. First, contrary to Fox's assertion, prior event studies have not focused exclusively on events that affect only one or a few companies. A considerable number of studies have used securities prices or returns to examine legislative, administrative-regulatory and judicial events and decisions that have affected large numbers of companies simultaneously. Table 1 lists twelve studies that involve such broad events, some affecting many firms in a single industry and others affecting firms across the economy. We compiled this list

\begin{table}
\caption{Twelve Studies of Market Reactions to Broad Events}
\end{table}

\textsuperscript{24} Fox rejects our critique of his methodology, arguing that our results can be used to test either the market model or the effects of certain kinds of judicial decisions. Fox, \textit{supra} note 5, at 1017 n.9. In our Article, we cite substantial evidence supporting reliance on the market model and explain at length why investors rationally could have considered the seven decisions we study to have been economically unimportant. Fox, in contrast, cites no evidence (other than the results of our study) that calls into question the validity of the market model, nor does he challenge our analysis of any of the seven decisions. His argument, while not devoid of theoretical merit, is unpersuasive.

\textsuperscript{25} \textit{Id.} at 1023. Fox, however, does not dispute that several aspects of judicial decisions make them attractive events upon which to base studies of market reactions. See Weiss & White, \textit{supra} note 1, at 569.

\textsuperscript{26} Fox, \textit{supra} note 5, at 1023.

\textsuperscript{27} \textit{Id.} at 1024-25.
through a quick and nonsystematic search of recent economic journals and takeover related research; we are confident that a more thorough search would produce a much longer list.

Table 1: Studies of "Broad" Events That Use Securities Price Returns

<table>
<thead>
<tr>
<th>Author</th>
<th>Date of Publication</th>
<th>Types of Events Studies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stigler</td>
<td>1964</td>
<td>L</td>
</tr>
<tr>
<td>Moore</td>
<td>1966</td>
<td>R</td>
</tr>
<tr>
<td>Largay and West</td>
<td>1973</td>
<td>R</td>
</tr>
<tr>
<td>Benston</td>
<td>1973</td>
<td>L</td>
</tr>
<tr>
<td>Jarrell</td>
<td>1981</td>
<td>L</td>
</tr>
<tr>
<td>Maloney and McCormick</td>
<td>1982</td>
<td>R, L</td>
</tr>
<tr>
<td>Jarrell</td>
<td>1984</td>
<td>R</td>
</tr>
<tr>
<td>Ross</td>
<td>1984</td>
<td>R</td>
</tr>
<tr>
<td>Hughes et al.</td>
<td>1986</td>
<td>R, J</td>
</tr>
<tr>
<td>Schipper et al.</td>
<td>1987</td>
<td>R, L</td>
</tr>
<tr>
<td>Office of the Chief Economist (SEC)</td>
<td>1987</td>
<td>L</td>
</tr>
<tr>
<td>Schumann</td>
<td>1987</td>
<td>L</td>
</tr>
</tbody>
</table>

* J: Judicial decision  
  L: Legislative event  
  R: Regulatory or administrative event

Second, Fox never explains why unanticipated corporate law decisions that have "predictive value" will have only small effects on individual firms. Again, he assumes a result to be valid rather than offering empirical (or other) verification. Moreover, even if the decisions' effects

28. Fox in fact acknowledges new studies in response to our criticisms of his analysis. Id. at note 1025 n.29.


30. Fox makes no attempt to expound upon the "predictive value" of the Zapata or any of the other decisions we studied. His failure to do so casts doubts upon his claims concerning the
on individual companies are small, share prices should react. Despite Fox's assertion to the contrary, a well-developed causative theory of market efficiency exists. That theory asserts, quite credibly, that investors seize upon any publicly available information that suggests an opportunity to earn an extraordinary return. Indeed, it is investors' demonstrated propensity to so behave that gives rise to "the paradox of the efficient market"—the observation that it is almost impossible to outperform the market by trading solely on the basis of publicly-available information precisely because so many other people have access to that information and are trying to use it to outperform the market.

Fox is correct that a change in a single company's share price will be hard to detect if the change is small in comparison to the usual daily volatility of that stock. But, if 500 companies each experience such "small" changes simultaneously, a sample of the 500 companies may well be able to capture and register the significance of those changes. It is worth emphasizing that we did not simply measure the effect of a single Delaware decision on a single company; rather, we examined seven decisions and measured the effect of each on approximately fifty Delaware and fifty non-Delaware companies. In essence, then, we used an overall sample size of 700 to test our hypotheses.

