

Delaware on defense

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Delaware's corporate law has a target on its back again. Since the late 1970s, shareholder activists and their allies in the academy have complained that the state's law favors management and boards at the expense of shareholders and have lobbied Congress and the Securities and Exchange Commission to adopt rules more favorable to shareholders.

In the 1970s, the upstarts pushed Congress to federalize corporate law, an effort that came to naught. They had more success after the collapse of Enron Corp. when Congress passed the Sarbanes-Oxley Act. Now the 1,136-page Restoring American Financial Stability Act proposed by Sen. Christopher Dodd, D-Conn., includes provisions that would impose majority voting for directors at public companies, bar staggered boards unless specifically approved by a company's shareholders and provide for an advisory say on pay. Delaware's corporate code allows companies majority voting but does not require it. The code also does not require shareholder approval for staggered boards, and the state's lawyers and judges have steadfastly resisted say on pay.

Wilmington lawyers can do little more than watch the progress of the proposals in the Dodd bill with "resigned helplessness," said Lawrence Hamermesh in December, just a few weeks before he moved from Widener University School of Law to a position at the SEC, where he's an attorney fellow in the division of corporation finance. "We're like everyone else looking at what's going on in Congress. It's such a sausage-making machine that it's impossible to be confident about any outcome."

The helplessness isn't absolute. Delaware does have two U.S. senators, the senior of which, Tom Carper, is a former governor of the state and especially aware that about a fifth of its annual budget comes from franchise fees paid by companies based all over the U.S. Critics claim those revenues lead Wilmington lawyers who in essence write the state's corporate code and the judges who interpret it to craft law that tilts toward the managers who choose a company's state of incorporation.

And the years of criticism have forced the Delaware corporate bar to set out a rationale defending their pre-eminence. Competition among the 50 states leads to outcomes that balance the desires of managers and shareholders and fosters innovation in corporate governance, which a regime mandated by either Congress or the SEC would stifle.

"I don't want to speak for Delaware," says Vice Chancellor Leo E. Strine Jr., one of the five judges on the state's Court of Chancery, "but I think the concern is that there is an awful lot of economic growth and jobs related to the ability of U.S. businesses to shape structures that work for them" under the state's corporate law, which gives companies broad leeway to craft an appropriate governance regime.

The real issue, he says, isn't Delaware's status, but that of the U.S. in the world economy. "Do we want to send a signal internationally that when we have crisis in the U.S., we engage in a flood of new mandates regardless of whether these mandates relate to what caused the crisis?" Strine asks rhetorically. "If perception is that national government is going to mandate specific procedures that have nothing to do with systemic risk, people will ask why they need to list on the NYSE."

Strine and others question the relationship between the Dodd bill's corporate governance provisions and improved corporate performance or reduced systemic risk. The shareholders of Enron, WorldCom Inc., **Tyco International Ltd.** and **HealthSouth Corp.** all suffered massive fraud despite single-class boards, and Bear Stearns Cos., **American International Group Inc.**, **Lehman Brothers Holdings Inc.** and Washington Mutual Inc. all failed despite the allegedly greater shareholder oversight fostered by such boards, they note. Given that roster, mandating the structure seems a dubious change, and one that would only increase pressure for short-term results.

As for majority voting, Delaware amended its corporate code in 2006 to make clear that companies may adopt single-class boards. "If the stockholders want it, they get it," Strine says. And while the SEC has debated proxy access for two years, Delaware last year made clear that its law permits shareholders the right to nominate directors on the company's proxy -- a move meant to suggest to institutional investors that Delaware accepts that shareholders should have relatively easy access to a proxy.

None of that has forestalled calls for the feds to prescribe governance guidelines. Delaware will not respond in kind. "Outside of areas critical to the protection of society, such as leverage limitations and capital requirements, Delaware is trying to approach this on the merits, and we don't want to be crisis-driven," Strine says. "Delaware can't step in front of the feds and say, 'Every corporation ought to have X' without being inconsistent with its preference for company specific private ordering."