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FORTY YEARS OF CHARTER COMPETITION:  
A RACE TO PROTECT DIRECTORS  
FROM LIABILITY?

Gordon Moodie

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**Forty Years of Charter Competition:  
A Race to Protect Directors From Liability?**

By Gordon Moodie<sup>1</sup>

ABSTRACT

This paper examines whether changes in director liability statutes can be linked to changes in a state's popularity as a site of corporate domicile. Using a new database of NYSE reincorporations over the past forty years, it finds such a link exists. Delaware surged ahead in the corporate charter market when it liberalized its director liability statute in 1967 and 1986. And states that imitated Delaware rapidly kept the highest share of their NYSE firms from reincorporating in Delaware. This shows that states "defensively compete" to prevent a corporate exodus to Delaware, even if they know they cannot overtake Delaware. It also shows that director liability statutes are an important consideration for corporations when choosing a state of domicile. Taken together with evidence that corporations are drawn to states with antitakeover statutes, this supports a view that states with a managerial focus do better in the market for corporate charters.

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<sup>1</sup> J.D., Harvard Law School 2004.

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## **Forty Years of Charter Competition: A Race to Protect Directors From Liability?**

By Gordon Moodie

### I. Introduction

Corporate law scholars have long struggled to understand the nature and effect of jurisdictional competition in corporate lawmaking. Thirty years ago, they drew the modern battle lines: some argued that competition resulted in states pandering to managers with law that was bad for shareholders;<sup>3</sup> others countered that competition produced the most efficient law for shareholders.<sup>4</sup> More recently, new dimensions have been added to the basic “race-to-the-top” and “race-to-the-bottom” dichotomy. Delaware’s competition with the federal government has been emphasized as at least as important as state-to-state competition,<sup>5</sup> and some scholars have forcefully questioned whether there is any competition at all in corporate law.<sup>6</sup> Thus there are roughly three broad schools of thought on this issue at the present time: that states compete (for better or for worse), that states do not compete, and that states (particularly Delaware) compete with the federal government.

A related debate is what has made Delaware the undisputed champion of the market for corporate charters. Over 60% of firms on the New York Stock Exchange are domiciled in Delaware, and the state receives 15-20% of its revenues from the several hundred million dollars it collects annually in franchise fees.<sup>7</sup> Answers to the question of why Delaware is dominant range from its friendliness toward managers,<sup>8</sup> the stability and depth of its corporate

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<sup>3</sup> William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

<sup>4</sup> Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

<sup>5</sup> Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588 (2003).

<sup>6</sup> Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002); Lucian Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 Yale L.J. 553, 583 (2002).

<sup>7</sup> Lucian Arye Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003).

<sup>8</sup> See Cary, *supra* n. 1.

law,<sup>9</sup> the quality of its specialized corporate judiciary,<sup>10</sup> the lack of other interest groups to compete with managers and shareholders,<sup>11</sup> the indeterminacy of its legal doctrine,<sup>12</sup> and network effects of well-established corporate law.<sup>13</sup> The question of why Delaware has been so successful is also linked to the broader question of how corporations decide where to incorporate, and what any state might do to attract them.<sup>14</sup> Here, recent empirical evidence has shown that states with antitakeover statutes do better in the market for corporate charters than those without.<sup>15</sup>

This paper contributes on both levels. On the more abstract question of the nature of jurisdictional competition, it shows that states do compete in a periodic and defensive manner in order to prevent their corporations from moving to Delaware. Even states that have no chance of winning corporations from Delaware will duplicate popular provisions of its corporate law to prevent firms from moving to Delaware, and those that duplicate quickly are rewarded by a lower loss of firms to Delaware than other states. On the question of what leads states—and particularly Delaware—to be successful in the market for corporate charters, this paper breaks new ground by highlighting the role of statutes limiting director liability. Delaware was rewarded handsomely when it innovated to protect directors in 1967 and 1986, and the states that copied it most quickly did the best at preventing their firms from migrating to Delaware. Putting the two pieces together, jurisdictional competition has produced a race, and a key aspect of the race has been to protect directors from liability.<sup>16</sup>

This paper is organized into seven parts. Part II briefly summarizes

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<sup>9</sup> ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 37-44 (1993).

<sup>10</sup> *Id.*; see also Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061 (2000).

<sup>11</sup> Mark J. Roe, *Delaware's Politics* (working paper).

<sup>12</sup> Ehud Kamar, *A Regulatory Competition Theory Of Indeterminacy In Corporate Law*, 98 COLUM. L. REV. 1908 (1998).