In sum, Fox's first set of criticisms of our methodology do not withstand close examination.

2. Speed and Accuracy of Share Price Reaction

Fox's second criticism focuses on the possibly ambiguous nature of the decisions we studied. He claims that the consequences of the decisions may take a long time—possibly years—to become evident and that, since commentators differ on the decisions' probable consequences, individual investors may have difficulty fathoming the decisions' true consequences. Accordingly, he concludes that share prices either may not

“predictive value" of Smith v. Jones, the supposedly more typical decision that he hypothesizes.

Fox, supra note 5 at 1021.

31. Id. at 1022.


33. Size of sample is important due to the statistical property that, for a given variance in an underlying population, the standard error of the mean of a sample drawn from that population decreases with the inverse of the square root of the size of the sample.

34. In addition, for one sample of 50, we made a further effort to explain the patterns of the individual companies' share price returns.

35. Fox, supra note 5 at 1033-34. It is important to distinguish, which Fox does not, between the consequences of a decision and the consequences of subsequent events that the decision did not foreshadow. For example, Zapata held that where demand is required, courts should undertake a very limited review of a special litigation committee's recommendations. At that time, Delaware courts generally accepted plaintiffs' claims that demand was futile (and therefore was not required) whenever all directors were named as defendants, either because they had benefitted from a
reflect accurately the decisions' predictable effects or may do so only over longer periods of time than we used.

Fox's criticisms are unconvincing, especially coming from one who assumes that judicial decisions in corporate governance cases contain information that is significant.36 A massive literature, which Fox credits, makes clear that investors have consistently responded rationally to a huge number of economic, political, social, technological, scientific, accounting, and legal events. Many of those events are at least as complex and ambiguous in their implications as are the judicial decisions we studied. If investors, many of whom are professionals whose livelihood depends on ferreting out economically significant information and trading on it,37 cannot discern the significance of the decisions we studied, those decisions may well not have economic significance. Further, if, as Fox claims, investors and other market participants are not prepared to rely on well-informed experts' views concerning the decisions' probable economic consequences, then the resulting absence of market reaction probably constitutes the best aggregate prediction that those decisions' are not economically significant. Fox appears to accept this conclusion.38

3. The Weiss-White Tests Are Not Sufficiently Sensitive

Fox hypothesizes that a corporate law decision might have an effect of only 0.1% on average share values, but that a change of this size would be too small to be captured by the Weiss-White tests, given the background variability (the standard errors) of the samples. Nonetheless, Fox claims, such a decision would be "certainly important in absolute economic terms" since "the aggregate effect of the decision would be more than $1 billion."39

Reasonable people can differ as to whether a 0.1% change is

challenged transaction or because they approved or failed to prevent that transaction. Thus, this aspect of Zapata seemed to have little importance.

A post-Zapata decision, Aronson v. Lewis, 473 A.2d 805 (Del. 1984), redefined the circumstances under which demand is deemed futile and swept many more cases into Zapata's "demand required" category. Since Zapata did not foreshadow the rule announced in Aronson, one cannot fairly claim that Aronson demonstrates Zapata's lack of consequence. On the other hand, Aronson well illustrates our argument concerning the malleability of the language courts typically use in corporate governance cases. See Weiss & White, supra note 1, at 604-05.

36. One difficulty we have in responding to Fox's comment is that he frequently mixes together analytically distinct arguments relating to event study methodology. For example, he suggests that no decision is likely to have a large impact on the value of any single firm's stock— an argument most pertinent to evaluating the sensitivity of event study methodology—as part of his assessment of why analysts are not likely to pay attention to judicial decisions—an argument most pertinent to evaluating whether the market reacts efficiently to all new information. Fox, supra note 5, at 1025.

37. Professional investors also generally incur comparatively low transaction costs when they trade.

38. Fox, supra note 5, at 1035.

39. Id. at 1038.
“important in absolute economic terms” in light of the other events that daily buffet the stock market and create the considerable amount of variability that we measured in our samples. More importantly, we did not conduct a single test of a single event; we conducted *seven* separate tests of *seven* separate events. We did not find a consistent pattern of significance for any of those tests. This was true whether one considers the proper test to be a comparison of Delaware companies with the market index, a comparison of non-Delaware companies with the market index, or a comparison of Delaware companies with non-Delaware companies.

