A New Delaware?

North Dakota has adopted a shareholder-friendly corporate code to get more companies to incorporate in the state. Will boards bite?

The Daily Deal
David Marcus
May 7, 2007

The gurus of good governance are at it again. Long dissatisfied with what they see as Delaware's pro-management bias, activist investors successfully lobbied the North Dakota state legislature to pass an amendment to the state's corporate law code that includes a number of shareholder-friendly governance provisions. Gov. John Hoeven signed the bill into law on April 12, thereby enabling a regime that provides for: majority voting; annual advisory votes by shareholders on executive compensation; direct access to the proxy; and provisions for shareholder approval of poison pills.

"This would be the wish list," says Patrick McGurn, executive vice president of Rockville, Md.-based Institutional Shareholder Services Inc., of the North Dakota law. "If you were going to a state legislature, you'd be happy if they did one of the things on this list. There's no statute that's even in the same zip code."

The entities that fomented the law remain anonymous. McGurn says he didn't know about the statute until the day it passed, and William H. Clark Jr., who wrote the law, is coy about who his clients were. A partner at Drinker Biddle & Reath LLP in Philadelphia, Clark first became involved in the governance game when he represented the Belzberg family in its 1990 hostile bid for Armstrong World Industries Inc.The Lancaster, Pa., producer of floor tiling defeated the bid by successfully lobbying the Pennsylvania General Assembly to pass an exceptionally management-friendly amendment to the state's corporate law.

Because only two publicly traded companies are incorporated in North Dakota, the bill faced minimal opposition. Clark and his clients chose the state at the start of their project in 2005, but its Assembly meets only biannually and had just completed a session. Clark tried to get the Vermont legislature to pass his proposal, but Chittenden Corp., a publicly traded bank based in Burlington, prevented passage of the bill. This year, Clark went to North Dakota.

The lawyer says he vetted the bill with shareholder activists. In addition to the provisions mentioned above, the law provides for the annual election of all directors, thus eliminating the staggered board, and would require a company to reimburse a shareholder who runs a successful proxy contest. The bill also bars the CEO of a company from serving as the chairman of its board and allows 10% of shareholders to call a special meeting.

Corporation franchise fees are a major source of revenue for Delaware, and North Dakota also hopes to profit from them. It will charge fees that are half of Delaware's and would earn them in

two ways: Either companies would go public as corporations of that state, or already-public companies would reincorporate there. The latter will likely prove difficult, says Lucian Bebchuk, a professor at Harvard Law School, since boards control reincorporation decisions. Clark says that shareholder pressure may over time push companies to leave Delaware for another jurisdiction.

Bebchuk adds that North Dakota also lacks Delaware's "infrastructure: the experienced and sophisticated Court of Chancery, the Delaware corporate bar and Delaware's convenient location." Chancery's five judges hear almost every corporate case of any significance filed in Delaware state court and thus have significant expertise in the area; North Dakota does not have such a specialized court. Instead, it has seven district courts, a Court of Appeals and a Supreme Court. North Dakota's new statute doesn't create a court devoted to the resolution of corporate law disputes.

Clark downplays the risks of this judicial inexperience. "My feeling is that given the rights that the shareholders have under the North Dakota statute, there should be less litigation," he says. "It's easier to change the composition of a board," since shareholders have such expansive rights.

The timing of the law's passage is somewhat odd, given that the Delaware courts have made significant efforts to become more shareholder-friendly after the 2002 adoption of the Sarbanes-Oxley Act and more recently have issued several rulings criticizing CEO compensation practices. But activists have remained fixated on poison pills for more than a decade after CEOs and boards stopped using them to thwart hostile takeovers, so their dislike of a Delaware regime that's quite shareholder-friendly by historical standards should come as no surprise.