Article

Corporate Charter Competition

Lynn M. LoPucki†

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† Security Pacific Bank Distinguished Professor of Law, UCLA School of Law. lopucki@law.ucla.edu.

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INTRODUCTION

For more than a century, Delaware has dominated the corporate charter competition. It currently supplies more than half of all public company charters. Delaware's competitors have lagged so far behind that some scholars have declared the competition to be over and Delaware the winner.[1]

Delaware's competitive strategy is principally judicial, not legislative.[2] The Delaware Court of Chancery, which interprets and enforces the Delaware General Corporation Law, is the American court most specialized in corporate law. Delaware's judicial strategy has been highly successful.[3] Other states have tried to emulate it by establishing their own chancery courts, but financial constraints and state constitutions blocked them.[4]

But even with more than half of all public companies in the United States incorporated in Delaware, the Delaware Chancery Court's corporate caseload is small—perhaps only the equivalent of one-and-a-quarter full-time Chancellors.[5] The United States

1. *E.g.*, Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684 (2002) ("The thesis of this Article is that the very notion that states compete for incorporations is a myth. Other than Delaware, no state is engaged in significant efforts to attract incorporations of public companies.").

2. *E.g.*, Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 589 (1990) ("My explanation [for Delaware's prominence] depends primarily on Delaware's expert judges. Because of Delaware's small size and its many corporate charters, Delaware judges see a high proportion of corporate cases, and develop corporate expertise.").

3. *E.g.*, Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 808 (2015) (referring to the Delaware Court of Chancery as "a highly regarded judiciary with the proven ability to act swiftly based upon a developed body of case law").

4. *See, e.g.*, Implementation of Courts of Chancery: Hearing on Assemb. Con. Res. 35 Before Nev. Leg. Legis. Comm'n's Subcomm. to Study the Benefits, Costs, & Feasibility of the Implementation of Courts of Chancery, 74th Interim Sess. (Nev. 2008), http://perma.cc/5DVQ-DRF4 ("Senator Care noted that the creation of a chancery court would require an amendment to the *Nevada Constitution* and the operation of the current business court does not require an amendment."); Black, *supra* note 2, at 590 (reporting that the New York City Bar Association believed they needed "a business court with knowledgeable judges" to compete with Delaware but that was "politically impractical because it required a state constitutional amendment").

5. COMM'N ON CONN.'S LEADERSHIP IN CORP. & BUS. LAW, A REPORT TO THE CONNECTICUT GENERAL ASSEMBLY 6 (2015) [hereinafter CONNECTICUT RE-

Bankruptcy Court for the District of Delaware's corporate caseload is four times that size.[6]

Over the past sixteen years, the Delaware Chancery Court has struggled to attract cases and, as a result, some believe that Delaware's strategy has begun to unravel.[7] The unraveling reveals a potentially fatal contradiction. Delaware's judicial strategy requires that the state attract both incorporations and litigation. But the interests of the plaintiffs' attorneys who choose venue for shareholder litigation are directly opposed to the interests of the managers who choose states of incorporation. Plaintiffs' attorneys want to maximize shareholder litigation and the associated attorneys' fees, while the managers want to minimize them.[8] Delaware has only recently recognized that it cannot appeal to both.

This Article uses systems-strategic analysis to explore the role of Delaware's judicial strategy in Delaware's success and determine the consequences of that strategy's possible failure. A systems-strategic analysis begins by identifying a law-related system for study, then describes how the system functions, and finally infers what goals the system is pursuing from that function.[9] Here, I analyze the system by which American corporate law is produced, adopted, and enforced—the corporate charter competition. Although charter competition extends to private

PORT] ("[O]nly a quarter of the Delaware Court of Chancery's work involves corporate disputes. The majority of its cases involve trusts and estates, probate and guardianship matters.").

6. The United States Bankruptcy Court for the District of Delaware (the "Delaware Bankruptcy Court") has approximately the same market share of large, public-company bankruptcies—forty-nine percent—as Delaware has of public-company incorporations—forty-eight percent. UCLA-LOPUCKI BANKR. RESEARCH DATABASE, http://lopucki.law.ucla.edu/index.htm (last visited Apr. 13, 2018) (one-variable study of venue (by city) for the years 2011–2016). The Delaware Bankruptcy Court has six full-time judges. *Judge's Info*, U.S. BANKR. COURT DIST. OF DEL., http://www.deb.uscourts.gov/judges-info-0 (last visited Apr. 13, 2018). Delaware's population would justify only one of the six.

7. Gregory DiCiancia, Note, *Limiting Frivolous Shareholder Lawsuits Via Fee-Shifting Bylaws: A Call for Delaware To Overturn and Revise Its Fee-Shifting Bylaw Statute*, 56 B.C. L. REV. 1537, 1574 (2015) (referring to "the growing doubt surrounding [Delaware's] future as the nation's corporate haven").

8. John Armour et al., *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1364 (2012) ("As a practical matter, the forum choice for representative litigation under corporate law (either a derivative suit or a class action suit) will usually be made by the law firms acting on behalf of plaintiffs, with little or no client input.").

9. *See* Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479, 497–509 (1997) (explaining how to conduct a systems analysis).

corporations and other types of entities, I have limited my analysis to the public-company context because the competition is most pronounced in that context and nearly all of the empirical studies necessary to conduct a systems analysis have been confined to that context. I use corporate terminology, but the analysis is equally applicable to publicly traded limited partnerships and limited liability companies, and the statistics I have generated include them.

Three principles structure the charter competition. First, a corporation can incorporate in any state. Second, regardless of the state chosen, the corporation will be allowed to do business in all states. Third, regardless of where the corporation does business, the law of the state of incorporation governs its internal affairs. Those affairs include substantially the entire scope of corporate law.

The system—charter competition—is composed of three subsystems operating simultaneously. In the first, corporations choose states of incorporation. In the second, states decide what packages of regulation to offer. In the third, courts chosen in a variety of ways interpret and apply the incorporation state's law to regulate the corporation.

My analysis concludes that the system's principal effects are to deregulate corporations and shield them from the democratic reimposition of regulation. The system accomplishes the former through a reiterative process in which corporations choose the states that regulate them least and the states reduce their regulations to increase their appeal. A few states compete for incorporations to gain filing-fee and franchise-tax revenues from foreign corporations, but most compete as one element in a broad effort to attract business activity by demonstrating the state's business friendliness.

The system's operation is obscured by its complexity, a justifying ideology of private ordering, and deliberate obfuscation. The structure of the charter competition insulates the law it produces from democratic control. The democratic process cannot reach the merits of corporate-law reform in Delaware, the other states, or at the federal level, and the structure preventing it is difficult to see.

As a result, charter competition provides corporate managers with power and privilege at a level they could not possibly obtain under a democratic system. Directors can sit formally atop their organizations with little or no responsibility for what

occurs within them.[10] Delaware's courts will not second guess managerial decisions.[11] Directors alone decide when—if ever—the corporation will share its wealth with shareholders.[12] As a practical matter, shareholders or creditors cannot hold directors and officers personally liable for their negligence, their gross negligence,[13] or their breaches of the fiduciary duties of loyalty and good faith.[14] Actions for breach of managers' fiduciary duties to shareholders belong to the corporation, and managers have virtually complete discretion to determine whether to bring those actions.[15] Managers fix their own compensation.[16] If the corporation's shares are widely held, other stakeholders can do nothing more than protest.[17] Because managers have almost

10. *E.g.*, *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009) (failing to hold the directors of Citigroup liable for the decimation of its business that occurred on their watch during the financial crisis).

11. Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 611 (2016) (referring to corporate law's "expansive grant of powers to the directors"); Robert B. Thompson, *Delaware's Disclosure: Moving the Line of Federal-State Corporate Regulation*, 2009 U. ILL. L. REV. 167, 178 (2009) ("Delaware's model of corporate governance, beyond the creation and naming functions described earlier, is to provide a predictable governance structure whose central tenet is to 'trust directors.'").

12. Baron v. Allied Artists Pictures Corp., 337 A.2d 653, 659 (Del. Ch. 1975) ("Before a court will interfere with the judgment of a board of directors in refusing to declare dividends, fraud or gross abuse of discretion must be shown.").

13. DEL. CODE ANN. tit. 8, § 102(b)(7) (2018) (authorizing corporations to exculpate directors for liability for breach of the fiduciary duty of care).

14. That is, the corporation can indemnify and insure managers against that liability. *Id.* Sections 145(a)–(b) require a finding that the directors or officers "acted in good faith and in a manner the [directors or officers] reasonably believed to be in or not opposed to the best interests of the corporation" as a condition of indemnification. But the finding can be made by the corporation itself or by "independent legal counsel in a written opinion" and it may not be necessary at all if the indemnification is pursuant to section 145(f) of the Delaware code. *Id.* § 145(d). Even if liability for the bad-faith actions of directors or officers cannot be indemnified at all, the corporations can and usually do provide insurance against liability for them. Directors almost never pay anything for their breaches of fiduciary duty. *See generally* Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006) (providing an empirical study of how often directors pay out-of-pocket).

15. That is, managers can prevent shareholders from bringing shareholder derivative actions by appointing independent directors to special litigation committees and, if there are no independent directors, the conflicted directors can appoint some.

16. *E.g.*, tit. 8, § 141(h) ("Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors.").

17. Federal law gives shareholders the right to a say on pay by voting to approve or disapprove directors' and officers' compensation, but the vote is

complete control over the proxy machinery[18] and the right to resist takeover attempts,[19] managers can perpetuate themselves in office. If some group of shareholders seeks to take control of the corporation by consolidating shareholdings, the managers can retaliate with poison pills that selectively dilute the troublemakers' holdings,[20] strategic speed ups[21] and delays[22] of the voting process, asset sales, lock-ups, customer assurance programs,[23] the issuance of new shares with unlimited voting rights,[24] and a variety of other antitakeover devices.[25]

Despite empirical evidence to the contrary, most scholars view the charter competition as a race to the top.[26] The standard

merely advisory. SEC, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 17 C.F.R §§ 229, 240, 249 (2017) (SEC Rule 14a-21a).

18. *E.g.*, Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475, 481 (2008) (referring to "the standard state law rules that produce reimbursement only if the insurgent wins control of the board" and citing those rules as "providing evidence that jurisdictional competition for incorporations is geared toward appealing to managerial interests").

19. Selectica, Inc. v. Versata Enters., No. 4241-VCN, 2010 WL 703062, at *24 (Del. Ch. Feb. 26, 2010), *aff'd*, 5 A.3d 586 (Del. 2010) ("[T]he board of directors is the defender of the metaphorical medieval corporate bastion and the protector of the corporation's shareholders." (quoting Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995))).

20. *E.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (validating poison pills).

21. *E.g.*, Ala. By-Prod. Corp. v. Neal, 588 A.2d 255, 258 (Del. 1991) (limiting *Schnell v. Chris–Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971), which had invalidated a speed up, to "those instances that threaten the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right").

22. *E.g.*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1288 (Del. 1998) (noting that "the combined effect of the two defensive measures would be to delay any acquisition of Quickturn by Mentor for at least nine months").

23. *E.g.*, Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from* Air Line Pilots Ass'n, International v. UAL Corp., 120 HARV. L. REV. 1239, 1244 (2007) ("PeopleSoft initiated a 'Customer Assurance Program' (CAP), under which PeopleSoft customers would receive back between two and five times their money if any company acquired PeopleSoft and then reduced the support for PeopleSoft's software products during the first four years of the customer's contract.").

24. DEL. CODE ANN. tit. 8, § 151(g) (2018) (authorizing "designation" of the "powers" and "rights" of shares by resolution when they have not been "set forth in the certificate of incorporation").

25. ALAN R. PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH 840–45 (2d ed. 2014) (discussing classified boards, poison pills, share repurchases, and lock-ups).

26. *E.g.*, Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 770 (1995) ("[T]here is a broad consensus that

account is that Delaware won the race by developing corporate law expertise and striking the most efficient balance between the rights of managers and shareholders.[27] Delaware alone provided a specialized court that could respond quickly and expertly to corporate needs and Delaware alone was able to credibly commit to continue serving the interests of corporations.[28] Delaware's lead is so great and the network effects so strong that no other state actively competes against it.[29] If some other state adopted a rule or practice that provided it with an advantage in the competition, Delaware could and would nullify the advantage by copying the rule or practice.[30]

The systems-strategic analysis I employ suggests that the standard account should be revised in essentially five respects:

First, the charter competition is neither dormant nor merely a competition between Delaware and the corporations' home states. Other states not only compete, but have attracted twenty-five percent of all public companies that have incorporated outside their home states.

Second, charter competition should be modeled not as an attempt to strike the right balance between managers and shareholders, but as a delegation of power to managers who then strike that balance through implicit contracting. That reconceptualization leads to the insight that states do not need corporate-law expertise to compete for incorporations.

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state competition to produce corporate law is a race to (or at least toward) the top.").

27. *E.g.*, CORP. LAW COUNCIL, EXPLANATION OF COUNCIL LEGISLATIVE PROPOSAL 11 (2015) [hereinafter COUNCIL EXPLANATION], http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf.

28. Delaware committed by giving the state to the corporations as a hostage. That is, Delaware increased its filing-fee and franchise-tax revenues to the extent that the state is dependent on them. *E.g.*, Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 235 (1985) ("[A] state budget largely dependent on franchise revenue is an asset that precommits the state to not welching on its corporate customers by radically revising its corporate law policy to the detriment of their interests . . . ."). *But see* Black, *supra* note 2, at 589 ("If the cost of re-incorporating is low, the gains from midstream opportunism are low as well, and the hostage is superfluous.").

29. Kahan & Kamar, *supra* note 1, at 748 ("The notion that states compete, and that this competition results in a metaphorical race, is a myth.").

30. *E.g.*, Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 557 (2002) (asserting that "Delaware could 'match' by adopting the challenger's improved rules").

Third, corporate charter competition as a system is neither a race to the top or the bottom. It is capable of generating only one result: deregulation. What remains of corporate law is not regulation, but mere obfuscation.

Fourth, Delaware employs a principally judicial strategy in the competition. That strategy, which requires Delaware to attract litigation as well as incorporations, is faltering. The shift to arbitration of shareholder litigation that is already in progress may strip Delaware of its competitive advantage and end its dominance.

Fifth, regardless of what happens to Delaware, for the foreseeable future charter competition will remain a highly stable system that is effectively beyond democratic control. The only solution to the problem of charter competition remains unthinkable: abandon the internal affairs doctrine.

This Article proceeds to those conclusions as follows. Part I first describes and analyzes the charter-competition system. The internal affairs doctrine provides the system's foundation. The system consists of three subsystems in which (1) corporations choose incorporation states; (2) states decide what corporate law packages to offer; and (3) courts do the actual regulating. The analysis concludes that Delaware's success is largely attributable to and dependent on its unique court system. Part II then explores Delaware's judicial strategy in more depth, argues that Delaware has had difficulty attracting the litigation on which the strategy depends, and describes the potentially fatal threat from arbitration bylaws. It concludes that Delaware may be unable to prevent the loss of its shareholder litigation and the consequent failure of its judicial strategy.

Part III seeks to project the effect of a failure of Delaware's judicial strategy on the corporate charter competition. It concludes that the competition could melt down to an equilibrium in which no state even purports to impose any corporate regulation and no state derives significant fees or taxes from the incorporations it attracts. It then concludes that although Delaware's position in the corporate charter competition is precarious, the charter competition itself rests on a stable foundation. Regardless of what happens to Delaware, charter competition will prevent the imposition of corporate regulation for the foreseeable future.

I. THE SYSTEM FOR CORPORATE REGULATION

Charter competition is the system by which U.S. jurisdictions regulate corporations. The internal affairs doctrine, which provides that the law of the incorporation state governs the corporation's internal affairs, is the system's foundation. That doctrine allows corporations to choose their regulators by choosing their states of incorporation.

In this Article, I use the term corporate regulation to refer to legal requirements that fall within the scope of the internal affairs doctrine.[31] Requirements fall within that scope if they apply to corporations, but do not also apply to individuals.[32] They include the traditional contents of corporation statutes, while excluding antitrust, fair trade, criminal, and other laws that apply to a person regardless of whether the person is a corporation.[33]

Generally speaking, corporations prefer to be regulated by the states that will regulate them least. Because states prefer to be chosen, they modify their corporation laws to reduce the laws' levels of regulation. Over more than a century, the pressure from these choices by the corporations and the states has systematically eliminated all meaningful regulation from American corporate law.[34]

As shown in Figure 1, the system in which the states compete consists of three subsystems. In the first, corporations choose states of incorporation. In the second, the states enact and revise their corporation laws, in the process sometimes creating courts, conferring jurisdiction, and specifying who may select venue and in what circumstances. In the third, the empowered courts regulate corporations in accord with the laws of their states of incorporation.

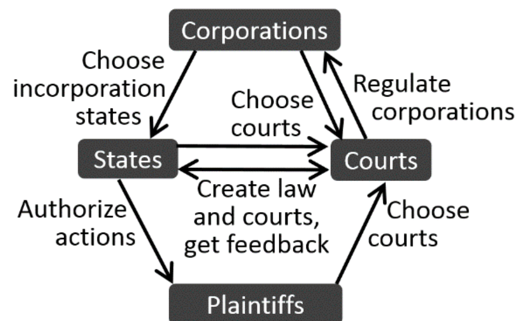
31. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (AM. LAW INST. 1971) (defining internal affairs doctrine).

32. *Id.* § 302 cmt. a (making the distinction between rules that apply only to corporations and rules that also apply to individuals).

33. *Id.* § 301 ("The rights and liabilities of a corporation with respect to a third person that arise from a corporate act of a sort that can likewise be done by an individual are determined by the same choice-of-law principles as are applicable to non-corporate parties.").

34. *E.g.*, Black, *supra* note 2, at 544 ("After a century of erosion through competition for corporate charters, what is left of state corporate law is an empty shell that has form but no content."); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962) (referring to "our great empty corporate statutes—towering skyscrapers of rusted girders, internally welded together and containing nothing but wind").