By undertaking seven tests, we increased substantially the power of our tests. Fox claims that our tests required an effect of at least 1.3% before a significant result would be registered, which would be true for a single test. However, our seven tests allowed us to lower this figure to 0.6%, or less than half of Fox’s figure. That is, if the average effect (positive or negative) of each court decision on share prices were greater than 0.6%, we would expect to find that at least one of the events would yield a statistically significant result. Since we did not find even one, we can (at the 95% confidence level) reject the hypothesis that the seven decisions had an average effect (positive or negative) of 0.6% or greater. Although we cannot rule out smaller effects, this merely brings us back to a discussion of what is a de minimis event, given the background noise, and what is an important event.

In sum, our tests were more extensive and more powerful than Fox allows. We believe that our findings of no significant investor reaction deserve considerable weight.

IV

IMPLICATIONS FOR CORPORATE LAW SCHOLARSHIP

Some implications of our findings for corporate law scholarship

40. Indeed, given that variability, it would take a sample size of approximately 8,500 Delaware companies to provide the statistical power to reject a possible effect that was of the magnitude of 0.1%. This is far larger than the number of companies listed on all stock exchanges in the United States.

41. We are assuming here that the expected investor reaction to *Unocal* would be negative. In any event, there was no significant difference between changes in stock prices of Delaware and non-Delaware companies following *Unocal*.

42. Fox, *supra* note 5, at 1036.

43. We also undertook second-stage tests for *Singer* to determine whether the lack of significance in the average result might be masking some underlying systematic relationships between the cumulative abnormal returns and relevant characteristics of Delaware companies in the sample. Again, we found no significant pattern.

44. For our seven tests, we would have required a sample of approximately 2,100 Delaware companies for each event in order to reject the hypothesis (if we found no significant results for all seven tests) that average effects as small as 0.1% flowed from the seven decisions.
should be emphasized to eliminate any confusion that Fox's comment may create.

**A. The Significance of Judicial Decisions in Corporate Governance Cases**

Our central research conclusion was that the seven decisions we studied "can best be viewed as parts of a process by which the Delaware courts continually attempt to fine tune the techniques they use to resolve disputes involving persistently troublesome issues of corporate governance."

One who adopts this perspective will focus on the multifaceted approach courts employ in most corporate governance cases, the inalleability of the language that courts typically use when they announce "rules" of corporate governance, and the probability that, in any given case, the court is striving to maintain what it believes is an optimal level of constraints on corporate managers, rather than seeking to realign dramatically those constraints.

Fox, by way of contrast, seems to suggest that a one-dimensional reading of court decisions, focusing on the doctrinal statements that courts make, may be more appropriate. He also latches on to our use of the term "indeterminate" and associates our views with those of the critical legal studies (CLS) movement.

Review of the literature makes clear that formalistic, one-dimensional readings of courts' doctrinal statements (of the sort that Fox seems to favor) provide the basis for CLS scholars' claims that doctrine is always indeterminate and, more importantly from a CLS point of view, that law is essentially politics. In the field of corporate law, for example, Gerald Frug has extracted from leading decisions two contrasting sets of doctrinal statements, each apparently universally applicable and capable of resolving—one way or the other—virtually any foreseeable corporate governance case. One cannot respond adequately to the challenge that Frug and other CLS scholars pose by merely assuming that judicial decisions have significance. One must try to develop either empirical evidence or theories of law (and approaches to reading decisions) more robust than those advanced by formalists.

Our empirical findings led us to reexamine the seven decisions that were the focus of our study and to propose analyses of them that: were

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45. Weiss & White, supra note 1, at 601. Fox, who quotes the first of our "research conclusions," Fox, supra note 5, at 1016, ignores this, the second.

46. See Weiss & White, supra note 1, at 602-07.

47. Fox, supra note 5, at 1018-21 & text accompanying n.72. If this is not what Fox intends to suggest, then we fail to see how his views concerning judicial decisions differ from ours.

48. Id. at 1020.

more nuanced; were more consistent with our empirical findings; and likely were more sensitive to the goals of the Delaware courts than were the analyses suggested by the conventional view. Our empirical work and that reevaluation also led us to suggest a general approach to reading decisions in corporate governance cases that we believe scholars, judges and lawyers will find more fruitful and enlightening than the approaches, suggested by either CLS scholars or formalists.

We assumed our reexamination of the seven decisions adequately illustrated our approach, but one further example may be helpful. Consider the Delaware Supreme Court's recent decision in Grobow v. Perot. Plaintiffs, shareholders of General Motors, alleged that GM's board of directors acted recklessly when it authorized the payment to Ross Perot of a multimillion dollar premium, representing "hush-mail," in connection with GM's repurchase of Perot's stock. Plaintiffs sought to hold all GM directors liable for the premium. They asserted that, because all directors had voted to approve the repurchase, no demand on GM's board was required.