<sup>13</sup> See Bebchuk & Hamdani, *supra* n. 4 at 586 (discussing Delaware's network externalities).

<sup>14</sup> See, e.g., Bebchuk & Cohen, *supra* n. 5 (exploring firms' decisions where to incorporate); Robert Daines, *The Incorporation Choices Of IPO Firms*, 77 N.Y.U. L. REV. 1559 (2002) (same for IPO firms).

<sup>15</sup> See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002).

<sup>16</sup> This paper's title was inspired by Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L.J. 1168 (1999).

the basic positions in the corporate “race” debate, and highlights how data in this paper challenge or support these views. Part III describes the 40 years of NYSE reincorporation data that was collected for this paper. Part IV examines the legal changes in Delaware and other states in the late 1960s that led to a surge in reincorporations, and shows that states that copied Delaware quickly did the best at preventing firms from moving to Delaware. Part V looks at Delaware’s charter competition performance when it was under threat of encroachment or preemption from the federal government. Like Part IV, part VI looks at how Delaware again came to the rescue of directors in 1986, and at how this led to an unprecedented surge of reincorporations and rapid duplication by other states. Statistical techniques are used to show a real link between states’ duplication of Delaware’s liability-limiting legislation and their ability to prevent firms from moving to Delaware. Finally, Part VII concludes with some observations of how Delaware’s current jurisprudence seems to be consistent with the main conclusions of the paper.

## II. The Race Debate in Corporate Law

### A. *Horizontal Competition*

Many scholars over the past century have argued that states compete to gain franchise taxes by producing corporate law that will attract corporations. To the winner of this race go significant spoils: New Jersey citizens paid no direct tax at the beginning of the century when that state sold the most corporate charters; today, Delaware’s franchise tax amounts to about \$3,000 per person.<sup>17</sup> With such a large prize up for grabs, it makes intuitive sense that states would compete to sell charters. And so for many years, the debate was not whether states competed to create law that attracted corporations, but whether the law that attracted corporations was also healthy for shareholders and society.

Some say it is not, because competition prompts states to pander to

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<sup>17</sup> Steffens, *New Jersey: A Traitor State*, 4 MCCLURE’S MAG. 649 (1905) (“New Jersey has sold us out for money. She passed her miscellaneous in corporation acts for revenue. And she gets the revenue. Her citizens pay no direct tax.”); Lucian Bebchuk and Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553, 583 (2002) (calculating Delaware franchise tax at \$3,000 per person).

managers at the expense of shareholders.<sup>18</sup> A law review note written ninety years ago declared, “The corporate laws of the states tend to drag down one another to the level of the lowest. Competition between the states produces a survival of the unfit, a truly anomalous situation.”<sup>19</sup> Twenty years later, Justice Brandeis dubbed the corporate law race as one “not of diligence but of laxity.”<sup>20</sup> Most famously, Professor William L. Cary condemned the situation as one in which “a pygmy among the 50 states prescribes, interprets, and indeed denigrates national corporate policy as an incentive to encourage incorporation within its borders.”<sup>21</sup> Cary believed competition produced inefficient corporate law in virtually every area, while modern analysts tend to take a more moderate view.<sup>22</sup> Both, however, advocate increased federal participation in corporate lawmaking, either by direct federal chartering, minimum federal standards, or an expanded interpretation of securities laws.<sup>23</sup> Recently, the race-to-the bottom theory was given an empirical lift with evidence that states with anti-takeover statutes do better at retaining corporations than states without such presumptively inefficient laws.<sup>24</sup>

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<sup>18</sup> Note, 33 AM. L. REV. 419 (1899) (“Little Delaware, gangrened with envy at the spectacle of the truck-patchers, sand-duners, clam-diggers and mosquito-wafters of New Jersey getting all the money in the country into her coffers,—is determined to get her little tiny, sweet, round, baby hand into the grab-bag of sweet things before it is too late.”)

<sup>19</sup> Note, *State Laws: Survival of the Unfit*, 62 U. PA. L. REV. 509, 510 (1914).

<sup>20</sup> *Liggett Co. v. Lee*, 288 U.S. 517 (1933) (Brandeis, J., dissenting)

<sup>21</sup> William C. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 701 (1974).

<sup>22</sup> Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437, 1509 (1992) (postulating that state law will produce inefficient law in areas that are “substantially redistributive” or that affect market discipline).