Figure 1: Corporate Charter Competition



This Part first describes the role of the internal affairs doctrine, then describes the function of each of the three subsystems separately, and ends by demonstrating the insulation of the system from democratic processes.

A. THE INTERNAL AFFAIRS DOCTRINE

The internal affairs doctrine is a conflicts of law rule unique to corporate law. The rule is that the law of the state of incorporation governs the corporation's internal affairs.[35] It defines internal affairs so broadly that the doctrine extends to virtually all of corporate law. The rule's immediate effect is to empower states of incorporation to make rules that apply extraterritorially. Its ultimate effect is to deregulate corporate law.

1. Externality-Generating Capacity

The internal affairs doctrine is usually described as applying only to the relationship among "the corporation and its officers, directors, and shareholders"[36] and is often justified as part

35. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (AM. LAW INST. 1971).

36. Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) ("The 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."); Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 161 (1985) (describing the internal affairs doctrine as "the notion that only one state, almost always the site of incorporation, should be authorized to regulate the relationships among a corporation and its officers, directors, and shareholders").

of an implied contract among those parties.[37] In practice, however, courts often apply the doctrine to the corporation's relationship with both contract[38] and tort[39] creditors. With the cooperation of the Delaware courts, managers have expanded the doctrine strategically to also cover persons interested in buying the corporation. The managers' main strategy is to subject acquiring shareholders to rules that burden them without similarly burdening nonacquiring shareholders. The poison pill is a prominent example.

The internal affairs doctrine's impact is broader than its scope. As Professor Jed Rubenfeld wrote, "[n]o corporate affairs are ever exclusively 'internal;' they will always have consequences of greater or lesser magnitude on the 'outside' world."[40] Professor Kent Greenfield provides these examples of internal rules with external impacts: "a rule that directors should maximize profit to shareholders, or a rule that directors should not disclose information to communities about their business practices absent a legal or financial imperative, or a rule that shareholders need not pay the debts of the corporation."[41]

Because rules that apply only internally have direct effects on third parties, incorporation states can enact corporate-law rules that have direct effects on third parties and apply to them

37. Elizabeth Cosenza, *The Persistent Problem of Multi-Forum Shareholder Litigation: A Proposed Statutory Response To Reshuffle the Deck*, 10 VA. L. & BUS. REV. 413, 423 (2016) ("The rationale for the internal affairs doctrine is . . . that upon acquiring stock, shareholders 'impliedly agree' that the internal affairs of the company should be governed by the laws of the state of incorporation."); Franklin A. Gevurtz, *Piercing Piercing: An Attempt To Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil*, 76 OR. L. REV. 853, 903 (1997) ("If shareholders do not like the laws of the state of incorporation, they do not have to invest in this corporation.").

38. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (AM. LAW INST. 1971) ("Matters which may also affect the interests of the corporation's creditors include the issuance of bonds, the declaration and payment of dividends, loans by the corporation to directors, officers and shareholders, and the purchase and redemption by the corporation of outstanding shares of its own stock.").

39. *E.g.*, Gregory Scott Crespi, *Choice of Law in Veil-Piercing Litigation: Why Courts Should Discard the Internal Affairs Rule and Embrace General Choice-of-Law Principles*, 64 N.Y.U. ANN. SURV. AM. L. 85, 90 (2008) ("The majority of courts apply the internal affairs doctrine to impose the law of the state of incorporation upon piercing claims, whether those claims are based on tort judgments or upon contract obligations.").

40. Jed Rubenfeld, *State Takeover Legislation and the Commerce Clause: The "Foreign" Corporations Problem*, 36 CLEV. ST. L. REV. 355, 376–77 (1988).

41. Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, L. & CONTEMP. PROBS., Autumn 2004, at 135, 136–37 (2004).

extraterritorially. For that reason, the internal affairs doctrine is often and correctly characterized as an "externality machine."[42]

2. Losing-State Generation

The effect of the internal affairs doctrine is that each state can regulate extraterritorially with regard to its own corporations but must yield to other states' extraterritorial regulation of their corporations. With respect to public-company incorporations, at least, the trade is an uneven one. Compustat[43] data on 7061 public-company incorporations show that, as compared with a hypothetical regulatory scheme that would require companies to incorporate in their headquarters states, Delaware gains 3879 corporations (fifty-five percent of the 7061).[44] Only four other states gain at all. Nevada gains 282 corporations (four percent), Maryland 262 corporations (four percent), Massachusetts six corporations (0.01%), and Wyoming five corporations (0.01%).[45] Minnesota breaks even, and the remaining forty-four states lose corporations.[46] California, home to 1210 companies but state of incorporation for only 112, is the biggest loser.[47] One might expect that such high concentrations of winners and losers would cause the consensus in favor of the internal affairs doctrine to break down.

42. *Id.* at 140 ("The internal affairs doctrine is easily characterized as an externality machine."); *accord* Lynn Stout & Sergio Gramitto, *Corporate Governance as Privately-Ordered Public Policy: A Proposal*, 41 SEATTLE U. L. REV. 551, 565 (2018) ("Joel Bakan has famously described corporations as 'externalizing machines.'").

43. Michael Bradley Michael, *The Untenable Case for Chapter 11*, 101 Yale L.J. 1043, 1094 n.58 (1992) ("COMPUSTAT is the most frequently used and comprehensive data base of annual accounting numbers for large corporations.").

44. Lynn M. LoPucki, Compustat: Table 1 Statistics (Dec. 20, 2016) (on file with author).

45. Lynn M. LoPucki, Compustat: Incorporation Count 3 (Oct. 15, 2016) (on file with author).

46. *Id.*

47. *Id.*

Table 1: The Biggest Winners from Corporate Charter Competition

Jurisdiction	Head-quarters	Shop Out	Shop In	Gain or Loss	Incorpora-tions
Delaware	85	39	3918	3879	3964
Nevada	74	29	311	282	356
Maryland	258	144	406	262	520
Massachusetts	499	279	285	6	505
Wyoming	1	1	6	5	6

With respect to the states shown, the table accounts for all companies with headquarters and jurisdiction of incorporation in the United States that were returned on a search for companies active in 2015 in the Compustat North America database. The total number of companies is 7061.

"Shop Out" is a firm headquartered in the jurisdiction that is incorporated elsewhere.
"Shop In" is a firm headquartered outside the jurisdiction that is incorporated in the jurisdiction.

3. Losing-State Acquiescence

Legally, the losing states could end the charter competition simply by rejecting the internal affairs doctrine. Although the Delaware Supreme Court has held that the internal affairs doctrine is "mandated by 'constitutional principles, except in the rarest situations,'"[48] commentators overwhelmingly disagree.[49] Alternatively, the states could end the competition by imposing conditions on foreign corporations' access to their domestic markets.[50] They have instead chosen to allow the competition to continue.[51]

48. McDermott Inc. v. Lewis, 531 A.2d 206, 217 (Del 1987).

49. *E.g.*, Timothy P. Glynn, *Communities and Their Corporations: Towards a Stakeholder Conception of the Production of Corporate Law*, 58 CASE W. RES. L. REV. 1067, 1082 (2008) ("Contrary to the claims of the Delaware Supreme Court, the internal affairs doctrine does not have a constitutional dimension."); Rubenfeld, *supra* note 40, at 357 (referring to the inference that "a state cannot regulate the internal affairs of a foreign corporation (at least with respect to shareholder voting rights) without violating the Commerce Clause" as "untenable").

50. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 311 (AM. LAW INST. 1971) provides that "[s]ubject to constitutional limitations," a state may prohibit a foreign corporation from doing business, or conducting other activities, within its territory or may impose conditions as the price of permitting the corporation to do such business or such other acts.

51. *E.g.*, MODEL BUS. CORP ACT § 15.05(c) (2007) ("This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.").

A powerful combination of factors explains the losing states' acquiescence to the internal affairs doctrine. First, all fifty states have adopted the doctrine with respect to public companies.[52] A state's switch to any other rule would initially create conflicts among the states and the possibility that "a corporation could be faced with conflicting demands."[53] Second, states may fear that if the internal affairs doctrine becomes unsettled, the federal government might issue charters, taking both the power to regulate corporations and the resulting filing-fee and franchise-tax revenues for itself.[54] That change would take revenues from even the losing states, because every state currently derives revenues not only from incorporations, but also from foreign corporations doing business in the state. Third, states joining in an effort to reform corporate law may "fear retaliatory responses from [other] states, particularly Delaware."[55]

Fourth, the losing states do not lose those revenues Delaware gains from winning. Losing states that would have taxed a corporation's incorporation in the state instead tax the corporation's doing business in the state. Corporations pay more and the losing states collect almost the same amount of money they would if they had retained their corporations. Losing does deprive states of their ability to regulate the corporations operating within their borders, but unilateral rejection of the internal affairs doctrine would be a dangerous way to attempt to solve that problem. Corporations might respond to the first states to reject the doctrine by moving their *operations* out of the state. Rejection of the internal affairs doctrine would, in any event, certainly

52. California and New York have partially rejected the internal affairs doctrine, but not with respect to public companies. CAL. CORP. CODE § 2115(c) (2010) ("This section does not apply to any corporation . . . with outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market . . . ."); N.Y. BUS. CORP. LAW § 1317 (McKinney 2003) (laying out the liability of foreign directors under New York corporate law); *id.* § 1320(a)(1) ("[A] foreign corporation . . . shall be exempt from the provisions of . . . subparagraph (a)(1) of section 1317 . . . if . . . [s]hares of such corporation were listed on a national securities exchange . . . .").

53. Edgar v. MITE Corp., 457 U.S. 624, 645 (1982).

54. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 636 (2003) ("[States] know that a crisis will attract federal attention and that their corporate law authority might be sapped if it does."); Lipton, *supra* note 11, at 641 (concluding that "the displacement of state control [of corporate litigation by arbitration] might pave the way for more intrusive, and substantive, federal regulation").

55. Note, *The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations for Its Continued Primacy*, 115 HARV. L. REV. 1480, 1499 (2002).

complicate a state's efforts to portray itself as business-friendly. Lastly, the beneficiaries of the internal affairs doctrine are the corporations physically located in the losing states. Rejection of the doctrine would deprive them of the freedom to choose their regulators. They might retaliate politically against the elected officials responsible for their loss of that freedom.

Together, these factors render the internal affairs doctrine virtually immutable. The losing states are not so much victims of the internal affairs doctrine as coconspirators keeping it in place. The doctrine enables states to import what amounts to a regulatory void in corporate law,[56] without having to accept political responsibility for doing so. As a result, the internal affairs doctrine remains firmly entrenched and provides a stable platform for the expansion of unregulated corporate power.

B. CORPORATE CHOICE OF INCORPORATION STATE

Even charter-competition skeptics agree that public companies shop for their states of incorporation.[57] Choosing a state makes that state the corporation's exclusive corporate regulator. Every corporation chooses a state of incorporation at its inception and can change its state of incorporation at any time by any of several simple and inexpensive methods of reincorporation.

Both public and private corporations shop for incorporation states. To illustrate, tiny Delaware is the incorporation state for 1.2 million private entities—nearly as many as the approximately 1.5 million incorporated in California.[58] This Article focuses, however, on the motives and choices of public companies.

Seventy-four percent of public companies are incorporated in a state other than the state in which they are headquartered.[59] If the advantages were sufficiently great, some portion of the remaining twenty-six percent would undoubtedly also be willing to incorporate elsewhere.

56. *See* sources cited *supra* note 34.

57. *E.g.*, Kahan & Kamar, *supra* note 1, at 735 ("*[F]irm choice*, rather than *state competition*, is therefore the proper paradigm to analyze corporate law.").

58. *About Agency*, STATE OF DEL.: DIV. OF CORPS., https://corp.delaware.gov/aboutagency.shtml (last visited Apr. 13, 2018) ("More than [one million] business entities have made Delaware their legal home."); Public Records Act request from Lynn M. LoPucki to California Secretary of State, Aug. 2, 2013 (on file with the author).

59. *Infra* Table 2.

1. Who Decides?

Managers, not shareholders, choose the incorporation state.[60] In an initial public offering, corporate insiders make the choice before they approach the underwriters.[61] The underwriters present the managers' choice to the prospective shareholders as a take-it-or-leave-it proposition. In the context of the overall investment opportunity, state of incorporation is not a salient term and will be overlooked.[62] Because all states offer essentially the same corporate law,[63] the choice among the states matters to a rational investor in only the rarest of circumstances. Thus scholars who model choice of incorporation state as a bargain between managers and shareholders are modeling a theoretical choice, not a choice in which shareholders are actually participating.

Managers also decide whether the corporation should later change its state of incorporation.[64] Corporations generally seek reincorporation after periods of abnormal positive returns to

60. Bebchuk & Hamdani, *supra* note 30, at 592 ("Under prevailing law, management has veto power over reincorporations."); Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 896 (2006) ("[M]anagers choose the state of incorporation."); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 252 (1977) ("[T]he decision as to which state to incorporate in is in almost all cases a managerial decision.").

61. Underwriter influence is apparently minimal. William J. Carney et al., *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, 2 HARV. BUS. L. REV. 123, 134 n.48 (2012) ("[W]e found that the jurisdiction had already been chosen for the IPO by the time the matter reached the underwriter (81% of the time).").

62. Allen, *supra* note 3, at 793 ("Companies that are going public often include provisions, such as classified boards and dual class common stock, which are not "stockholder friendly," in their organizational documents. Eager investors often overlook such provisions.").

63. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1062 (2000) ("[V]ariations in state corporation laws are minimal."); Romano, *supra* note 28, at 278 (finding in a survey of corporations that "the top 200 non-Delaware firms did not perceive the corporation laws of their state of incorporation to differ much from Delaware's code"); Winter, *supra* note 60, at 255 ("[T]he Delaware Code is no longer significantly different from those of a number of other states.").

64. *See, e.g.*, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1460 (1992) ("[M]anagers . . . have considerable influence over reincorporation decisions."); *id.* at 1475 ("[N]otwithstanding the requirement of shareholder approval, Delaware and other states have significant room (and incentives) to adopt value-decreasing rules for the governance of certain corporate law issues.").

shareholders.[65] In theory, shareholders could refuse to approve the managers' choice, but such refusals are rare.[66] While some older studies suggested a generally positive market reaction to reincorporation to Delaware,[67] a more recent study using a better methodology shows a negative, but statistically insignificant, market reaction to reincorporation in Delaware.[68] Shareholders' indifference to reincorporation in Delaware leaves managers free to do it.

2. What Is the Basis for Choice?

A substantial literature reports the bases on which corporations choose their states of incorporation. These include the cost of incorporation in the state; particular features of the state's substantive law; the quality of the state's courts; the preferences of the corporation's professional advisors; the perceived political responsiveness of the state; the state's reputation; and the familiarity of the managers and investors with the state's corporate-law package.

a. Direct Costs

Although Delaware is by far the most expensive state in which a large public company can incorporate, the direct costs of incorporation are sufficiently small that they are unlikely to affect many companies' decisions.[69] To be incorporated in a state, a corporation pays an initial incorporation fee, an annual renewal fee, and, in some states, an annual franchise tax. In most states, the annual fees and taxes for even a large public company

65. Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 281 (1980) (finding that "over the [two] years preceding the month of the switch, stockholders earn positive abnormal returns").

66. *But see* Dave Ebersole, *Reforming Ohio Corporate Law and Securities Regulation To Facilitate Investment in Ohio*, 7 OHIO ST. ENTREPREN. BUS. L.J. 451, 451–56 (2012) (describing shareholder rejection of Abercrombie & Fitch Co.'s attempt to reincorporate from Delaware to Ohio).

67. Robert Anderson IV & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049, 1058–59 (2016).

68. *Id.* at 1052 ("We show that Delaware law does not add to or subtract significant value from publicly traded companies.").

69. Bebchuk and Cohen argue that "the extra costs of going out of state" are "likely to be trivial for firms that are very large." Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where To Incorporate*, 46 J. LAW & ECON. 383, 398 (2003).

are only a few hundred dollars.[70] In Delaware, they reach $250,000 annually for the largest companies.[71]

To do business in each state other than its state of incorporation, a corporation also pays qualification fees, renewal fees, and, in some states, an annual franchise tax. With only a few exceptions, the fees for doing business in a state approximately equal the fees for incorporating and renewing in the state.[72] The result is that incorporation in a state where the corporation does not do business adds the cost of the incorporation state to the corporation's total costs, but incorporation in a state where the corporation does do business probably does not increase the corporation's total costs at all.

To change its incorporation state after the initial selection, the corporation must also pay legal fees, additional state filing fees, and perhaps the costs of printing and distributing proxy statements.[73] In 1985, Romano estimated the typical reincorporation cost for a public company at $40,000[74] and noted the highest reincorporation cost estimate in her survey was $1.1 million.[75] Black estimated typical reincorporation costs at $40,000 to $80,000 in 1990.[76] These costs of reincorporation do not appear to be high enough to affect corporate decision making.

b. Substantive Law

The crux of the charter competition debate has been whether managers choose incorporation states to benefit themselves (race to the bottom) or to benefit both themselves and shareholders in some efficient combination (race to the top). But the literature identifies only a single difference in corporate law that clearly causes corporations to choose one state over another.

70. Kahan & Kamar, *supra* note 1, at 690 tbl.1, 692 tbl.2 (showing amounts by state).

71. *Annual Report and Tax Information*, STATE OF DEL.: DIV. OF CORPS., https://corp.delaware.gov/frtax.shtml (last visited Apr. 13, 2018).

72. CAL. FRANCHISE TAX BD., CALIFORNIA'S CORPORATION TAXES: FREQUENTLY ASKED QUESTIONS 2 (2003), https://ftb.ca.gov/forms/misc/1083.pdf (explaining corporations doing business in California pay the minimum franchise tax).

73. *See, e.g.*, Romano, *supra* note 28, at 246 (discussing reincorporation costs).

74. *Id.* Adjusted for inflation, that is about $88,110 in 2015 dollars.

75. *Id.* at 249.