The court ordered the suit dismissed on the ground that plaintiffs failed to plead with sufficient particularity facts demonstrating that demand was excused. Specifically, the court ruled that Grobow's complaint did not allege facts sufficient to create a reasonable doubt that GM's board had acted recklessly when it authorized the payment to Perot. The court also held that the complaint did not support plaintiffs' claims that the repurchase was a self-dealing transaction and that GM's board had not acted in good faith.

A conventional, doctrine-oriented analysis of Grobow might run as follows. The central issue in the case concerns the circumstances under which a plaintiff who alleges that a board acted recklessly may be excused from making demand. The Delaware court's holding that

50. Compare Weiss & White, supra note 1, at 569-79 (describing decisions) with id. at 596-601 (reevaluating and analyzing decisions). Donald McCloskey recently observed: "Positive economics is a formula for publication. But, unhappily, it is not a formula for insight." McCloskey, The Rhetoric of Law and Economics, 86 Mich. L. Rev. 752, 765 (1988). Our study, we believe, demonstrates that empirical work has value if it stimulates new thinking about assumptions that have obtained considerable currency.

51. Whether the approach to reading cases that we suggest has relevance to other areas of law is unclear but interesting to consider. At one faculty workshop where we presented our study, there was an extended discussion of whether one could have predicted accurately, at the time it was handed down, that Brown v. Board of Education, 347 U.S. 483 (1954), would have significant effects. Several participants suggested that Brown's "significance" became apparent only after the Court decided several subsequent cases, the results of which one could not clearly have predicted on the basis of what the Court said in Brown. See supra note 35.

52. 539 A.2d 180 (Del. 1988)
53. Id. at 186.
54. Id. at 190.
55. Id. at 188.
Grobow's generalized allegations of recklessness were insufficient to create a reasonable doubt that GM's board had acted recklessly (and that demand thus was excused) effectively establishes a new pleading requirement that will make it extremely difficult for shareholders of Delaware companies to maintain derivative suits based on allegations that directors acted recklessly. Shareholders are unlikely to have access to detailed information demonstrating that directors made decisions recklessly—the very information they must have to satisfy Grobow's pleading requirement. Moreover, if their complaints are dismissed because demand is not excused, shareholders will be unable ever to obtain such information through discovery. In fact, one could reasonably view Grobow as directed at sharply limiting, if not reversing, the Delaware court's controversial decision in Smith v. Van Gorkum, which held that directors may be liable for their recklessly made business decisions.

Our study suggests that Grobow could, and probably should, be analyzed quite differently. We start from the premise that Grobow probably represents an effort to fine tune Delaware law, rather than to change it dramatically—that is, that Grobow probably was not an "event" to which investors would attach economic significance. That leads us to construe the decision as involving resolution of two sequential issues: first, whether GM's payment to Perot involved any impropriety; second, how the court should dispose of Grobow's claim if it concludes the payment was not improper.

As to the first issue, the Delaware court made clear that it did not consider GM's payment to Perot to be improper. The court acknowledged that the payment could be characterized pejoratively as hush-mail. Nevertheless, it described the payment to Perot and accompanying agreement as a not unreasonable response to the perceived threat that Perot posed to GM management's effort to reorient and restructure one of the world's largest companies.

Given the court's view of the merits, the central issue that it confronted was how most appropriately to dispose of plaintiffs' claims. Allowing the case to go to trial, on the assumption that defendants ultimately would prevail, was one possibility. However, if the court allowed the case to proceed, GM would be denied most of the benefits that its payment to Perot was designed to produce. The controversy between Perot and GM's management—and the accompanying disruption to

56. 488 A.2d 858 (Del. 1985) (holding board acted recklessly in approving sale of company to unrelated party). Grobow could be viewed as effectively reversing Van Gorkum because, if demand is unlikely to be excused in any case alleging recklessness, the board of the company involved can recommend that the suit be dismissed and the court is likely to accept that recommendation. See supra note 35.

57. Grobow, 539 A.2d at 189-190.
GM's reorganization plans—would continue at least until after the trial ended.\footnote{58}

Another possibility would be to dismiss the complaint on the ground that it failed to state a claim upon which relief could be granted. Such action would be problematic, though, because the rules of civil procedure generally require that a complaint be read in the light most favorable to the plaintiff.\footnote{59} Similarly, the court would have found it difficult to grant summary judgment to defendants because, in a case where the plaintiffs alleged that GM's board had recklessly authorized a wasteful payment, key factual issues were sure to be in dispute.