<sup>23</sup> Cary, *supra* n. 1 (minimum standards); Address of Judge Peter Grosscup to the Ohio State Bar Association in July 1905, *The Corporation Problem and the Lawyer’s Part in Its Solution*, 39 AM. L. REV. 835, 849-51 (1905) (federal chartering); Ralph Nader, *The Case For Federal Chartering*, in *CORPORATE POWER IN AMERICA* 67 (R. Nader & M. Green eds. 1973) (federal chartering); Henning, *Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come?*, 21 DE PAUL L. REV. 915 (1972) (same); Lucian Arye Bebchuk & Allen Ferrell, *A New Approach To Takeover Law And Regulatory Competition*, 87 VA. L. REV. 111 (2001) (federal incorporation option and mandatory federal switching rule);

<sup>24</sup> See, e.g., Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002); Lucian Arye Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003).

The opposite view is that state competition is efficient.<sup>25</sup> Professor Ralph K. Winter formulated this “race-to-the-top” argument in a powerful and classic rebuttal to Professor Cary’s pessimistic view.<sup>26</sup> He made two insightful points. First, he argued that just because a state’s law favors manager does not mean it is inefficient. Managerial discretion—in the form of a business judgment rule, for example—may be efficient by encouraging risk taking and innovation.<sup>27</sup> Second, Winter correctly observed that corporate law is not the only constraint on managerial behavior. The capital markets, product markets, and corporate control markets will punish corporations laboring under an inefficient corporate law, prompting them to move to a more efficient state, to be taken over, or to pass quietly into desuetude. Winter recognized that takeover laws posed a problem for his theory though, and also conceded that short-term looting may occur before the disciplinary function of the various markets he identified could be brought to bear on a corporation. Modern proponents of the race-to-the top view have further developed Winter’s points,<sup>28</sup> formulated explanations for the prevalence of takeover laws,<sup>29</sup> adduced empirical evidence to support their model of state competition,<sup>30</sup> and made calls for regulatory competition in other areas of the law.<sup>31</sup>

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<sup>25</sup> Actually, both views share assumptions about states competing against one another; they are opposite only in their position on the normative desirability of state-to-state competition.

<sup>26</sup> Ralph K. Winter, Jr., *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

<sup>27</sup> See, e.g., *Cramer v. General Telephone & Electronics Corp.*, 582 F.2d 259 (3rd Cir. 1978) (“The rationale for the [business judgment] rule is that in order for the corporation to be managed properly and efficiently, directors must be given wide latitude in their handling of corporate affairs.”)

<sup>28</sup> See, e.g., Roberta Romano, *THE GENIUS OF AMERICAN LAW* (1993); Frank H. Easterbrook & Daniel R. Fischel, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

<sup>29</sup> See, e.g., Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987); Easterbrook and Fischel, *ECONOMIC STRUCTURE*, supra n. 26 at 212.

<sup>30</sup> See Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. Fin. Econ. 525, 533 (2001) (finding that Delaware law increases Tobin’s Q measure of shareholder value by about five percent). *But see* Guhan Subramanian, *The Disappearing Delaware Effect*, working paper, at [http://www.law.harvard.edu/programs/olin\\_center/corporate\\_governance/papers/Subramanian\\_Paper.pdf](http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/Subramanian_Paper.pdf) (finding Delaware law no longer increases firm value and suggesting that judicial sanction of “Just Say No” defense in mid-1990s is responsible for disappearance).

<sup>31</sup> Roberta Romano, *Empowering Investors: A Market Approach To Securities Regulation*, 107 YALE L.J. 2359 (1998); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 906 (1998).



These rival positions will probably remain at loggerheads. The data in this paper strongly suggest that large corporations migrated to jurisdictions that moved most rapidly to limit the personal liability of insiders. But whether such limitation is a good or bad thing for shareholders is unknown, as indicated in the following passage from the influential Institutional Shareholder Services proxy voting guide:

The extent to which corporate directors and officers should be indemnified and their personal liability limited against judgments resulting from their acts as corporate agents is a difficult question for shareholders. On one hand, shareholders want directors and officers to be responsible for their actions, and accountable for their failures... On the other hand, shareholders recognize that directors and officers are asked to make extraordinarily difficult choices, and that it is not in the interest of shareholders for them to be too risk averse.<sup>32</sup>

To the extent that corporations choose their state of domicile based on corporate laws whose inefficiency or efficiency is unknown, the “top” or “bottom” aspect of the race debate will be inconclusive.<sup>33</sup> True, there is some evidence that corporations gravitate to states with stronger antitakeover provisions,<sup>34</sup> supporting a race-to-the-bottom view for all those who believe in the inefficiency of such statutes. But this paper shows that other legal rules whose efficiency or

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<sup>32</sup> Institutional Shareholder Services, U.S. PROXY VOTING MANUAL (2004). ISS recommends case-by-case voting on management proposals to limit liability or expand indemnification. See also AFL-CIO, PROXY VOTING GUIDELINES 8 (2004) (advising that voting fiduciary “may support” liability-limiting or indemnification proposals when the company “persuasively argues that such action is necessary to attract and retain directors.”).