76. Black, *supra* note 2, at 558 (estimating the cost of public company reincorporation at $40,000 to $80,000).

That difference is between laws that protect managers against takeovers and laws that do not. Professor Guhan Subramanian showed that "managers migrate to (and fail to migrate away from)"[77] three types of antitakeover statutes: (1) control share acquisition statutes; (2) business combination statutes; and (3) pill validation statutes. Subramanian characterized his finding as "generally consistent with the explicit prediction of race-to-the-bottom theorists and inconsistent with the explicit prediction of race-to-the-top theorists."[78] Similarly, Professors Lucian Bebchuk and Alma Cohen found that corporations are more likely to choose Delaware when their home states provide managers with fewer protections against takeovers.[79]

In a separate article, Bebchuk reasoned that a race to the bottom would occur with respect to rules related to managers' ability to "significantly redistribute" wealth from the corporation to themselves.[80] He identified the rules governing managerial self-dealing, the taking of corporate opportunities, and insider trading[81] as likely to produce races to the bottom. He also predicted a race to the bottom in rules governing "the regulation of takeovers and proxy contests, the protection of creditors, disclosure regulation, and the protection of constituencies other than providers of capital" because those rules could create significant externalities.[82] With respect to insignificantly redistributive rules, Bebchuk reasoned that the race would be to the top,[83] but he did not identify specific rules.

Contrary to Subramanian, Bebchuk, and Cohen, Professor Robert Daines found that "[p]oison pill or control share statutes make it *more* likely that firms will leave a state and incorporate in Delaware," but he cautioned that "this effect is not robust and is theoretically questionable given the ease with which firms can

77. Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1838 (2002).

78. *Id.* at 1848.

79. Bebchuk & Cohen, *supra* note 69, at 387 ("[S]tates with no anti[-]takeover statutes, such as California, do poorly and retain a relatively small fraction of the companies located in them. . . . [S]tates that amass most or all standard antitakeover statutes are the most successful both in retaining in-state firms and in attracting out-of-state firms.").

80. Bebchuk, *supra* note 64, at 1460.

81. *Id.* at 1462.

82. *Id.* at 1494.

83. *Id.* at 1462 ("[M]arket discipline will probably discourage managers from seeking inefficient rules with respect to insignificantly redistributive issues.").

opt into or out of these provisions."[84] He should also have noted that Delaware has case law validating poison pills, so it is far from clear how a poison-pill statute in the home state could be driving reincorporations to Delaware.[85]

c. Courts

Numerous sources stress the importance of the Delaware court system to corporations' decisions to incorporate in Delaware.[86] At least twenty-two states have created business courts of some nature,[87] and some have done so in the hope of competing with Delaware for incorporations.[88] But Delaware retains several clear advantages.

In Delaware, the five-judge Court of Chancery has jurisdiction over corporate matters, and appeals are directly to the five-justice Supreme Court. The Delaware system is unique in at least three important respects. First, Delaware's Chancery

84. Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1597 (2002) (emphasis added).

85. Paul H. Edelman & Randall S. Thomas, Selectica *Resets the Trigger on the Poison Pill: Where Should the Delaware Courts Go Next?*, 87 IND. L.J. 1087, 1089 (2012) (noting that since 1985 "Delaware judges have struck down some new variations of the poison pill as entrenchment mechanisms, but generally, they have approved traditional rights plans as useful bargaining devices for well-intentioned boards of directors").

86. *E.g.*, LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 5 (2007), https://corp.delaware.gov/whycorporations_web.pdf ("Many experienced lawyers believe that the principal reason to recommend to their clients that they incorporate in Delaware is the Delaware courts and the body of case law those courts have developed."); Black, *supra* note 2, at 589 ("My explanation [for Delaware's prominence] depends primarily on Delaware's expert judges."); John F. Coyle, *Business Courts and Interstate Competition*, 53 WM. & MARY L. REV. 1915, 1983 (2012) ("[Business] courts can attract—and have attracted—litigation business to the jurisdiction that creates them . . . ."); Romano, *supra* note 28, at 277 ("[T]he product Delaware offers is not simply particular statutes, but also their interpretation by courts."); Omari Scott Simmons, *Delaware's Global Threat*, 41 J. CORP. L. 217, 221 (2015) ("Delaware's key contribution to U.S. corporate governance is the production of substantially judge-made corporate law . . . .").

87. Lee Applebaum, NAT'L CTR. FOR STATE COURTS, FUTURE TRENDS IN STATE COURTS: THE STEADY GROWTH OF BUSINESS COURTS 70 (2011), http://www.ncsc.org/~/media/Microsites/Files/Future%20Trends/Author%20PDFs/Applebaum.ashx ("These 'business courts' assign specialist judges to manage and decide commercial and business cases and have increased from three pilot dockets in 1993 to over 40 court programs within 22 states in 2010."); *see* Coyle, *supra* note 86, at 1918 ("Over the past twenty years, specialized trial courts with dockets comprised primarily or exclusively of business cases—commonly known as business courts—have been established in nineteen states in the United States.").

88. *See supra* note 4; *see also* Coyle, *supra* note 86.

Court is probably the only specialized business court authorized to operate without juries.[89] Second, the court has a long tradition of publishing its opinions in West Reporters and on Westlaw and Lexis, which has created a large body of precedent.[90] By contrast, the business courts of most competing states have only recently begun publishing their opinions on websites and some do not publish them at all.[91] Third, although the Delaware Chancery Court has a substantial noncorporate caseload, that court's corporate law caseload has been sufficiently large and concentrated that Delaware's judges have been able to develop considerable corporate-law expertise.

d. Legal Advice

The knowledge and beliefs of legal advisors play an important role in corporations' choice of incorporation state. In a study of initial public offerings, Daines found that whether the corporation's law firm had "clients in many states" was more important in choosing between the company's home state and Delaware than any other variable he tested.[92] National law firms tended to recommend Delaware incorporation, while law firms with clients in only one state tended to recommend home-state incorporation.[93] In a survey of lawyers and underwriters, Carney et al. found that underwriters' and issuers' lawyers overwhelmingly recommended "incorporation of public corporations in Delaware regardless of the corporation's location."[94] The lawyers' familiarity with Delaware law was an important factor. Seventy-five percent of underwriters' lawyers and fifty-five percent of issuers' lawyers agreed with the statement "I *don't* recommend incorporation in states other than Delaware or my state because I

89. *Supra* note 4 and accompanying text; *see also* Kahan & Kamar, *supra* note 1, at 711 (showing eight business courts that offer trial by jury).

90. Daines, *supra* note 84, at 1583 ("Other states, lacking Delaware's established precedent, unique case flow, and specialized courts, are likely less able to develop a distinctive and predictable body of case law.").

91. Coyle, *supra* note 86, at 1957–58 (providing a table showing that twelve of seventeen business courts publish opinions on the courts' websites).

92. Daines, *supra* note 84, at 1595.

93. *Id.* ("[L]ocal lawyers advise firms to incorporate locally, while national lawyers advise firms to incorporate in Delaware."). Daines does not indicate how he determined which firms had "clients in many states."

94. Carney et al., *supra* note 61, at 140 (reporting that for underwriters' lawyers, the proportion was ninety-seven percent; for issuers' lawyers the proportion was eighty-three percent).

am relatively unfamiliar with the details of the laws and courts of these other states."[95]

e. Political Responsiveness

Some scholars assert that corporations favor their home state because the corporations can more easily influence their home state's legislature in seeking changes to corporate law.[96] For example, Bebchuk and Cohen state:

> [A] firm located in a state—especially a large firm located in a small state—might hope that its stature and clout in the state would lead judges or public officials to give it favorable treatment with respect to some corporate law issues that might arise. Similarly, a firm located in a state might expect that, if it displays "loyal citizenship" by incorporating in the state, it would increase its chances of getting favorable treatment from public officials on issues unrelated to corporate law that might arise in the firm's dealings with the state.[97]

Bebchuk and Cohen also found that "states that have a heavily Democratic electorate, and thus are more likely to have activist judges, are less successful in attracting firms."[98]

f. Other Attractors

Several scholars have recently proposed that corporations choose Delaware for other features that have no specific locus in Delaware's laws, courts, or administrative procedures. Omari Scott Simmons proposes that attraction to Delaware is largely explained by Delaware's brand, which includes "reputation, visibility to top management, time-in-business, customer lists, competitors, academic curriculum, and discursive debate."[99] Michael Klausner proposes that charters have network effects that enhance their value when large numbers of corporations adopt them.[100] William J. Carney et al. found in a survey of underwriters' and issuers' attorneys that corporations chose Delaware "be-

95. *Id.* at 143.

96. Daines, *supra* note 84, at 1578 ("The most plausible benefit from local incorporation is that *it allows managers to influence the firm's corporate law rules* by lobbying the legislature for particular corporate law reforms.").

97. Bebchuk & Cohen, *supra* note 69, at 398–99.

98. *Id.* at 421.

99. Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1139 (2008).

100. Klausner, *supra* note 26 (discussing the effects of corporate contracts and associated network externalities).

cause they believe that investors who might purchase the company's securities are familiar only with Delaware law."[101] Finally, Brian Broughman et al. provide evidence that because most attorneys are fluent in home-state law and Delaware law, "a firm raising financing from in-state and out-of-state investors will choose Delaware to provide in-state and out-of-state investors a legal language that all can speak."[102] Because each of these factors can operate independently of Delaware's law, courts, or administrators, none depends on assumptions about Delaware's superiority.

In summary, corporations choose states through a diffuse process in which reputation and familiarity dominate, providing Delaware with a strong advantage. Delaware's only tangible advantage is its judicial system. Protection of managers against takeover is the only substantive law issue that clearly matters. Both takeover protection and the direct costs of incorporation weigh against Delaware to the extent they matter at all.

C. STATE CHOICE OF CORPORATE LAW PACKAGE

In the second subsystem of the system for corporate regulation, states decide what corporate-law packages to offer. Because managers choose the incorporation state, states tend to compete to offer the packages most attractive to managers.[103] The packages consist of four elements: (1) a corporation statute; (2) a method for legislative amendment; (3) a court system that includes judges, attorneys, and precedent; and (4) a state agency that maintains corporate records.[104] The state determines what

101. Carney et al., *supra* note 61, at 137 ("92% of underwriters' lawyers and 83% of issuers' lawyers agreed that 'Delaware is a better place than my state to incorporate for public companies because investors are more familiar with Delaware law.'").

102. Brian Broughman et al., *Delaware Law as Lingua Franca: Theory and Evidence*, 57 J.L. & ECON. 865, 893 (2014).

103. *E.g.*, COMPARATIVE COMPANY LAW: A CASE-BASED APPROACH 375 (Mathias Siems & David Cabrelli eds., 2013) (empirical finding that "the [United States] tends to favour directors more often than other countries"); William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 621 (2006) ("Externalities do occur because Delaware's strategy structurally favors management on allocational questions."); Glynn, *supra* note 49, at 1069 ("Because managers will select the law that favors their interests, states competing for corporate charters (most notably Delaware) craft corporate legal norms to appeal to managers, not to all firm stakeholders.").

104. In a pamphlet printed and distributed by the Delaware Department of State, Black describes the "source of Delaware's prestige—even cachet" as including:

actions may be brought and, within limits discussed below, what courts may adjudicate them.

1. Modeling State Competition

Three models compete to explain the states' choices of what packages to offer. In the competition model, substantially all states compete to attract all incorporations. In the defensive-competition model, Delaware competes for all incorporations while the other states compete only for the incorporations of corporations headquartered within their borders. In the no-competition model, no state competes because Delaware has already won. My data suggest that the competition model best describes the operation of this subsystem.

a. The No-Competition Model

Professors Kahan and Kamar, the leading proponents of the no-competition model, claim that corporate charter competition is a myth.[105] They acknowledge that states are changing their corporation codes in ways that make the codes more attractive to corporations, but argue that the increasing attractiveness is merely an "incidental effect."[106] "No state other than Delaware," they say, "is engaged in significant efforts to attract incorporations of public companies."[107] Other leading scholars agree.[108]

> the Delaware General Corporation Law which is one of the most advanced and flexible corporation statutes in the nation. It includes the Delaware courts and, in particular, Delaware's highly respected corporations court, the Court of Chancery. It includes the state legislature which takes seriously its role in keeping the corporation statute and other business laws current. It includes the Secretary of State's Office which thinks and acts more like one of the corporations it administers than a government bureaucracy.

BLACK, *supra* note 86, at 1. *See* Klausner, *supra* note 26, at 843 ("A state's charter is a large package of contract terms, which includes the state's substantive and procedural laws, the right to use the state's judiciary to resolve disputes, and access to its bar for legal advice and representation.").

105. Kahan & Kamar, *supra* note 1, at 684 ("The thesis of this Article is that the very notion that states compete for incorporations is a myth. Other than Delaware, no state is engaged in significant efforts to attract incorporations of public companies.").

106. *Id.* at 701 ("Of course, states occasionally take actions, such as revising their corporation codes, that have the incidental effect of making them more attractive as corporate domiciles.").

107. *Id.* at 723 n.154.

108. *E.g.*, Black, *supra* note 2, at 589 ("Rational legislators in other states will presumably realize the futility of competing with Delaware."); Daines, *supra* note 84, at 1600 ("There is simply no meaningful actual competition for national firms outside of Delaware."); Mark J. Roe, *Is Delaware's Corporate Law*

The essence of Kahan and Kamar's argument is that states other than Delaware are charging such low fees and taxes that they cannot derive significant revenues from incorporations. Because the states cannot derive significant revenues from competition, Kahan and Kamar conclude that competition cannot be occurring.[109]

Kahan and Kamar misperceive the competition in three respects. First, the competition is not merely a competition for fees and taxes. It is a competition to attract investment to the state by appearing business friendly. To accomplish that, states strategically conflate the attraction of businesses with the attraction of incorporations.[110]

Second, Kahan and Kamar disregarded competitive efforts that they considered to be unsuccessful. Delaware has actual

Too Big To Fail?, 74 BROOK. L. REV. 75, 77 (2008) (stating that "no other state actively seeks the incorporation business," that "Delaware is alone in the rechartering market" and the "few states that tried to compete on one level or another have stopped doing so").

109. Kahan & Kamar, *supra* note 1, at 748 ("Even if they attracted a substantial number of public corporations, they would neither earn meaningful additional franchises taxes under their current tax structures nor profit significantly from an increase in legal business. Accordingly, they do preciously little to attract incorporations.").

110. LEGISLATIVE COMM'N, REPORT TO THE 71ST SESSION OF THE NEVADA LEGISLATURE BY THE LEGISLATIVE COMMISSION'S SUBCOMMITTEE TO ENCOURAGE CORPORATIONS AND OTHER BUSINESS ENTITIES TO ORGANIZE AND CONDUCT BUSINESS IN THIS STATE 4 (2000), https://perma.cc/WS7B-UUQA (referring to "18 recommendations designed to promote business incorporation and retention and economic development and diversification in Nevada"); N.C. COMM'N ON BUS. LAWS & ECON. ANNUAL REPORT 4 (1995) ("There is no reason why the legal environment of North Carolina should not be as attractive to business as its physical environment (thereby inducing out-of-state corporations to incorporate here) so long as changes in that environment can be made without adversely affecting other constituencies within the state."); *CT Seeks To Challenge Delaware's Business-Friendly Legal Environment*, HARTFORD BUSINESS.COM (June 9, 2014), http://www.hartfordbusiness.com/article/20140609/PRINTEDITION/306069911/ct-seeks-to-challenge-delaware (discussing Connecticut's "10-year plan to challenge and eventually overtake Delaware as the leading state in the country for businesses and corporations to locate, incorporate and do business").

competitors. At present, Nevada,[111] Maryland,[112] Oklahoma,[113] Connecticut,[114] North Dakota,[115] South Dakota,[116] and Wyoming[117] are either actively competing or preparing to do so. Kahan and Kamar discussed Nevada and Maryland's efforts to compete for incorporations, but dismissed Nevada's efforts as directed mainly at nonpublic companies, Maryland's as directed at

111. Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 940 (2012) ("Nevada has capitalized on this opportunity by offering, and aggressively marketing, a unique product—a no-liability corporate law—that has proven attractive to a subset of American companies.").

112. Jay C. Hartzell et al., *The Role of Corporate Governance in Initial Public Offerings: Evidence from Real Estate Investment Trusts*, 51 J.L. & ECON. 539, 545–46 (2008) (finding that sixty-eight percent of real estate investment trusts making initial public offerings chose to incorporate in Maryland). Maryland has modified its Corporations and Associations Code to accommodate real estate investment trusts; forty-four provisions expressly refer to them. MD. CODE ANN., CORPS. & ASS'NS §§ 1-101 to 12-1006 (West 2017). The corresponding number for California's Corporations code is sixteen. Only four provisions of Delaware's General Corporation Law chapter of title 8 (Corporations), and twelve provisions of title 6 (Commerce and Trade), expressly refer to real-estate investment trusts.

113. Oklahoma adopted the Delaware General Corporation Law in 1986. After the *ATP Tour* decision in 2014, Oklahoma amended its corporation law to provide that "[i]n any derivative action instituted by a shareholder of a domestic or foreign corporation, the court . . . upon final judgment, shall require the nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees . . . incurred as a result of such action." OKLA. STAT. ANN. tit. 18, § 1126(c) (West 2014); *see* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

114. CONNECTICUT REPORT, *supra* note 5, at 1, exhibit 1 (showing chart comparing Connecticut and Delaware corporation laws "with the purpose of . . . recommending ways to attract and retain Connecticut businesses").

115. *See* Stephen M. Bainbridge, *Why the North Dakota Publicly Traded Corporations Act Will Fail*, 84 N.D. L. REV. 1043, 1045 (2008) (stating that North Dakota's "idea" is to "attract incorporations away from Delaware by being more shareholder-friendly than Delaware").