Taking these observations into account, we view the Delaware court's discussion of demand and the specificity of pleading necessary to establish excuse of that demand as the latest in a series of efforts to deal with a persistently troublesome problem—"how best to dispose of non-meritorious derivative claims that cannot easily be dealt with using customary summary procedures."\footnote{60} By establishing that "[a] trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor,"\footnote{61} Grobow created an alternative basis upon which trial courts can summarily dispose of derivative suits that they believe lack merit—a basis that allows trial courts considerably more discretion than they posses under the rules of civil procedure.

Putting aside one's view of the result in Grobow or of the Delaware court's statements therein, we believe the alternative analysis of Grobow suggested by our study produces insights quite different from those provided by an analysis based on the conventional view. Whether those insights are of greater value to lawyers, courts, or scholars is for the reader to decide.

B. Implications For the Work of Other Corporate Law Theorists

In our Article, we pointed out that our results, however one explains them, raise serious questions about the validity of studies that assume market forces exert a major constraining influence on states' ability to adopt corporate laws that favor corporate managers.\footnote{62} Fox reaches the

\footnote{58. The central facts of the GM-Perot transaction had received widespread publicity and were detailed in the plaintiff's complaint. If we assume that the court was prepared to discount expert testimony that plaintiffs predictably would introduce to the effect that the payment to Perot was so large as to constitute "waste," the court probably believed it was unlikely to learn significantly more from a trial than it already knew.}

\footnote{59. But cf. Grobow, 539 A.2d at 187, n.6 ("neither inferences nor conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest are accepted as true.")}

\footnote{60. Weiss & White, supra note 1, at 599.}

\footnote{61. Grobow, 539 A.2d at 187.}

\footnote{62. Weiss & White, supra note 1, at 588, 590, 603.}
same conclusion and expands somewhat on our earlier development of this point.\footnote{63} We also observed that our findings appear to undermine theories of the corporation developed by "contract-oriented commentators [who] tend to construe courts' doctrinal statements as [if they were] designed to allow one to predict with considerable confidence how a court will resolve all future controversies involving [similar] transactions or issues."\footnote{64} Again Fox agrees,\footnote{65} though here he suggests, inaccurately, that our conclusions are at odds.\footnote{66}

V

Conclusion

Our study presents our empirical findings and suggests an approach to analyzing judicial decisions in corporate governance cases. In addition, it raises serious questions about many of the theories advanced by the law-and-economics scholars who we identify as "contract-oriented commentators." Fox largely agrees with those implications of our study, but places greater emphasis than do we on possible limitations of the market model. What remains to be seen is how the commentators whose work is criticized in Professor Fox's and our debate will respond to this study and to Fox's and our respective observations.

\footnote{63. Fox, supra note 5, at 1042-43. Fox asserts that we "fail to give . . . serious consideration," id. at 1017, to the possibility that a market model event study is an inappropriate technique for evaluating the effects of corporate law decisions and implies that we did not consider seriously the implications of that possibility. We reported that "[i]nitially, we were skeptical about [this possibility] . . . but we ultimately concluded that it may have some validity." Weiss & White, supra note 1, at 589. This statement, together with the discussion that followed, id. at 589-90, evidences that we considered seriously, and at some length, the power of this argument and its implications. See also id. at 602-03.}

\footnote{64. Weiss & White, supra note 1, at 594; see also id. at 603-04.}

\footnote{65. Fox, supra note 5, at 1041-44.}

\footnote{66. Fox asserts that we claim "the contractual approach requires . . . that doctrinal statements in judicial opinions be regarded as broad rules the very words of which become implied terms of the contract." Id. at 1040 (emphasis added). However, the statement quoted at note 45, supra, makes clear that the view Fox attributes to us represents only our description of views expressed by other commentators. Their neoclassical view of contract law tends to dominate much of current contract-oriented discourse in corporate law, but we appreciate that it does not represent the only basis on which one can view corporations as essentially contractual entities. See Bratton, The "Nexus of Contracts" Corporation: A Critical Appraisal (forthcoming). On the other hand, Fox's contractual concept, which leaves to courts the resolution of almost all interpretive questions, provides little meaningful guidance as to the specific terms of the "contract" he postulates. See Weiss & White, supra note 1, at 594 n.188.}