116. Seth Tupper, *Look Out, Delaware: Here Comes South Dakota*, RAPID CITY J. (Jan. 4, 2015), http://www.rapidcityjournal.com/news/local/look-out-delaware-here-comes-south-dakota/article_f4625607-8bf6-517b-8c7a-0ea0397022a8.html (describing the newly elected South Dakota Secretary of State as "a Republican who campaigned on making South Dakota a haven for business incorporation [who] plans to dedicate a staff member to it and other special projects").

117. Kevin G. Hall & Marisa Taylor, *US Scolds Others About Offshores, but Looks the Other Way at Home*, MCCLATCHY DC (Apr. 5, 2016), http://www.mcclatchydc.com/news/nation-world/national/article70008302.html (describing Wyoming's aggressive competition for anonymous incorporation). Although I could find no evidence that Wyoming competes for public company incorporations, it is one of only five states that attracts more than it loses. *See supra* Table 1.

only investment companies, and both as not sufficiently successful.[118] In essence, they define Delaware's competitors out of existence.

Third, Kahan and Kamar implicitly assume that competition cannot exist without at least two active competitors. But other scholars have noted that charter competition will prevent corporate regulation even if Delaware is the only competitor.[119] That is, if Delaware were the only competitor, Delaware's strategy should be to continue to make its corporation law more attractive to managers in order to further increase its market share and to fend off potential competitors who could enter at any time. Thus, so long as the internal affairs doctrine is in effect, corporate law will continue to evolve toward serving the interests of the managers who choose the state of incorporation.

b. The Defensive Competition Model

Most scholars adhere to a model in which Delaware competes to attract corporations and the corporations' home states compete to retain corporations by changing their corporation laws defensively. The states' motive for defensive competition cannot be filing fees and franchise taxes. If a corporation reincorporates to Delaware, Delaware gets filing fees and franchise taxes that would otherwise have gone to the home state, but the home state receives an equal amount of revenues from the newly foreign corporation's registration to do business in the home state. More plausible explanations presented by the literature for defensive competition are, first, that local corporate interests lobby for their states to compete[120] and, second, that home states compete in order to benefit local lawyers who seek to retain the corporations as clients.[121]

118. Kahan & Kamar, *supra* note 1, at 716–22.

119. William W. Bratton & Joseph A. McCahery, *An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition*, 54 WASH. & LEE L. REV. 629, 676 (1997) (claiming that "only one state, Delaware, competes for charters on a national basis").

120. Timothy P. Glynn, *Delaware's* VantagePoint*: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 99–100 (2008) ("Although it is true that other state legislatures generally have followed Delaware's lead on corporate law matters . . . this may be more attributable to successful local interest group lobbying than to a strategic attempt to attract out-of-state incorporations.").

121. Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 214 (2006) ("The modus operandi for the states' activity is most typically corporate lawyers acting in their self-interest and not government officials.").

Scholars' belief that charter competition is merely between Delaware and the home states[122] is based on a series of studies of initial public offerings. Those studies report proportions of incorporation in states other than Delaware or the home state as ranging from three to seven percent[123]—levels the scholars regard as de minimis. But nineteen percent of all public companies are now incorporated in states other than Delaware or the home state.[124] A comparison of my 2015 statistics to Professor Subramanian's 2000 statistics shows that home-state incorporations have declined sharply, while Delaware and other-state incorporations have both increased moderately.[125] I conclude that charter competition is not merely between Delaware and the corporations' home states.

c. The Competition Model

As shown in Table 2, nineteen percent of public companies are incorporated in a state other than Delaware or the company's home state. The competition model is the only one that can account for these companies.

122. Bebchuk & Cohen, *supra* note 69, at 420 ("The choice is thus not among a multitude of competitors for the national market but rather between incorporating in the home state or in Delaware."); Bebchuk & Hamdani, *supra* note 30, at 575 ("[F]irms in each local market are currently making a choice that is effectively between incorporating in their home state or in Delaware."); Fisch, *supra* note 63, at 1062 ("Corporations choose between incorporating in their home state and incorporating in Delaware. Virtually no corporation chooses any other alternative.").

123. Broughman et al., *supra* note 102, at 872 ("Only 3.5 percent of sample firms choose to incorporate in a jurisdiction other than Delaware or their home state."); Carney et al., *supra* note 61, at 147 ("In 93% of the IPOs, incorporation was in either Delaware or the home state."); Daines, *supra* note 84, at 1562 ("In spite of all the debate about firms' freedom to incorporate *anywhere*, the importance of corporate law, and spirited state competition for charters, firms' actual choices are much more mundane: *97% of public firms incorporate either in their home state or Delaware*.").

124. *Infra* Table 2.

125. In a study of all public company incorporations using 2000 Compustat data, Subramanian found "that 15% of [public] companies are incorporated neither in their home state nor in Delaware[,]" noting that "this statistic is somewhat at odds with the conventional view . . . that managers consider the charter decision to be between their headquarters state and Delaware." Subramanian, *supra* note 77, at 1816.

Table 2: Trend in Public Company Place of Incorporation

Incorporation state	Year 2000	Year 2015
Home state other than Delaware	2737 (35%)	1814 (26%)
Delaware	3910 (50%)	3918 (55%)
Neither Delaware nor home state	1173 (15%)	1329 (19%)
Total	7820 (100%)	7061 (100%)

The 2000 data are from Subramanian.
The 2015 data are from LoPucki.

Delaware's small size confers an advantage. As other scholars have noted, small states are better suited to offensive competition than large ones.[126] The monetary prize for winning at the level that Delaware has is approximately one billion dollars a year.[127] That is twenty-five percent of Delaware's four billion

126. Mark J. Roe, *Delaware's Shrinking Half-Life*, 62 STAN. L. REV. 125, 131 (2009) ("Only smaller states are potential competitors, and they are few enough that internal politics could stymie each of them from emerging as effective ongoing competitors."). To illustrate, the populations and population rankings of the four states most actively engaged in charter competition are Wyoming (579,000, rank 50); North Dakota (755,000, rank 46); Delaware (962,000, rank 44); and Nevada (3 million, rank 32). *State Population Totals and Components of Change: 2010–2017*, U.S. CENSUS BUREAU (Jan. 18, 2018), https://www.census.gov/data/tables/2017/demo/popest/state-total.html. The most active foreign competitors are small island countries, including the Cayman Islands (62,348), Bermuda (61,070), Mauritius (1,268,315), and the Seychelles (95,235). *Countries in the World by Population (2018)*, WORLDOMETERS, http://www.worldometers.info/world-population/population-by-country (last visited Apr. 14, 2018).

127. DEFAC GENERAL FUND REVENUE WORKSHEET 1 (Sept. 19, 2017), http://finance.delaware.gov/publications/defac/09_17/revenues.pdf (showing net franchise plus LP and LLC fees actually collected in fiscal year 2017 as $986.9 million).

dollar annual budget,[128] and so well worth Delaware's competitive effort. But it is only one-half of one percent of California's $190 billion budget.[129]

The benefits from small size do not, however, preclude larger competitors. In one respect, large states have greater incentives than small states to compete defensively. Large states are home to large numbers of public companies that pay fees and franchise taxes to Delaware. By matching Delaware's benefits, a large state can relieve a large number of local companies from having to pay Delaware's high cost of incorporation.[130]

Nor does Delaware's commitment preclude competition. Scholars differ over whether states must evidence a long-term commitment to attract incorporations. Some attribute Delaware's success to such a commitment. They argue that the state's dependence on incorporation revenues makes Delaware effectively a corporate hostage, assuring the state's future behavior.[131] Others have argued, however, that long-term commitment is unnecessary because reincorporation costs are low. A corporation can leave if and when its incorporation state becomes inhospitable.[132]

Corporate charter competition is alive and well, and Delaware's continued dominance is not inevitable. The competition model is the one that best describes the success of Nevada, Maryland, and Massachusetts shown in Table 1 and the dispersion of formerly home-state incorporations show in Table 2.

128. STATE OF DEL., OFFICE OF THE GOVERNOR, FISCAL YEAR 2016 OPERATING AND CAPITAL BUDGET SUMMARY 8 (2016), https://budget.delaware.gov/budget/fy2016/documents/budget-summary.pdf (estimating a general fund operating budget of $3,908.5 million for fiscal year 2016).

129. *See* Brandon Martin, *California's State Budget: The Governor's Proposal*, PUB. POL'Y INST. CAL. 1 (Jan. 10, 2018), http://www.ppic.org/wp-content/uploads/JTF_Budget0118JTF.pdf (reporting California's proposed 2018–2019 budget as $190.3 billion).

130. William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 48–49 (describing the process used by Georgia to match its corporate laws to those deployed in Delaware).

131. Romano, *supra* note 28, at 240 (referring to the "hostage theory of the states' conduct in the charter market").

132. Black, *supra* note 2, at 589 ("If the cost of re-incorporating is low, the gains from midstream opportunism are low as well, and the hostage is superfluous.").

2. The Corporate-Law Production Subsystems

Each state assembles and offers a corporate-law package consisting of a corporation law, a method for amending it, a judicial system, and an administrative agency. The statutes and agencies are similar across states. Delaware, as previously noted, provides a court system more highly specialized in corporate law than other states can offer. This Section addresses the differences in amendment methods, which have important effects on speed and responsiveness.

States change their corporate-law packages by enacting laws. The formal process is the same as that for changing other laws of the state. But two relevant informal differences exist.

First, thirty-two states have adopted some version of the Model Business Corporation Act (MBCA)[133] and even some non-MBCA-adopting states have adopted particular provisions of the MBCA.[134] In essence, those states have outsourced the production of their corporate law and, to some degree, surrendered control over it.

In substance, the MBCA is similar to the Delaware law,[135] and the MBCA's adopters include both states that actively compete for charters and states that do not.[136] The drafters of the

133. The Model Act today is the general corporation statute for thirty-two states and the District of Columbia, and is the source of many provisions in the general corporation statutes of other states. *2016 Revision to Model Business Corporation Act Makes Its Debut*, BUS. L. TODAY (Dec. 2016), https://www.americanbar.org/content/dam/aba/publications/blt/2016/12/mbca-201612.authcheckdam.pdf. *See generally* MODEL BUS. CORP. ACT (CORP. LAWS COMM., revised 2016).

134. MODEL BUS. CORP. ACT; Jeffrey Beck with Zachary Redman, *Nevada: Delaware of the West?*, DEAL LAWS., Nov.–Dec. 2011, at 1 ("In 1991 and 1995, for example, the Nevada Legislature revamped its mergers and consolidations law through the enactment of provisions derived or adapted from the Model Business Corporation Act . . . to incorporate uniform procedures for mergers, equity exchanges, and conversions.").

135. *See, e.g.*, R. Franklin Balotti & Megan W. Shaner, *Safe Harbor for Officer Reliance: Comparing the Approaches of the Model Business Corporation Act and Delaware's General Corporation Law*, 74 LAW & CONTEMP. PROBS. 161, 173 (2011) ("Under both the MBCA and Delaware law, directors and officers owe essentially the same fiduciary duties to a corporation and its stockholders."); Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 J. CORP. L. 99, 129 (2004) ("The MBCA is generally similar to Delaware law, with some fairly notable differences.").

136. *See, e.g.*, CONNECTICUT REPORT, *supra* note 5, at 4 (recommending that Connecticut continue to pattern its corporate laws after the MBCA); *id.* at 1–20 (discussing Connecticut's desire to supplant Delaware as the leading venue in which to incorporate). Wyoming and South Dakota are also MBCA-adopters that compete for charters. *See State Corporation Laws*, U.S. LEGAL, https://

MBCA and Delaware statutes seem to share the same pro-private-ordering philosophy. Both pride themselves on receiving outside input[137] and copy each other's work.[138] As a result, the laws are probably about equally attractive.

The principal difference is that the MBCA drafters tend to adopt bright-line rules, including MBCA rules regarding fiduciary duties, while the Delaware drafters prefer vagueness and indeterminacy.[139] The difference in judicial capabilities seems to be driving that difference in drafting policy. Because Delaware has specialized courts, it can deliver flexible law that its courts adjust at the time they apply it. Because the MBCA states lack specialized corporate courts, they must spell out the rules in their statutes.[140]

The second informal difference is that Delaware's in-state drafting process enables Delaware to act more quickly and respond more directly to competitive considerations.[141] The de facto drafter of the MBCA is the twenty-four member Corporate Laws Committee of the American Bar Association's Business Law Section (the "Committee");[142] the de facto drafter of the Delaware statute is the twenty-two member Council of the Corporate Law Section of the Delaware State Bar Association (the

corporations.uslegal.com/basics-of-corporations/state-corporation-laws (last visited Apr. 14, 2018).

137. Jeffrey M. Gorris et al., *Delaware Corporate Law and the Model Business Corporation Act: A Study in Symbiosis*, 74 LAW & CONTEMP. PROBS. 107, 116 (Winter 2011) ("The Council, similar to the Committee on Corporate Laws, receives input from a national constituency about areas for statutory improvement.").

138. *Id.* at 107 (stating that the "central point of this article is that there has been a constructive symbiosis" between the MBCA and Delaware law).

139. *Id.* at 116 (referring to "MBCA's propensity to build bright-line rules into the statute in an attempt to create greater certainty"); E. Norman Veasey, *On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles Through the Delaware Lens*, 74 LAW & CONTEMP. PROBS. 95, 105 (Winter 2011) (acknowledging the author's preference for "the indeterminacy of the Delaware law").

140. *See, e.g.*, Gorris et al., *supra* note 137, at 108 (acknowledging that "the current MBCA remains arguably a better model than the current DGCL for states lacking Delaware's highly developed judicial system and corporate case law").

141. *E.g.*, *id.* at 116 ("The Council, similar to the [ABA's] Committee on Corporate Laws, receives input from a national constituency about areas for statutory improvement; but the Council acts faster to address new issues and proposed changes.").

142. *Corporate Laws Committee*, AM. BAR ASS'N (last modified Mar. 8, 2018), https://apps.americanbar.org/dch/committee.cfm?com=CL270000.

"Council").[143] Both offer comment periods before finalizing their work.[144]

The drafters differ in that Council members are Delaware lawyers, responsible only to Delaware, and free to pursue Delaware's interest in maintaining its revenue flow.[145] By contrast, Committee members are from a diversity of states and are drafting for states other than their own—states that have a variety of interests other than charter competition. Delaware's Council meets secretly, whenever necessary, and the Delaware legislature adopts its recommendations without process or deliberation.[146] By contrast, the Committee meets four times a year, without regard to legislative schedules.[147] In most MBCA-adopting states, corporate bar associations and other interest groups actively participate in the legislative process and slow it down.

Non-MBCA-adopting states, such as Nevada, could in theory adopt Delaware's process. But the non-MBCA states tend to be larger, and larger states are more likely to have interest groups that will insist on participation in the legislative process.[148]

The speed of Delaware's response proved decisive in the largest corporate law upheaval of the modern era. In its 1985 decision in *Smith v. Van Gorkom*, the Delaware Supreme Court held directors personally liable for damages in the sale of a $690 million company.[149] The case immediately became a corporate

143. *E.g.*, Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1755 (2006) ("[F]or decades now the function of identifying and crafting legislative initiatives in the field of corporate law has been performed by the Corporation Law Section of the Delaware State Bar Association. In particular, it is the governing body of the Corporation Law Section—its Council—that develops such initiatives.").

144. *Id.* at 1758 (noting that the Council's recommendations must be approved by the Corporation Law Section and the Delaware Bar's Executive Committee before being submitted to the legislature).

145. The Council is comprised of Delaware State Bar Association members and lacks any non-Delaware lawyers. *Id.* at 1755–56.

146. *Id.* at 1754 ("The members of the Delaware General Assembly, however, have not taken on any significant role in initiating or drafting changes to the DGCL. Nor are those amendments the product of any legislative staff, or of any lobbyists engaged by individual businesses.").

147. *See Corporate Laws Committee*, *supra* note 142 (noting that the Committee has "[t]hree standalone in-person meetings a year plus an in-person meeting at the Business Law Section Spring Meeting").

148. For example, California and New York are non-MBCA states. *See State Corporation Laws*, *supra* note 136.

149. Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985).

cause célèbre.[150] Delaware quickly enacted legislation allowing companies to exculpate directors of all liability for breach of the duty of care, making it the only state in which a corporation could do so.[151] Professor Sarath Sanga reports that "[f]ollowing the adoption of [the exculpation legislation], the reincorporation rate [to Delaware] spiked more than five-fold and achieved an historical maximum. Within three years, the reincorporation rate returned to pre-shock levels."[152] By the speed of its response, Delaware was able to convert a calamity of its own making into a major source of new incorporations.

In summary, Delaware's system for amending its corporate-law package provides Delaware with three important advantages. First, Delaware's system allows the drafters to focus directly on competitive advantage. Second, Delaware can more quickly and easily amend its package legislatively, because the process is entirely in-state and interest groups other than the state bar do not participate. Third, by their rulings in cases, Delaware's courts can amend the package without legislation.

D. Court Regulation of Corporations

The third subsystem of the system for corporate regulation is the one by which the incorporation states enforce their corporation laws. States can enforce some aspects of their laws administratively. For example, all states require that incorporators furnish information to the state as a condition of incorporation. If an incorporator does not furnish the information, the state can refuse the filing and the corporation does not come into existence.[153] If a corporation fails or refuses to pay renewal fees or franchise taxes, its charter becomes void.[154] If a corporation abuses or misuses its charter, the state can obtain an order from

150. *E.g.*, Bryn R. Vaaler, *2.02(b)(4) or Not 2.02(b)(4): That Is the Question*, 74 LAW & CONTEMP. PROBS. 79, 81 (Winter 2011) (describing the *Van Gorkom* decision as having "sent shock waves through the corporate world").

151. *Id.* ("Faced with the fear of a mass exodus of qualified directors from the boardrooms of Delaware corporations, the Delaware legislature adopted section 102(b)(7) of the DGCL within eighteen months [of the *Van Gorkom* decision].").

152. Sarath Sanga, *Network Effects in Corporate Governance* 4 (Nw. Univ. Pritzker Sch. of Law, Pub. Law & Legal Theory Series, No. 17-31, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3086245.

153. *E.g.*, DEL. CODE ANN. tit. 8, §§ 103, 106 (2018).

154. *E.g.*, *id.* § 510 (voiding the charters of corporations that fail or refuse to pay fees or franchise taxes).

a court of the state revoking the charter.[155] Pursuant to the Supreme Court's decision in *Trustees of Dartmouth College v. Woodward*,[156] the states have also reserved the power to revoke or amend charters by statute.[157] The predominant view is that only the state that issued the charter can revoke it.[158] In the aggregate, those rights provide the states with virtually complete control over the states' relationships with the corporations they charter.

Those rights do not, however, entitle the chartering states to resolve corporations' disputes with their stakeholders. In the absence of legislation or agreement, stakeholders can sue the corporation or its other stakeholders wherever they can obtain jurisdiction. Which courts resolve those disputes and how they resolve them can determine the nature and quality of the law a state can deliver to the state's corporate customers.

States can achieve greater control over the interpretation and enforcement of their corporate laws by providing and controlling the courts that resolve disputes under them. Perhaps even more importantly, by providing and controlling the courts, states can obtain better feedback on the interpretation, enforcement, and reception of their laws. That feedback may enable states to design and implement more attractive corporation laws.

State control over the forums in which corporate stakeholders can litigate potentially exists across a wide spectrum. At one extreme, a chartering state might provide that disputes among the corporation and its directors, officers, and shareholders be resolved only in the chartering state's courts.[159] A state might

155. *E.g.*, *id.* § 284 (granting the state court jurisdiction to "revoke or forfeit the charter of any corporation for abuse, misuse or nonuse of its corporate powers, privileges or franchises").

156. 17 U.S. 518 (1819).

157. *E.g.*, tit. 8, § 394 (reserving the power to amend Delaware charters).

158. Montana v. Blixseth (*In re* Blixseth), 484 B.R. 360, 370 (B.A.P. 9th Cir. 2012) ("[T]he courts of several states have held that jurisdiction to dissolve a corporation rests only in the courts of the state of incorporation.").

159. A state cannot prevent another state from adjudicating a dispute under the first state's laws, but other states could accede to such a requirement as a matter of comity. *In re* Daniel Kloiber Dynasty Tr., 98 A.3d 924, 939 (Del. Ch. 2014) ("In my view, Delaware also cannot unilaterally preclude a sister state from hearing claims under its law."); Sarah C. Haan, *Federalizing the Foreign Corporate Form*, 85 ST. JOHN'S L. REV. 925, 943 (2011) ("The notion that only a state's own courts could "interfere with" or "control" a state's corporations disappeared, and courts interpreted the doctrine to mean that any court could apply the corporate law of the state of incorporation to an out-of-state corporation.").

allow such disputes to be resolved by any court with jurisdiction over the parties, but allow the corporation—by a charter or bylaw provision—to require that resolution be only in the chartering state's courts.[160] A state might provide a specialized court that hears only corporate-law cases, a specialized court that hears corporate and other business cases, or only courts of general jurisdiction.[161] The state might take steps to assure that the judges of its specialized courts have business expertise or require that its specialized courts publish their opinions.[162] A state might allow the corporation to require that resolution be in any court of the corporation's choosing.[163] At the other extreme, a state might allow resolution of all disputes by arbitration[164] or be legally unable to prevent charter or bylaw provisions requiring that all disputes be resolved by arbitration.[165]

Because Delaware charters fifty-five percent of public corporations, Delaware generates the largest proportion of corporate litigation.[166] As a result, Delaware is able to provide a Chancery Court that has the highest degree of corporate specialization among the states.[167] The effect is that Delaware has a high degree of control over how its corporation law is interpreted and enforced and a high level of feedback on how to make its law more attractive.

Delaware's closest competitor, Nevada, generates a much smaller proportion of corporate litigation. Nevada provides a

160. *E.g.*, tit. 8, § 115.

161. At present, no state has a court that hears only corporate-law cases. Numerous states have specialized business courts or business dockets.

162. Joshua Halen, *Transforming Nevada into the Judicial Delaware of the West; How To Fix Nevada's Business Courts*, 16 J. BUS. & SEC. L. 139, 143 (2015) ("The Nevada Chancery Subcommittee focused on four areas of improvement to the Nevada Business Courts: (1) the need for published opinions[;] (2) time to disposition of cases[;] (3) expertise of business court judges[;] and (4) establishing judicial precedent.").

163. This was the effect of the Delaware Supreme Court's opinion in *Boilermakers v. Chevron* prior to the adoption of title 8, section 115 of the Delaware Code. *See* Boilermakers Local 154 Ret. Fund v. Chevron, 73 A.3d 934 (Del. Ch. 2013).

164. *See, e.g.*, Corvex Mgmt. LP v. Commonwealth REIT, No. 24-C-13-001111, 2013 WL 1915769 (Md. Cir. Ct. May 8, 2013) (enforcing an arbitration bylaw under Maryland law).

165. Allen, *supra* note 3, at 754–57 (discussing the availability of arbitration over state objections).

166. *See supra* Table 2.

167. Allen, *supra* note 3, at 808.

specialized "Business Court" at two locations within the state[168] and maintains that "[s]election of judges is based on their specialized experience in business litigation."[169] The Nevada Business Court is, however, more a separate docket than a separate court. It does not publish its opinions.[170] Delaware's Chancery Court provides Delaware with substantially greater control over the interpretation and enforcement of Delaware's corporation law than the Nevada Business Court provides to Nevada. That, in turn, gives Delaware an important advantage over Nevada in the charter competition.

E. Insulation from Democratic Control

An important feature of the system for corporate regulation is that the system is insulated from democratic control.[171] In a simple model of democratic control, citizens elect representatives who enact legislation. That legislation contains the rules by which the society operates.

In the system for corporate regulation, no group of citizens elects representatives who decide how corporations are regulated. To put it another way, no point of entry exists through which any group of citizens can decide whether corporate regulations are necessary. I consider the relevant groups of citizens in three categories: (1) citizens of incorporation states, such as Delaware; (2) citizens of doing-business states, such as California; and (3) citizens of the United States.

1. Insulation from Citizens of Incorporation States

Citizens of the incorporation state have the right, but not the power, to regulate public companies. The incorporation state citizens have that right only because the companies chose to incorporate there. The company likely chose the state because the

168. *See, e.g.*, *Business Courts*, SILVERFLUME, https://www.nvsilverflume.gov/wN?businessCourts (last visited Apr. 14, 2018) ("The establishment of the business court is an embodiment of Nevada's efforts to attract corporations and other business entities to organize in Nevada."); *id.* ("Official business courts are established in Reno (Second Judicial District Court) and Las Vegas (Eighth Judicial District Court).").

169. *Id.*

170. Halen, *supra* note 162, at 165 ("The main concerns of the Business Courts have been its broad subject matter jurisdiction, retention of juries, and unpublished opinions.").

171. Greenfield, *supra* note 41, at 142 ("Corporations located outside of Delaware can adopt Delaware's laws for their internal affairs, leaving non-shareholder stakeholders affected by those laws but with no democratic mechanism to influence those laws.").

state does not impose significant regulation. If the incorporation state's citizens do impose significant regulation, the company can reincorporate in a state whose citizens will not, and the company will remain unregulated. Regulation is thus beyond the citizens' power.

Delaware's legislative process illustrates the emptiness of its citizens' choice. The citizens of Delaware elect the legislature, but the legislature does not hold hearings or deliberate with respect to corporate law. It rubber-stamps the decisions of the Delaware corporate bar.[172] Nor does the Delaware corporate bar have the power to impose significant regulation. If it tried, public companies would leave Delaware and Delaware would lose about twenty-five percent of its state revenues.[173] Because the corporate charter competition exists, *no one* in Delaware has the power to impose significant corporate regulation, even if all considered it necessary for the nation's economic system to operate well.

2. Insulation from Citizens of Doing-Business States

States have the right to regulate foreign corporations doing business within their borders.[174] That right to regulate exists even though the company is incorporated elsewhere, provided that the regulation does not interfere with interstate commerce.[175]

However, all fifty states have adopted the internal affairs doctrine as their conflicts of law rule with respect to public companies.[176] If a state merely adopts a corporate regulation, the regulation will not apply to the large majority of public companies because they are incorporated in other states.[177] To make

172. *See* Hamermesh, *supra* note 143, at 1754.

173. DEFAC GENERAL FUND REVENUE WORKSHEET, *supra* note 127, at 1 (recording Delaware's net revenue for fiscal year 2017 as $3.9 billion, with net franchise and LP/LLC fees comprising $983.9 million of that total).

174. Mo. Pac. R. Co. v. Kirkpatrick, 652 S.W.2d 128, 132 (Mo. 1983) (en banc) ("It has been held both before and after the Fourteenth Amendment that a State may impose on a foreign corporation for the privilege of doing business within its borders more onerous conditions than it imposes on domestic companies.").

175. 1 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 1:4 (3d ed. 2010) ("As a consequence of [corporations] being denied citizenship status, states may, as a valid exercise of their police powers, regulate foreign corporations conducting business within their borders, provided the regulations do not impermissibly affect commerce.").

176. *See supra* note 52 and accompany text.

177. *See supra* notes 36–37 and accompanying text (describing the impact of the internal affairs doctrine).

its regulation applicable to foreign corporations, the state would have to change its conflicts rule.

Rejection of the internal affairs doctrine would put the rejecting state's conflicts of law rule in conflict with that of every other state. As a result, the regulation enacted would apply only in cases filed in the enacting state. Other states would continue to apply the law of the incorporation state. Rejection would signal "business-unfriendliness," and risk the loss of not just incorporations, but also some amount of business activity.

As a result, the citizens of a state lack the power to regulate foreign corporations doing business in the state. The severe adverse consequences following any attempt to regulate would not result from the regulation, but rather from the state's disturbance of the charter competition's structure. The effect of that disturbance would likely overwhelm the effect of the regulation.

3. Insulation from Citizens of the United States

Scholars agree that the federal government has the right to make corporate law, including the right to preempt the states from making it.[178] The federal government actually regulates disclosure in connection with sales of securities and a small, unimportant miscellany of other matters.[179]

Federal regulation is not, however, a point of entry through which U.S. citizens can decide whether corporate regulation is needed. Federal regulation would violate a long-standing norm, might itself be frustrated by international charter competition, and is impractical because the U.S. Senate is structured in a manner that gives Delaware an effective veto.[180]

By long-standing tradition, the federal government regulates only securities disclosures.[181] The remainder of corporate

178. *See, e.g.*, Bratton & McCahery, *supra* note 103, at 624 ("Congress could draw on the same Commerce Clause on which it draws in supplementing the state system to occupy the entire field of corporate law.").

179. *E.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 402, 116 Stat. 745, 787–88 (2002) (codified as amended at 15 U.S.C. § 78m(k)) (prohibiting personal loans to executives).

180. David R. Mayhew, *Supermajority Rule in the U.S. Senate*, 36 PS: POL. SCI. & POL. 31, 33–34 (2003) ("[That Senators do not have equal intensities across issues] helps to promote continual vote-trading among members and across issues in the form of explicit or implicit logrolling. In the particular case of the U.S. Senate, the rules of that body that allow slowdowns give, in effect, extra stacks of trading chips to intense minorities that face not-so-intense majorities." (internal citations omitted)).

181. *E.g.*, James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 179–82 (2017) (arguing that federal law

law is solely the province of the states. As Bratton and McCahery put it:

> In theory, under the prevailing norm, national regulation covers the securities markets and mandates transparency respecting firms with publicly traded securities, while internal corporate affairs are left to the states. In practice, federal lawmakers sometimes disregard the norm, entering into internal affairs as the national system grows episodically. But they follow a norm of cooperation even as they make these incursions. Federal regulators never structure interventions so as to disrupt the state equilibrium. They leave Delaware in place . . . .[182]

The incursions to which Bratton and McCahery refer have been minimal. Even in the face of a "corporate governance crisis,"[183] the legislation Congress enacted was primarily addressed at disclosure and had no substantial effect on the rules regarding corporate governance.[184]

Even if the federal government imposed corporate regulation, corporations might respond by incorporating in countries that did not regulate them, while continuing to do business and raise capital in the United States. The corporate law of the new countries of incorporation would apply,[185] the United States

should be confined to stock trading issues, while state law should operate in a separate domain free from federal interference); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1527 (2005) ("[T]he substantive corporate governance provisions [of Sarbanes-Oxley] overstep the traditional division between federal and state jurisdiction . . . ."); *id.* at 1597 (claiming that "the SOX mandates . . . are not proper subjects for federal government action"). *But see* Robert Thompson, *Delaware's Dominance: A Peculiar Illustration of American Federalism*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 57, 62 (Stephen M. Bainbridge et al. eds., 2018) ("Federal rules regularly use disclosure requirements to muscle management toward a desired substantive result.").

182. Bratton & McCahery, *supra* note 103, at 620.

183. Jonathan R. Macey, *A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules*, 81 WASH. U. L.Q. 329, 355 (2003) ("[T]he corporate governance crisis in America, with Enron as its poster child, represents a failure of both our system of mandatory rules, and of the contracting processes, which, together, constitute the infrastructure of the U.S. corporate governance system." (emphasis omitted)).

184. Veasey, *supra* note 139, at 97 ("Congress has moved in the direction of some federalization of corporate-governance structures by the enactment of the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010. Yet, even with those federal intrusions, state-based corporate law, including the business judgment rule, is mostly unharmed." (emphasis omitted)).

185. *See, e.g.*, McDermott Inc. v. Lewis, 531 A.2d 206, 217–19 (Del. 1987) (applying the law of Panama to a company headquartered in the United States but incorporated in Panama).

would suffer the embarrassment of an incorporation outflow, and the corporations would remain unregulated.[186]

Lastly, the U.S. Senate is structured in a manner that allows Delaware to block any legislation that threatens its position.[187] Delaware has two Senators, the same number as states with forty times its population. Because Delaware's intense financial interest in preventing federal corporate regulation so overwhelms the state's other interests, Delaware's Senators can choose committee assignments, place holds on legislation,[188] and trade their votes to prevent federal corporate regulation.[189]

The failure to regulate corporate law is not the result of contemporary political decisions at either the state or federal level. Corporations doing business in the United States are beyond democratic control for historical reasons having nothing to do with current needs.[190]

II. DELAWARE'S JUDICIAL STRATEGY

In the context of systems analysis, strategies are "changes in conduct by a system participant made with the intention to improve the participant's treatment by the system."[191] This Part examines Delaware's competitive strategy to determine its nature and its effect on the system. The examination shows Delaware's strategy is principally judicial and highly dependent on Delaware's ability to attract cases to its courts.

Strategies are plans for achieving goals. Scholars agree that maintaining Delaware's billion-dollar-a-year revenue flow from fees and franchise taxes is at least one of Delaware's goals. They differ as to whether maintaining Delaware's flow of shareholder

186. Bebchuk, *supra* note 64, at 1508 ("[E]ven when an issue is governed by a federal rule, companies may still have some ability to opt out of this rule by incorporating abroad."). *But see* Haan, *supra* note 159, at 955–60 (showing that U.S. courts usually apply U.S. law to the issue of veil-piercing of non-U.S. corporations).

187. *See, e.g.*, LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 123 (2005) (noting that Delaware Senator Joseph Biden "engineered the omission of venue reform from the [1996] omnibus bankruptcy bill" and that change allowed Delaware to continue its dominance of large, public company bankruptcy).

188. MARK J. OLESZEK, CONG. RESEARCH SERV., "HOLDS" IN THE SENATE 1 (2017), https://fas.org/sgp/crs/misc/R43563.pdf (describing the process by which even a single senator can delay or prevent Senate action).

189. *See* Mayhew, *supra* note 180.

190. LOPUCKI, *supra* note 187, at 4–8 (explaining how Delaware achieved dominance in the charter competition in the period 1899–1913).

191. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 6 (1996).

litigation is a separate goal promoted by the Delaware bar for its own benefit,[192] or an essential part of the state's strategy for maintaining its revenue flow.[193]

This Part argues for the latter view. Delaware has rationally chosen to maintain its case flow, because maintaining Delaware's case flow is essential to maintaining Delaware's revenue flow. Delaware's Chancery Court and body of precedent are widely acknowledged to be central to Delaware's attractiveness. Without shareholder litigation, the Chancery Court would confer no advantage and its body of precedent would quickly become an historical artifact. Delaware's judiciary is not an add-on; it is an essential part of the package Delaware offers. Delaware's choice to double down on its risky judicial strategy is thus not an error but merely a demonstration of the precariousness of Delaware's position. Other strategies present even greater risks to Delaware's continuation in its role as the nation's de facto corporate lawgiver.

A. DELAWARE'S STRATEGIC CHALLENGE

Americans have a low opinion of large corporations.[194] Maintaining the legitimacy of a nondemocratic system that confers

192. *See* Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 873 (2016) (arguing that the fee-shifting issue "presented an unprecedented conflict between the interests of the State and those of Delaware lawyers"); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 472 (1987) ("[T]he rules that Delaware supplies often can be viewed as attempts to maximize revenues to the bar, and more particularly to an elite cadre of Wilmington lawyers who practice corporate law in the state."); John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, COLUM. L. SCH.: CLS BLUE SKY BLOG (Oct. 14, 2014), http://clsbluesky.law.columbia.edu/2014/10/14/fee-shifting-and-the-sec-does-it-still-believe-in-private-enforcement [https://perma.cc/QD6P-N9TX] ("Delaware is uniquely conflicted on this issue, because *ATP Tour* could imply a significant decline in Delaware-based litigation, but such a decline would greatly benefit management and directors of Delaware corporations. Never before have the interests of the Delaware bar and its clients clashed so directly.").

193. Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1681 (2016) (concluding that Delaware's prohibition on fee shifting bylaws "can be rationalized as preserving the critical component of judicial lawmaking as part of the package that constitutes Delaware corporate law").

194. *See, e.g.*, *Big Business*, GALLUP, http://www.gallup.com/poll/5248/big-business.aspx (last visited Apr. 14, 2018) (reporting that, as of this writing, thirty-four percent of respondents were satisfied with "the size and influence of major corporations," five percent were dissatisfied but wanted major corporations to have more influence, fifty percent were dissatisfied but wanted major corporations to have less influence, and nine percent were dissatisfied but

power and privilege on large corporations and allows them to regulate themselves is no small task. Despite that challenge, Delaware's corporate-law regime is highly regarded.[195]

Should the popular perception of Delaware corporate law turn sharply negative, Delaware could be replaced in a variety of ways. In Part III, I suggest that corporations might reject Delaware in favor of cheaper states, but that is only one of several possibilities. In extreme circumstances, the federal government might be able to enact regulatory corporate law or replace state chartering with federal chartering.[196] States could reject the internal affairs doctrine and instead directly regulate the corporations headquartered or doing business within their borders.[197]

wanted corporations to "keep [their] influence as it is now"); *Views of Banks, Large Corporations, Small Businesses Improve Since 2010*, PEW RES. CTR. (Dec. 31, 2015), http://www.pewresearch.org/fact-tank/2016/01/04/millennials-views-of-news-media-religious-organizations-grow-more-negative/ft_16-01-04_millennialviews_improve (reporting the proportions of various groups "who say [large corporations] have a positive effect on the way things are going in this country today" as ranging from twenty-one to thirty-eight percent); *The Burson-Marsteller CNBC Corporate Perception Indicator*, BURSON-MARSTELLER (Aug. 15, 2014), http://www.burson-marsteller.com/what-we-do/our-thinking/the-burson-marstellercnbc-corporate-perception-indicator/the-burson-marstellercnbc-corporate-perception-indicator/#! (last visited Apr. 14, 2018) (finding on slide 14 that members of the general public in developed markets believe by a margin of forty-six to thirty-five percent "it is a bad thing when corporations are strong and influential, because they rig the system so they do not have to act responsibly").

195. Allen, *supra* note 3, at 808 (referring to the Delaware Court of Chancery as "a highly regarded judiciary with the proven ability to act swiftly based upon a developed body of case law"); Bratton & McCahery, *supra* note 103, at 620 ("Delaware legitimately plays a national role."); Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 354 (2013) ("In the case of Delaware-chartered corporations, the incentive to have intra-corporate disputes resolved by Delaware courts is arguably even greater because of the high regard in which Delaware's courts are held and the efficiency with which they resolve complex business disputes."); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 60 (2009) ("Delaware's corporate law enjoys extraordinary respect and prestige, as do the state's corporate lawyers and judges.").

196. *See* Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2498 (2005) ("In nearly every decade of the twentieth century, the decade's major corporate law issue either went federal or federal authorities threatened to take it over.").

197. *See, e.g.*, Glynn, *supra* note 49, at 1096 (advocating that states abandon strict adherence to the internal affairs doctrine).

Private regulators such as stock exchanges or shareholder advisory services could become the de facto regulators.[198] Corporations themselves could reject charter competition in favor of a level playing field administered by some neutral institution. Alternative forms of business organization, controlled by customers, employees, franchisees, local governments, or others could arise.

Those possibilities put Delaware in a bind. To maintain its legitimacy, Delaware must appear to impose meaningful regulation. But to attract incorporations, it must not impose meaningful regulation. That may explain why corporate law hovers near emptiness but consistently avoids getting there.

B. Delaware's Strategy

Delaware's strategy for appearing to regulate without actually doing so has three elements: (1) Delaware portrays its law as authorizing a system of private ordering; (2) obscures its actual methods through verbosity and complexity; and (3) administers its grant of power and privilege through a loyal and sophisticated judiciary over which Delaware has substantially complete control.

1. Private Ordering

Delaware characterizes its lack of regulation as "private ordering."[199] The claim is that corporate law governs only the relationship among "the corporation and its current officers, directors, and shareholders."[200] Because that relationship is contractual and among sophisticated parties, it necessitates only minimal regulation. As then-Chancellor Strine put it: "Delaware's corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to struc-

198. *See* A.C. Pritchard, *Markets as Monitors: A Proposal To Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 1020 (1999) ("An exchange-based antifraud regime harnesses the markets themselves as effective, low-cost monitors for fraud.").

199. *E.g.*, Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996) ("At its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial private ordering.").

200. *See* sources cited *supra* note 36. *But see* Rubenfeld, *supra* note 40, at 376–77 ("No corporate affairs are ever exclusively 'internal'; they will always have consequences of greater or lesser magnitude on the 'outside' world.").

ture their relations, subject to relatively loose statutory constraints and to the policing of director misconduct through equitable review."[201]

Delaware's defenders posit that the private ordering thus facilitated enables Delaware corporations to operate more efficiently.[202] Corporations incorporated in other states either struggle along at a competitive disadvantage, reincorporate to Delaware, or were incorporated in their home jurisdictions for noneconomic reasons.[203]

The private ordering story fails to take into account the powerful negotiating position that corporate law confers on managers,[204] the inability of some affected parties to negotiate at all,[205] and the tremendous impact that the unregulated corporation has on society.[206] But the ideology of private ordering serves its function by existing and remaining plausible as an explanation for, and defense of, corporate charter competition.

2. Obfuscation

The second element of Delaware's strategy is obfuscation.[207] In reality, American corporate law is an absence of regulation

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201. Jones Apparel Grp., Inc. v. Maxwell Shoe Co., 883 A.2d 837, 845 (Del. Ch. 2004).

202. *E.g.*, Romano, *supra* note 28, at 235 (claiming to show empirically "a bandwagon effect in favor of adopting a successful innovation" in the charter competition context).

203. *Id.* at 278 ("[T]he non-Delaware corporations stressed historical associations with their incorporation state that created a public identification between state and firm.").

204. Bebchuk & Hamdani, *supra* note 30, at 603 ("[T]he uncertainty of Delaware law disguises the extent to which Delaware's law favors managers over shareholders."); Bratton & McCahery, *supra* note 103, at 621 ("Externalities do occur because Delaware's strategy structurally favors management on allocational questions."); David A. Skeel, Jr., *Corporate Governance and Social Welfare in the Common-Law World*, 92 TEX. L. REV. 973, 989 (2014) (reviewing CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER (2013)) ("Delaware's resolution of most corporate governance issues . . . tends to favor the interests of managers.").

205. *Cf.* Crespi, *supra* note 39, at 90–91 (noting that a majority of courts apply the law of the state of incorporation to veil-piercing claims). Most tort creditors with veil-piercing claims cannot negotiate at all.

206. *See* Lynn M. LoPucki, *Algorithmic Entities*, 95 WASH. U. L. REV. 887, 894–96 (2018) (arguing that charter competition may prevent U.S. jurisdictions from banning entities controlled by malicious software).

207. Bebchuk & Hamdani, *supra* note 30, at 603 ("Explicit, bright-line rules favoring managers could conceivably encourage shareholder groups to push for federal intervention. In contrast, indeterminate standards applied by courts in

that is effectively beyond democratic control.[208] If generally understood, the current arrangement would be politically unacceptable.[209] The arrangement survives in large part because the complexity of the charter competition and the complexity, indeterminacy, and verbosity of the resulting law obscure it.

More specifically, the Delaware General Corporation Law (DGCL) lacks clarity,[210] is excessively lengthy as a whole,[211] is expressed in sentences that are themselves extraordinarily lengthy and complex,[212] is deliberately redundant,[213] and eschews the within-sentence-paragraphing that is used in nearly all other statutes and regulations to reduce ambiguity and make them easier to read. Delaware court opinions are also unnecessarily lengthy and obscure.[214] They multiply legal distinctions

case-specific ways make the extent to which Delaware's law favors managers much less salient.").

208. *See supra* Part I.E.

209. Bebchuk & Hamdani, *supra* note 30, at 603 ("[I]ndeterminate standards applied by courts in case-specific ways make the extent to which Delaware's law favors managers much less salient."); Greenfield, *supra* note 41, at 136 (arguing that the "ability of corporations to elect their governance law is illegitimate as a democratic matter and inefficient as an economic matter").

210. *See* Carney & Shepherd, *supra* note 130, at 50 ("Even the briefest comparison of the Delaware statute's language with the Model Act's language demonstrates the Model Act's much greater clarity and precision."); Jens C. Dammann, *Indeterminacy in Corporate Law: A Theoretical and Comparative Analysis*, 49 STAN. J. INT'L L. 54, 56 (2013) ("Prominent voices in the literature argue that regulatory competition has made Delaware law inefficiently indeterminate.").

211. The Delaware General Corporation Law is more than 100,000 words. *See* DEL. CODE ANN. tit. 8 (2018). By contrast, the Nevada Corporation Law is less than 50,000 words. *See* NEV. REV. STAT. §§ 75.010–92a.500 (2017).

212. Carney & Shepherd, *supra* note 130, at 50 (noting that the first sentence of DEL. CODE ANN. tit. 8, § 251(g) contains 952 words and is "virtually impossible to read").

213. Harvard Law School Professor Holger Spamann has published a version of the Delaware General Corporation Law that is half as long, without alteration of meaning, simply by removing redundancies. *See Del. Gen. Corp. L.*, SIMPLIFIED CODES, http://simplifiedcodes.com/?page_id=39 (last visited Apr. 14, 2018).

214. Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909 (1998) ("[T]he well-documented indeterminacy of Delaware corporate law . . . is evident in the state's ample use of vague standards that make prediction of legal outcomes difficult. While Delaware law offers relatively clear rules that govern technical aspects of corporate governance, the fiduciary duties at its core are open-ended.").

and categories excessively,[215] describe them indeterminately,[216] and revise them frequently.[217] These characteristics create precisely the opposite of the clear and predictable rules that scholars assume business people prefer.[218] Even on so simple a matter as which of the rules in its corporation law must be followed and which may be privately ordered away, Delaware law provides no answer.[219]

Complexity and ambiguity enable Delaware to generate patterns of outcomes that are directly in conflict with the apparent intent of the rules. One example of this subterfuge is that corporate directors nearly always escape liability for their own wrongdoing.[220] The techniques by which they do it—indemnification, directors' and officers' insurance, and court approval of shareholder litigation settlement—together achieve a result that each individually purports to prevent. A second example is that directors have a duty of oversight, but the Delaware courts' verbalization of that duty makes it virtually impossible for directors to violate it.[221] A third example is that corporate law ostensibly

215. Carney & Shepherd, *supra* note 130, at 12 ("[T]he set of decisions now contestable in court has grown exponentially."); *id.* at 30 (showing graphically the large number of modes of review recognized in Delaware law).

216. *Id.* at 15–16 ("Delaware's high reversal rate is consistent with Delaware law's being so indeterminate that Delaware appellate and trial judges disagree on its application with relative frequency, their specialized expertise notwithstanding."); Kamar, supra note 214, at 1909; Fisch, *supra* note 63, at 1063 ("Delaware precedent . . . although well developed . . . is far from clear and predictable.").

217. Carney & Shepherd, *supra* note 130, at 16–17 (stating that "new rules have been announced with remarkable regularity").

218. *See id.* at 29–30 (citing other scholars' arguments that the corporate laws of other states provide greater certainty than Delaware corporate law); Fisch, *supra* note 63, at 1099 ("[T]he standards[-]based muddiness of Delaware law retains a degree of ex post review for which courts are well suited.").

219. Jones Apparel Grp., Inc. v. Maxwell Shoe Co., 883 A.2d 837, 847–48 (Del. Ch. 2004) (rejecting the view that provisions of the Delaware General Corporation Law that do not contain "magic words" authorizing modification by a provision in the certificate or bylaws cannot be modified by a provision in the certificate or bylaws).

220. Black et al., *supra* note 14, at 1138 ("As an empirical matter, out-of-pocket liability for outside directors over the last several decades has been rare.").

221. For example, the first prong of the *Caremark* test is breached only if "the directors utterly failed to implement any reporting or information system or controls." Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006). To fail the test, a corporation would have to have no accounting system at all.

bars directors with conflicts of interest from controlling corporate decisions.[222] But at the same time, the law requires that the courts ignore structural bias—the cultural obligation to reciprocate when a friend or confidant selects one to become a board member. The effect is to enable conflicted directors to control corporate decisions indirectly across a wide range of situations by delegating the decisions to friends and confidants.[223]

A second function of complexity is to shield Delaware corporate law from criticism by diffusing the criticism's target. A vaguely and abstractly stated legal doctrine, qualified by statements scattered throughout a lengthy opinion, is difficult to criticize because it can neither be repeated nor credibly summarized. Similarly, it is difficult to prove that Delaware fails to regulate corporations when Delaware's corporation law is more than 100,000 words in length.[224] No matter how many provisions are shown to be void of regulation, the possibility remains that others are not.

A third function of complexity is to make Delaware law difficult to copy. As Kahan and Kamar put it, "fact-intensive and standard-based law also bolsters Delaware's market power. It is hard for other states to replicate such law and to tap Delaware's network and learning benefits."[225] Proving the ability of Delaware judges to express matters clearly when they want to, Chief Justice Leo Strine summarized: "By making its law a muddle, Kahan and Kamar say, Delaware makes it difficult for other states to copy it."[226]

Finally, Delaware's tolerance for complexity and indeterminacy gives its courts the flexibility to constantly generate new

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222. *See* DEL. CODE ANN. tit. 8, § 144(a)(1) (2018).

223. Kahn v. M & F Worldwide Corp., 88 A.3d 635, 647 (Del. 2014) (holding that a director who had been the controlling shareholder's business partner for twenty years was independent for the purpose of representing the interests of the minority shareholders in reviewing the controlling shareholder's offer to purchase their shares).

224. *See supra* note 211.

225. Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1247 n.170 (2001); Kahan & Kamar, *supra* note 1, at 741 ("[Delaware's] law would be vulnerable to emulation at low costs if it were more determinate."). *But see* Kamar, *supra* note 214, at 1910–11 ("[T]he substantive content of Delaware law is unlikely to form a major basis of Delaware's competitive advantage, since other jurisdictions can easily copy this content . . . .").

226. Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1264 n.33 (2001).

rules and exceptions to existing rules. That in turn enables them to favor managers in the case before the court without creating precedent that would bind them in future cases.[227]

3. Judicial Regulation

Judicial regulation is the third element of Delaware's strategy. Instead of seeking to provide the right rules, Delaware long ago elected to avoid rules and instead regulate on a case-by-case basis.[228] As Professor Jill Fisch has noted, "Delaware corporate law relies on judicial lawmaking to a greater extent than other states."[229] Fiduciary standards and standards of review dominate Delaware corporate law. Delaware's statutes include neither.[230] The vagueness and complexity of Delaware's judicial opinions make it difficult to predict how the courts will decide future cases. Delaware's proponents all but concede that, without its courts, Delaware would have no advantage over other states.[231]

The function of this ambiguity is to enable Delaware to address threats to its reputation,[232] while permitting managers who do not pose such threats to do virtually anything they please.[233] Professor Edward Rock observes:

227. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997) (characterizing Delaware corporate law as "a set of stories that is typically not reducible to a rule").

228. Fisch, *supra* note 63, at 1076 ("Delaware courts also apply the relevant legal standards in a fact and case specific manner. As a result, one court's determination that a particular course of dealing was reasonable under the relevant legal test provides little guidance to corporate actors about subsequent decisions applying the same legal test.").

229. *Id.* at 1074.

230. *Id.* at 1074–75.

231. Gorris et al., *supra* note 137, at 108 ("[T]he current MBCA remains arguably a better model than the current DGCL for states lacking Delaware's highly developed judicial system and corporate case law.").

232. In *Puda Coal*, two directors in China stole all of the assets of a public Delaware company eighteen months before the three U.S. directors realized it. 30 F. Supp. 3d 230 (S.D.N.Y. 2014). In rejecting the technically sound argument of the U.S. directors for a resolution that would leave the shareholder derivative action in the control of one of the wrongdoers, Chancellor Strine noted the interests of Delaware: "I'm just wondering how, if my state embraces this, we are not subject to totally legitimate ridicule." Transcript of Oral Argument and the Court's Ruling at 6–7, *In re* Puda Coal, Inc. Stockholders Litig. (Del. Ch. Feb. 19, 2013) (No. 6476-CS).

233. *See* Rock, *supra* note 227, at 1013 ("[T]he 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."); *id.* at 1106 ("The core of my claim is that we should understand Delaware fiduciary duty

> Directors of Delaware corporations can do anything they want, as long as it is not illegal, and as long as they act in good faith . . . . [T]he formulation is largely empty until the concept of good faith is defined. . . . [T]he Delaware courts fill out the concept of "good faith" through fact-intensive, normatively saturated descriptions of manager, director, and lawyer conduct, and of process—descriptions that are not reducible to rules . . . .[234]

Courts can use doctrines such as bad faith, proper purpose, and reasonableness to distinguish litigants who have done something in a clumsy or striking manner—with the potential to embarrass Delaware—from other litigants who have reached the same end in a graceful and inconspicuous manner that poses no threat to Delaware. By making that distinction, Delaware can maximize its delegation of privilege and power, while minimizing risks to its legitimacy.

Delaware's strategy requires that the state maintain its own court system.[235] First, judges must take Delaware's interests into account, even though those interests are not legally relevant. That is, judges must decide cases in ways that protect the state's efforts to sell charters.[236] Only judges employed by Delaware have direct incentives to do that. Second, the lawyers who practice before the Delaware Chancery Court are the principal source of information and advice to the Delaware Legislature. The lawyers function as the legislature's eyes and ears and as a check on Delaware's judiciary.[237] The requirement that each maintain an office in the state assures these lawyers' loyalty to the state.[238] Third, Delaware's delivered law is largely a product of Delaware's judicial culture.[239] The results would be markedly

law as a set of parables or folktales of good and bad managers and directors, tales that collectively describe their normative role.").

234. *Id.* at 1015.

235. *See* Veasey, *supra* note 139, at 96 ("A rational corporation law or corporate-governance regime, such as Delaware's, depends on a rich body of case law and the expertise, prompt service, and independence of, and trust in, the judiciary.").

236. *See, e.g.*, *supra* note 232 and accompanying text.

237. *See supra* notes 143–46 and accompanying text.

238. *See* DEL. CT. CH. R. 170(a) ("Any person admitted to practice in the Supreme Court of this State shall be entitled to practice as an attorney in this Court so long as such person . . . maintains an office in this State for the practice of law.").

239. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1411 (2005) ("Enabling acts, such as the Delaware General Corporation Law (DGCL), are part of the corporate law. They create only a skeletal framework, however. The 'flesh and blood' of corporate law is judge-made.").

different if the judges of other states or arbitrators applied Delaware law. As Chancellor Strine put it:

> The important coherence-generating benefits created by our judiciary's handling of corporate disputes are endangered if our state's compelling public policy interest in deciding these disputes is not recognized and decisions are instead routinely made by a variety of state and federal judges who only deal episodically with our law.[240]

Lastly, judicial lawmaking through a small, concentrated judiciary without juries further renders Delaware's system impervious to copying.[241]

Thus Delaware is committed to a strategy that maintains and leverages the existence of its uniquely specialized court system. To abandon its judicial strategy would leave Delaware with little more than its vaunted reputation and its familiarity. To stick with its judicial strategy, Delaware must attract both incorporations and cases. Change that threatens the flow of Delaware litigation threatens Delaware.

C. THE JUDICIAL STRATEGY'S DECLINE

Despite the inherent conflict between the policies that will attract incorporations and those that will attract shareholder litigation, Delaware managed to do both until 2001. That year, the Delaware Chancery Court cut the plaintiffs' attorneys fees in the *Digex* case.[242] The court continued making cuts in later cases.[243] Although the numbers of business organization cases filed in the Chancery Court has remained roughly the same since then, Delaware is apparently suffering substantial losses in its market share of the litigation against Delaware corporations.[244]

To stem the loss of market share, Delaware employed two strategies simultaneously. First, in early 2009, Delaware began offering Delaware corporations secret arbitration by Chancery

240. *In re* Topps Co. S'holders Litig., 924 A.2d 951, 959 (Del. Ch. 2007).

241. *See* Kahan & Kamar, *supra* note 1, at 708 (noting that the Delaware Chancery Court "hears all cases without a jury").

242. *See* John Armour et al., *supra* note 8, at 1371 ("[The] law firm sought approval for a $24.75 million fee [but was] instead awarded $12.3 million . . . .").

243. John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 643–45 (2012) (attributing Delaware's loss of shareholder litigation to "more intensive fee scrutiny" beginning with the *Digex* fee cut in 2001).

244. *Id.* at 607 (reporting "a large decline in the proportion of corporate lawsuits involving Delaware companies . . . filed in Delaware courts" after 2001, based on data for the period 1994–2010); Stevelman, *supra* note 195, at 61 ("[D]isputes in high-profile mergers and acquisitions (M&A) transactions and allegations of fiduciary self-dealing governed by Delaware corporate law are more commonly being litigated outside of Delaware's state courts.").

Court judges "in a Delaware courthouse during normal business hours."[245] The authorizing legislation declared that the state did so to "preserve Delaware's preeminence in offering cost-effective options for resolving disputes, particularly those involving commercial, corporate, and technology matters."[246] This secret arbitration option would have made Delaware's Chancery Court more attractive, but in a two-to-one decision in 2013, the Third Circuit ruled that secret arbitration before sitting judges violated the First Amendment right of public access to government dispute resolution proceedings.[247] The Supreme Court denied certiorari,[248] and Delaware responded by abandoning the arbitration of shareholder litigation altogether.[249]

The second strategy, forum-selection bylaws, met with quick success. In early 2010, a Delaware Chancery Court judge suggested that Delaware corporations adopt bylaws limiting the venues in which their shareholders could sue them.[250] Over 250 publicly traded companies adopted forum-selection bylaws even before the Delaware Chancery Court validated them in 2013.[251] Technically, *Boilermakers v. Chevron* allowed forum-selection bylaws to direct shareholder litigation anywhere.[252] But shortly after the decision, the Delaware legislature limited forum-selection bylaws to directing litigation solely to Delaware.[253] Delaware's new strategy was then clear. Instead of trying to *attract* plaintiff's attorneys to file their cases in Delaware, Delaware

245. Del. Coal. for Open Gov't, Inc. v. Strine, 733 F.3d 510, 513 (3d Cir. 2013).

246. H.B. 49, 145th Gen. Assemb. (Del. 2009).

247. *Del. Coal. for Open Gov't, Inc.*, 733 F.3d at 521.

248. Strine v. Del. Coal. for Open Gov't, Inc., 134 S. Ct. 1551 (2014).

249. *See Delaware's Options for Alternative Dispute Resolution*, DELAWARE.GOV, https://corplaw.delaware.gov/alternative-dispute-resolution (last visited Apr. 14, 2018) (noting that Delaware courts offer mediation and appoint arbitrators).

250. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

251. *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939, 944 (Del. Ch. 2013).

252. City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 230–31 (Del. Ch. 2014) (upholding a bylaw directing litigation to the corporations' home states).

253. DEL. CODE ANN. tit. 8, § 115 (2018) ("[N]o provision of the certificate of incorporation or the bylaws may prohibit bringing [internal corporate] claims in the courts of this state.").

and its corporations would join forces to *require* plaintiffs' attorneys to file their cases in Delaware. From 2010 through 2015, the number of business cases filed in the Delaware Chancery Court increased by more than sixty percent.[254]

In 2014, the conflict between attracting incorporations and attracting litigation resurfaced with the Delaware Supreme Court's decision in *ATP Tour, Inc. v. Deutscher Tennis Bund* (*ATP Tour*).[255] In that case, the Delaware Supreme Court upheld a bylaw that required the members of a nonprofit corporation—the equivalent of shareholders—to pay the corporation's attorneys' fees if they sued but did not win the "full remedy sought."[256] The *ATP Tour* decision would have discouraged shareholder litigation and probably delighted corporate managers. The Delaware legislature quickly reversed the decision by prohibiting *all* fee-shifting bylaws.[257] The Council made the decision for the Delaware legislature. The Council explained that "few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys' fees to attempt to rectify a perceived corporate wrong, no matter how egregious."[258] By reversing *ATP Tour*, Delaware was deliberately allowing shareholders to continue suing its corporations.

Professor Stephen Bainbridge characterizes Delaware's reversal of *ATP Tour* as a "self-inflicted wound"[259] that "threatens to undermine Delaware's profitable position as the leading state of incorporation."[260] Bainbridge argues that shareholder litigation is excessive, corporations' "key constituencies" could have used fee-shifting bylaws to reduce the inefficient portions of it, and Delaware's prohibition of fee-shifting bylaws will cause Delaware corporations to reincorporate in states that permit fee-shifting bylaws.[261]

254. *See infra* Figure 2.

255. 91 A.3d 554 (Del. 2014).

256. *Id.* at 560.

257. DEL. CODE ANN. tit. 8, § 109(b) (2018) ("The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim . . . .").

258. COUNCIL EXPLANATION, *supra* note 27, at 4.

259. Bainbridge, *supra* note 192, at 876.

260. *Id.*; *see also* DiCiancia, *supra* note 7, at 1574 ("[T]he Delaware courts have a strong interest in authorizing fee shifting in securities class actions to protect this status.").

261. Bainbridge, *supra* note 192, at 870–71, 875 (discussing specific states).

While the controversy over *ATP Tour* continued, yet another case-retention problem erupted. In January 2016, the Delaware Chancery Court refused to approve a "disclosure settlement"[262] in the *Trulia* shareholder litigation.[263] The court was concerned that the additional information Trulia furnished to the shareholder class pursuant to the settlement would not have been meaningful, while $375,000 of corporate funds would have been paid to the plaintiffs' attorneys[264] and the corporate defendant would have received a release that might have prevented other shareholders from later filing meritorious litigation.[265] In its opinion refusing to approve the settlement, the court acknowledged that its "enhanced judicial scrutiny of disclosure settlements could lead plaintiffs to sue fiduciaries of Delaware corporations in other jurisdictions in the hope of finding a forum more hospitable to signing off on settlements of no genuine value," immediately adding that it "is within the power of a Delaware corporation to enact a forum selection bylaw to address this concern."[266]

262. A disclosure settlement is a settlement in which the plaintiff shareholder class receives nothing but additional information. John Marsalek et al., *The Demise of Disclosure-Only Settlements?*, DORSEY & WHITNEY LLP (Jan. 28, 2016), https://www.dorsey.com/newsresources/publications/client-alerts/2016/01/demise-of-disclosure-only-settlements.

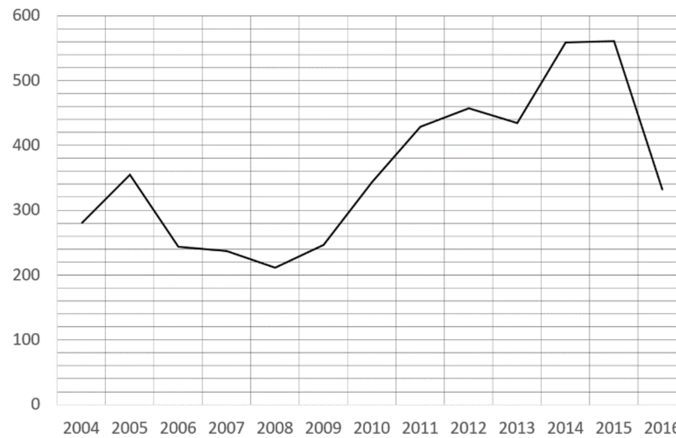
263. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 908 (Del. Ch. 2016).

264. *Id.* at 890.

265. *Id.* at 898 ("[P]ractitioners should expect that disclosure settlements are likely to be met with continued disfavor . . . unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims . . . .").

266. *Id.* at 899.

Figure 2: Number of Business Organization Cases Filed in the Delaware Chancery Court



But the corporations did not invoke forum selection bylaws. They preferred to pay the plaintiffs' attorneys fees in, and get their releases from, more hospitable forums.[267] *Trulia* sparked another large outflow of shareholder litigation from Delaware, erasing Delaware's nominal gains in filings since 2010.[268]

Figure 2 shows the number of "business organization" cases shown on the Delaware Chancery Court dockets posted on Westlaw. The increase from 2008 to 2014 and the decline 2015 to 2016 are largely merger settlement litigation in which multiple cases are filed, and nothing but settlement approval actually litigated. Delaware's corporate cases probably declined in the period from 2000 to 2004.[269]

267. Sean J. Griffith, *Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? (Steven Davidoff Simon & Randall S. Thomas, eds.) (forthcoming 2018) (manuscript at 18), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2855950 ("[O]nce the corporation has become a defendant in merger litigation, that corporation has a strong incentive to buy the broad, cheap releases that disclosure settlements provide.").

268. CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2015 AND 1H 2016 M&A LITIGATION 3 (2016) ("Plaintiffs filed in Delaware for 61 percent of the litigated deals over the first three quarters of 2015 but only 26 percent of litigated deals in [the fourth quarter of 2015 and the first half of 2016].").

269. John Armour et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 705 fig. 1 (2009) (showing slight decline).

The outflow demonstrated a crucial limitation of Delaware's litigation retention strategy. Forum-selection bylaws can force cases into Delaware only when the corporations want them there. To get cases, Delaware must compete against other state and federal courts. In that competition, the appeal of experienced, astute, and courteous judges goes only so far. What forum shoppers want is to win their cases. If the Delaware Chancery Court will not rubber stamp their settlements, the corporations will seek approval from courts that will.[270] The problem, from Delaware's point of view, is that the Delaware Chancery Court cannot give settling parties the rate of approvals they could achieve through forum shopping while still maintaining the appearance of propriety. Yet that appearance is a crucial component of Delaware's judicial strategy.

D. ARBITRATION BYLAWS

The biggest challenge to Delaware's judicial strategy—arbitration bylaws—is yet to come.[271] Arbitration bylaws provide for the resolution of internal corporate claims—particularly claims by the shareholders against the corporation and its directors and officers—through arbitration. Arbitration bylaws will be attractive to corporate managers because they can sharply reduce both the level of shareholder litigation[272] and the publicity it receives. Reduction in the level of shareholder litigation will result from elimination of the principal incentive for bringing cases—fee awards by courts to plaintiffs' attorneys.[273] Reduction in the level of publicity will result from the secrecy that is pervasive in private arbitration.

Delaware probably cannot prevent its corporations from adopting arbitration bylaws. The United States Supreme Court

270. William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 254 (1979) (observing that "competing courts would offer not a set of rules designed to optimize dispute resolution but a set designed to favor plaintiffs regardless of efficiency").

271. Brian JM Quinn, *Arbitration and the Future of Delaware's Corporate Law Franchise*, 14 CARDOZO J. CONFLICT RESOL. 829, 845 (2013) ("[I]t is entirely possible following a policy change at the SEC that Chancery-sponsored arbitration could come into widespread use as a method for stemming shareholder litigation.").

272. Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304, 2311 (2013) ("[T]he fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy.").

273. If arbitration bylaws did not provide for the award of attorney's fees to successful plaintiffs, arbitrators would have no basis on which to award them. *See* Beacon Towers Condo. Tr. v. Alex, 42 N.E.3d 1144, 1145 (Mass. 2016).

has held that contracts for arbitration are enforceable, and that federal policy preempts contrary state laws.[274] The Delaware courts are irretrievably committed to the view that charters and bylaws are contracts between the corporation and its shareholders,[275] leaving Delaware little room to insist that arbitration bylaws are not arbitration contracts protected by federal law.

Arbitration bylaws present an existential threat to Delaware. The threat is that public companies will adopt bylaw or charter provisions that provide for the arbitration of shareholder litigation—leaving the Chancery Court without cases. Once a sufficient number of companies have done so, arbitration providers could replicate every feature of the Delaware court system, including specialized judges, speedy dockets, abundant precedent, and even appeals—except fee awards and public access. Corporations would no longer have any incentive to litigate in public.

In addition to eliminating fee awards and public access, companies and their managers might prefer arbitration to the Delaware court system for three other reasons. First, arbitrations could occur in locations convenient to the parties and their attorneys—including cyberspace. Because the arbitrations would not be in the Delaware courts, the parties would not need to be represented by members of the Delaware bar. Second, the companies and their managers could write their own procedures and tailor them to different kinds of cases. Small cases could be heard by a single arbitrator without the possibility of appeal, while bet-the-company cases were heard by three arbitrators with the possibility of appeal. If shareholders objected to the procedures, the companies and their managers could negotiate the objections. Third, cases filed anywhere other than in the designated arbitration tribunal could be immediately dismissed, eliminating the problem of multidistrict litigation.[276]

274. AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 341 (2011) ("When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.").

275. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013) ("As our Supreme Court has made clear, the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL.").

276. Sean J. Griffith & Alexandra D. Lahav, *The Market for Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053, 1070 (2013) (acknowledging that "for any large merger there are likely to be a number of plaintiffs' attorneys filing several competing and fundamentally related claims in multiple jurisdictions").

The widespread adoption of arbitration bylaws by Delaware corporations would sharply reduce the amount of shareholder litigation on the Delaware Chancery Court's docket. That court would no longer be privy to new issues as they arose, and the production of new precedent would slow. More importantly, because the Delaware bar would have less involvement in cases and less contact with clients, they would be less able to advise the Delaware legislature. The companies' new lawyers would have the information flow needed, but they might not have connections to Delaware that would make them loyal to the state. The Delaware legislature would be flying blind. It could offer far less advantage to companies in return for the premium price Delaware extracts for its incorporations.

Until recently, scholars believed that Delaware dominance of American corporate law was secure for the foreseeable future.[277] That belief was based in large part on their assumption that the competitor would be another state, in which case Delaware could simply match its offer.[278] But Delaware cannot offer the advantages of arbitration. States cannot operate secret tribunals. States cannot require class-action waivers. The Delaware Chancery Court might be able to provide Chancellors at locations convenient to the parties, and to conduct hearings and trials by teleconferencing. But it would be providing these services in direct competition with private companies who did not have to meet the requirements of due process—including public access.

Public companies have already begun to adopt arbitration bylaws,[279] and a few courts have upheld them under Maryland

277. Bratton & McCahery, *supra* note 103, at 624 ("Delaware looks to be in better shape than ever."); Klausner, *supra* note 26, at 847 (asserting that Delaware's "lead in the charter market is likely to be permanent").

278. Bebchuk & Hamdani, *supra* note 30, at 557 (asserting that "Delaware could 'match' by adopting the challenger's improved rules"); Klausner, *supra* note 26, at 847 (stating that if another state adopted a law with benefits greater than Delaware's it is "difficult to imagine why Delaware would not meet the competition and adopt the law as well").

279. Allen, *supra* note 3, at 780–82 (naming six companies that have adopted arbitration bylaws).

law.[280] Potential issues regarding their adoption remain unsettled, but the objections are weak.[281] One of those issues—asserted by the SEC staff—is that arbitration bylaws are impermissible waivers of compliance with the federal securities laws.[282] The SEC's objection probably does not apply to the arbitration of state law derivative actions. The SEC's policy against arbitration bylaws in public offerings may already have been reversed by the Trump administration.[283]

In *American Express v. Italian Colors*, the Supreme Court recently eliminated what might have been the strongest objection to arbitration bylaws—that they would de facto eliminate the remedies of shareholders whose claims were so small that they could only be brought as class actions. Instead, the court said that "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[284]

In 2015, Delaware put its defenses against arbitration bylaws in place. First, section 115 of the DGCL prohibits arbitration agreements contained only in certificates of incorporation or bylaws.[285]

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280. Del. Cty. Empls. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 WL 1271528, at *11 (D. Mass. Mar 26, 2014) (stating in dicta that the court would uphold an arbitration bylaw adopted before the plaintiff purchased stock without knowledge of it); Katz v. Commonwealth REIT, No. 24-C13-001299, at 1–3 (Cir. Ct. Balt. Feb. 19, 2014); Corvex Mgmt. LP v. Commonwealth REIT, No. 24-C-13-001111, at 27 (Cir. Ct. Balt. May 8, 2013).

281. Allen, *supra* note 3, at 770 (referring to the argument that an arbitration bylaw is substantive under Delaware law as "weak"); *id.* at 773–74 (dismissing the argument that mere purchase of stock is too flimsy a basis on which to find a contract for arbitration).

282. *Id.* at 775–82; *id.* at 777 (arguing that "[t]he Staff's position is at odds with United States Supreme Court precedent that an agreement to arbitrate is not a waiver of substantive rights.").

283. Sarah N. Lynch, *U.S. SEC's Piwowar Urges Companies To Pursue Mandatory Arbitration Clauses*, REUTERS (July 17, 2017), https://www.reuters.com/article/usa-sec-arbitration/secs-piwowar-urges-companies-to-pursue-mandatory-arbitration-clauses-idUSKBN1A221Y (reporting an SEC Commissioner's statement encouraging requests by corporations to include mandatory arbitration provisions in public offering documents).

284. Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304, 2311 (2013).

285. *See* Andrew Holt, *Protecting Delaware Corporate Law: Section 115 and Its Underlying Ramifications*, 5 AM. U. BUS. L. REV. 209, 210 (2016) (stating that section 115 "does 'invalidate any provision selecting only non-Delaware courts, or any arbitral forum'" (quoting Jack B. Jacobs, *New DGCL Amendments Endorse Forum Selection Clauses and Prohibit Fee-Shifting*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 17, 2015), https://corpgov.law.harvard.edu/2015/06/17/new-dgcl-amendments-endorse-forum-selection-clauses-and-prohibit-fee-shifting)).

> The certificate of incorporation or the bylaws may require . . . that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. 'Internal corporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.[286]

But section 115 is in apparent conflict with section 2 of the Federal Arbitration Act (FAA). The latter provides that written agreements to arbitrate are "valid, irrevocable and enforceable."[287] The United States Supreme Court has held that "[w]hen state law prohibits outright the arbitration of a particular type of claim, the FAA displaces the conflicting rule."[288]

Second, Delaware adopted the Delaware Rapid Arbitration Act (DRAA).[289] The DRAA provides a highly expedited arbitration procedure that Delaware corporations can adopt by signed agreement.[290] It authorizes the Chancery Court to appoint as arbitrators persons who have been Delaware lawyers for at least ten years,[291] making DRAA arbitration potentially an arm of the Delaware legal community and potentially a replacement for the Delaware Chancery Court. If the parties do not specify the location of the arbitration hearing, the arbitrator can decide whether to hear it in Delaware or elsewhere.[292] But the DRAA's requirement that the arbitration agreement be "signed" is apparently intended to exclude arbitration bylaws.[293] As currently configured, the DRAA would not apply to most shareholder litigation because the shareholders of public companies do not sign the companies' bylaws.

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286. DEL. CODE ANN. tit. 8, § 115 (2018).

287. 9 U.S.C. § 2 (2012).

288. AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 334 (2011).

289. *See* Delaware Rapid Arbitration Act, DEL. CODE ANN. tit. 10, §§ 5801–5812 (2018).

290. *Id.* § 5803.

291. *Id.* § 5805(b)(2).

292. *Id.* § 5807(a).

293. H.B. 49, 148th Gen. Assemb. 2015 Sess. (Del. 2015), http://lawprofessors.typepad.com/files/de-rapid-arbitration-act.pdf (Frequently Asked Questions appended to bill) ("Specifically, the requirement that the arbitration agreement is signed by all parties to the arbitration is meant to exclude the possibility that provisions in a certificate of incorporation or by-laws would bind stockholders who did not personally sign a document expressly agreeing to arbitration under the Act.").

If the courts invalidate section 115 of the DGCL, Delaware could expand the DRAA to include bylaw-imposed arbitration. But competing arbitration systems would not impose fee awards on defendants, so Delaware could not do so and remain competitive. Without the award of fees to plaintiffs' attorneys, the change from class and derivative actions to arbitration would sharply reduce the magnitude of shareholder dispute resolution, perhaps leaving Delaware with too little for its new arbitration-based strategy to be effective.

If the arbitration of internal corporate claims replaces litigation, Delaware's judicial strategy may no longer be viable. The next Part speculates on what would happen next.

III. THE COMPETITIVE MELTDOWN SCENARIO

Delaware's Council[294] and most scholars[295] conceptualize the charter competition as a contest to strike precisely the right balance between the statutory rights of managers and shareholders. In fact, no American corporation statute strikes such a balance. Corporation statutes are composed almost entirely of default rules.[296] The better conceptualization is that state corporation statutes allow managers and shareholders to strike precisely the right balance by contract. The balance struck heavily favors managers because, as the entity's initiators, they initially possess all the power and can cede to shareholders only as much as they consider necessary to attract investment.

294. *See* COUNCIL EXPLANATION, *supra* note 27, at 11 (referring to "the careful balance that the State has strived to maintain between the interests of directors, officers, and controlling stockholders, and the interests of other stockholders").

295. Fisch, *supra* note 193, at 1676 (reporting University of Delaware Professor Charles Elson's comment that "the Delaware legislature sought to maintain a corporate law that balanced the interests of shareholders and managers"); Kahan & Kamar, *supra* note 1, at 739–40 ("Because both managers and shareholders influence incorporation decisions, Delaware can benefit from designing its product to be attractive, if not equally so, to both shareholders and managers of as many corporations as possible."); Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 537 (2005) ("[F]irm managers are constrained by market forces to seek out corporate law that is best for investors."); Winter, *supra* note 60, at 256 ("States seeking corporate charters will thus try to provide legal systems which optimize the shareholder-corporation relationship.").

296. *But see* Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 S.M.U. L. REV. 383, 384 (2007) (asserting the dominant view is that "most corporate law rules" are default rules).

But if one considers not merely the statutes but the entire corporation-law packages of the states, Delaware is arguably an exception. Delaware's judicial strategy uses purportedly mandatory rules regarding fiduciary duty to regulate in a variety of areas. That use is disingenuous, serving Delaware's interests and public decorum by appearing to regulate more than it does. Nevertheless, Delaware's courts do, to some degree, balance the rights of managers and shareholders.

Competing states have been unable to match Delaware's charade because they lack chancery courts. But so long as Delaware can plausibly maintain that it enforces high fiduciary standards, the other states cannot abandon the pretense that they also enforce such standards. Abandoning that pretense of enforcement would risk the respectability of their charters and perhaps detract from the respectability of the states themselves.[297]

If Delaware's judicial strategy were to fail and the cases migrate to secret arbitration, the states' need to maintain a regulatory facade would disappear. Delaware could no longer have one standard on the books and enforce a different one in its courts. Given a choice between a statute with fiduciary constraints that would be enforced by neutral arbitrators and a statute with no constraints at all, managers would choose the latter. Delaware would have to make the same choice.

To abandon the cloak of pseudo-regulation, a state's corporation law might provide that "the certificate of incorporation and the bylaws shall govern the relations among the shareholders, the directors, the officers, and the corporation. To the extent the certificate of incorporation and the bylaws do not provide for a matter, this Act governs."[298] To go a step further, the law of a state seeking to compete with Delaware might provide that "to the extent that the Delaware General Corporation Law grants any right, privilege or ability to Delaware corporations, corporations of this state shall have the same rights, privileges and abilities." The corporation and its shareholders could agree to abolish shareholder litigation,[299] to litigate in the courts of the most

297. Nevada apparently decided to take the risk, by largely eliminating director's fiduciary duties. Barzuza, *supra* note 111, at 936 ("In offering lax corporate law, Nevada capitalizes on its reputation as a lax regulator.").

298. I took this language from the UNIFORM PARTNERSHIP ACT § 105 (UNIF. LAW COMM'N 2013), changing only the entity type.

299. Abolition might or might not be effective, but effectiveness would not depend on the contents of the state's corporation law.

convenient state or states (which might include Delaware),[300] or to submit their disputes to arbitration.[301] By enacting such provisions, a state would immediately achieve contractarian efficiency with respect to its corporate law.

Of course, establishing the relationship between the corporation and the state would still require some mandatory rules. They include the rules authorizing the Secretary of State to maintain records and make them available, the rules requiring corporations to furnish information and pay fees and taxes, and the rules specifying the penalties for failure to comply. But the relationships among the corporation and its officers, directors, and shareholders—including their preferred manner of dispute resolution—would be established by contract.

From the perspective of domestic corporations, a state's adoption of this contractarian strategy would be hardly noticeable. Existing corporations could keep the certificates of incorporation and bylaws they already have. Except for the addition of the two or three sentences set forth above,[302] the state's corporation statute could remain the same. The effect of the changes would be merely that any mandatory rules that governed the relationship among the corporation and its officers, directors, and shareholders would have become default rules. Few mandatory rules exist in American corporation laws anyway.

Adoption of the contractarian strategy would fundamentally change the corporate charter competition. The states currently purport to compete in large part on the basis of their corporate-law expertise, as reflected in the supposed quality of their corporate laws and judicial decisions. To compete by the contractarian strategy, a state needs no corporate-law expertise. The corporations, institutional shareholders, and shareholder advisory services would supply the expertise. Because it would, for the first

300. DEL. CONST. art. I, § 9 provides:

> All courts shall be open; and every person for an injury done him or her in his or her reputation, person, movable or immovable possessions, shall have remedy by the due course of law, and justice administered according to the very right of the cause and the law of the land, without sale, denial, or unreasonable delay or expense.

DEL. CODE ANN. tit. 10, § 341 (2018) provides that "[t]he Court of Chancery shall have jurisdiction to hear and determine all matters and causes in equity." Any chartering state could provide that by incorporating in the chartering state, the corporation and its officers and directors submit to the jurisdiction of the Delaware Court of Chancery.

301. *See, e.g.*, Allen, *supra* note 3, at 751 (discussing the availability of arbitration).

302. *See supra* text accompanying note 298 and the following sentence.

time, be clear which rules of corporate law were mandatory and which were default, a corporation incorporated in a contractarian state could elect to have the default rules of any state or private body apply. The debate over what rules were best would continue, but the states would no longer participate.[303]

In competing against the contractarian strategy, Delaware would gain little advantage from lawyers' knowledge of Delaware law or Delaware's body of judicial precedent. Corporations formed in other states could adopt the portions of Delaware law they wanted and sweep away the rest merely by drafting charter or bylaw provisions that said so.

A state's adoption of the contractarian strategy would not solve all of its competitive problems. The state would still have to maintain an agency that sold charters, collected fees, taxes, and information, and made the corporate information available to law enforcement, paying customers, and the general public. The state would have to be competitive in that realm. But, like enacting a corporation law composed of only default rules, operating a corporate-records website requires no corporate-law expertise.

Explicit adoption of the contractarian strategy by a single state would provide that state with an advantage in charter competition against Delaware, Nevada, and other states whose statutes continued to contain mandatory rules. Perhaps more importantly, it would provide the state with an advantage in competing for business activity by demonstrating once and for all the state's business friendliness. I consider it reasonably clear that if a state adopted the contractarian strategy, it would attract both national attention and public-company incorporations.

To predict the effect of a state's adoption of the contractarian strategy on the charter competition *system* is more difficult. The first step is to predict the optimal strategic responses of the other states. To do that by the systems-strategic method requires a reiterative process—predict tentative initial responses, project where they lead, and then consider whether knowing the results would change the initial responses.

To illustrate, assume that after the first state's adoption of the contractarian strategy, other states followed. Because the corporate laws of those states would be identical—imposing no

303. Translated to game theory, the corporate charter competition would then be a prisoner's dilemma problem.

regulation at all—competition among them would be confined to (1) price, that is, taxes and fees for incorporation in the state; and (2) the quality of the states' corporate administrators. Delaware might amend its laws to prevent foreign corporations from using the Delaware courts, and rely on the quality of its courts, combined with an assumed illegality of arbitration, to retain its corporations. But if those defenses failed, the competition might melt down to a new level of triviality. To corporations, the states would no longer be providers of corporate law. Corporate law would be the contents of the articles or certificates of incorporation.[304] The states would be mere websites in price competition to register and verify the corporations' existences.

To the states, corporations would no longer be providers of filing fees and tax revenues. Prices would decline to approach the costs of operating the states' websites. The least efficient states might even continue to compete at a loss in order to save face. If this projection is correct, no state would benefit from the contractarian strategy in the long run. But it does not necessarily follow that no state should pursue it.

Until events unfolded, the states could not be sure the projection was correct. Delaware's courts might prove to be a durable advantage, preventing a complete meltdown. Other states may or may not be able to free-ride on Delaware's courts or to offer arbitration as an alternative. In the midst of this uncertainty, it makes more sense for a state that wants to compete for charters to be the first mover rather than hope that all states will refrain. Even if a state's adoption of a contractarian corporate statute merely provoked a federal takeover of corporate chartering, the state provoking it would have proven itself the most business friendly. Thus I conclude that it makes sense for a state to adopt a contractarian corporation law now.

CONCLUSION

The principal functions of the corporate charter competition are to deregulate corporate law and to insulate the deregulation from political reversal. The system deregulates by allowing the managers of each corporation to choose the state that regulates

304. This transformation has already occurred with respect to fiduciary duties in Delaware LLCs and limited partnerships. Brinckerhoff v. Enbridge Energy Co., 159 A.3d 242, 245 (Del. 2017) ("Another benefit under Delaware law is the ability to eliminate common law duties in favor of contractual ones, thereby restricting disputes to the four corners of the limited partnership agreement ('LPA').").

the corporation and—through the mechanism of the internal affairs doctrine—requiring all other states to acquiesce.

State benefits from competition are sufficiently large that several states compete actively. Even the noncompeting states conform their corporate laws to the corporate laws of the competing states. Earlier scholarship had assumed that, if states competed at all, they did so to gain filing fee and tax revenues. The states' primary motive—to attract business activity—went unnoticed. Except in Delaware, incorporations are not themselves significant business activity. But competing for incorporations is a means by which the states demonstrate their business-friendliness and thereby attract other business activity.

More than a century of charter competition has produced corporate law devoid of meaningful regulation. If a state imposed meaningful regulation on managers, managers would reincorporate to a state that did not.

Charter competition purports to be a system that generates law reflecting the combined preferences of corporate stakeholders and the state and federal governments. But in reality, charter competition reflects only the managers' preferences to be free from meaningful regulation. That is, regardless of other stakeholders' preferences, charter competition would produce the same product. The system's design assures that at least one state will always be willing to modify its corporation laws to appeal to managers, that managers will be able reincorporate if necessary to avoid regulation, and that corporations will remain unregulated. Deregulation is the only result the competition's design can produce.

Charter competition is effectively beyond democratic control. That is, no path exists by which citizens or their representatives could impose meaningful regulation on corporations without first making other difficult or impossible changes. Charter competition is therefore a system in which corporations, not citizens or their representatives, hold the power to regulate.

Delaware dominates the charter competition by leveraging its unique Chancery Court. Unlike the courts of other states, the Chancery Court is significantly specialized in corporate law, publishes its opinions, has a large body of precedent, tries cases without juries, and has the resources and motivation to provide quick hearings. In reliance on its judicial advantage, Delaware enacted a vague, complex, and incomplete corporation law. Those qualities have made it possible for Delaware judges to re-

solve cases based largely on the interests of managers and Delaware. The litigation provided work for Delaware lawyers and enabled them to develop corporate expertise. Because they had that expertise, the state gave its lawyers control over the legislative process with respect to corporate law.

Delaware's highly successful judicial strategy now appears to be unraveling. Beginning in 2001, Delaware Chancery Court cuts to the fees of plaintiffs' attorneys began making it difficult for that Court to attract cases. In 2010, the Court changed strategies by encouraging corporations to adopt bylaws that required plaintiffs' attorneys to sue in Delaware. Delaware corporations adopted those "forum selection" bylaws. But the corporations have been reluctant to invoke them when the Delaware courts seemed less likely than other courts to approve their questionable settlements. If the Delaware courts do not approve questionable settlements, the plaintiffs' attorneys and the Delaware corporations will take the cases to other courts that will. If the Delaware courts do approve questionable settlements, Delaware's reputation and the charter competition's legitimacy may be impaired. Either way, Delaware is in trouble.

Arbitration bylaws may be Delaware's coup de grace. Corporations have already begun adopting them and United States Supreme Court opinions prevent the states from banning their use. Delaware cannot compete with private arbitration companies by converting its judges into arbitrators. Corporations want secret arbitration, but the Constitution prohibits Delaware judges from providing secrecy.

Nor would the expansion of Delaware's Rapid Arbitration Act to unsigned arbitration provisions in certificates and bylaws solve Delaware's problem. Arbitration bylaws will not merely move the same cases to a different forum. Arbitration bylaws can and will bar plaintiffs from proceeding in representative capacities and bar arbitrators from providing fee awards to successful plaintiffs. Because most plaintiffs who bring shareholder litigation do not individually have enough money at stake to warrant even the cost of arbitration, the system's shift to arbitration will sharply reduce the number of cases brought.

Without enough cases, Delaware's judicial strategy would fail, leaving that state with little advantage over competing states. Competing states may seize the opportunity by adopting statutes that allow certificate of incorporation and bylaw provisions to displace the provisions of their corporation laws to the full extent of the internal affairs doctrine. Because states need

no corporate law expertise to enact such a statute and their courts need no corporate law expertise to enforce arbitration awards, Delaware's history, familiarity, networks, and precedent would count for little. Corporate charter competition might turn solely on price and the quality of the states' websites. No state could gain significant revenues in so competitive an environment. But charter competition would still provide a forum in which the states could demonstrate their business friendliness, and by doing so attract significant business activity.

Thus, even without Delaware and without charter competition revenues for Delaware's successors, corporate charter competition would continue. The structure of the competition is its root cause, and that structure remains stable: corporations can incorporate anywhere. Once incorporated, corporations can do business anywhere. The law of the incorporation state governs their internal affairs. Until at least one of those three fundamental and long-standing principles is abandoned, corporate charter competition will prevent meaningful regulation of corporations.