<sup>33</sup> For example, there is not much agreement as to which way as vivid a case as *Smith v. Van Gorkom* points in regards to the desirability of state-to-state competition. Compare Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 519 (1987) (*Smith v. Van Gorkom* is consistent with race-to-the-bottom theory because it enhances the ability of managers to resist takeover offers by undertaking extensive and lengthy diligence and consideration), with Bartley A. Brennan, *Current Developments Surrounding the Business Judgment Rule: A “Race to the Bottom” Theory of Corporate Law Revived*, 12 WHITTIER L. REV. 299 (1991) (Section 102(b)(7), which overturned *Van Gorkom*, is consistent with race-to-the-bottom theory because it was favored by managers).

<sup>34</sup> See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002); Lucian Arye Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003).

inefficiency is unknown also have had a strong—and perhaps stronger<sup>35</sup>—influence on a corporation’s domicile choice, lowering the chance of a definitive answer on the impact of jurisdictional competition on shareholder wealth.

Data in this paper highlight another fact that complicates pure theories of jurisdictional competition: firms very seldom leave Delaware. From 1960 to 2002, 327 firms reincorporated in Delaware, yet only 34 left during this time—less than 1 per year on average. And only 11 moved from Delaware to a state other than their home state.<sup>36</sup> Commentators suggested that Delaware could lose corporations in the early 1980s because its judges had become too moralistic, but it lost only four firms in the first half of the 1980s.<sup>37</sup> Similarly, prominent business lawyer Martin Lipton suggested firms consider reincorporating outside Delaware in the wake of its *Interco* decision in 1987, but only 2 firms left in the ensuing two years.<sup>38</sup> The evidence suggests that Delaware has “lobster trap” qualities as a state of domicile—easy to enter voluntarily, but hard to exit.<sup>39</sup> One reason for this may be that reincorporation requires the approval of both shareholders and managers, and is thus unlikely to occur in response to a legal change that favors one group over the other. Another reason is that Delaware’s enduring institutional advantages may simply outweigh the ripples and eddies in its substantive legal doctrine.<sup>40</sup> Finally, corporations may feel they are better protected from truly unexpected doctrinal swings in Delaware, since the federal

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<sup>35</sup> For example, compare in Appendix B the reincorporation response to 102(b)(7) in 1986 with the response to Delaware’s antitakeover statute in 1988. The former clearly dwarfs the latter, even though the importance of the antitakeover statute to attracting and retaining corporations was emphasized in the legislature as a key reason for its passage.

<sup>36</sup> Departures from Delaware are listed in Appendix C.

<sup>37</sup> John C. Coffee, Jr., *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759, 768 (1987) (reporting that corporate lawyers were recommending Texas rather than Delaware as a state of incorporation in the early 1980s).

<sup>38</sup> Laurie P. Cohen, *Lipton Tells Clients That Delaware May Not Be a Place to Incorporate*, WALL ST. J., Nov. 11, 1988, at B7, col. 1 (preferring Pennsylvania, Ohio, and New Jersey).

<sup>39</sup> See Edward Rock, *Securities Regulation As Lobster Trap: A Credible Commitment Theory Of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 692 (2002) (explaining “lobster trap” analogy).

<sup>40</sup> Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553 (2002). But see Wells M. Engledow, *Handicapping The Corporate Law Race*, 28 J. CORP. L. 143, 164 (2002) (“it is not implausible to believe that a state may “out-Delaware” Delaware and overhaul its corporate infrastructure and code so as to gain efficiencies and greater market share.”).

authorities (and, if courts were to blame, the Delaware legislature in a preemptive manner) would be likely to intervene if Delaware went berserk, but may be indifferent to unexpected swings in the corporate law of smaller states.<sup>41</sup>

### *B. Vertical Competition*

Scholars have moved beyond the traditional horizontal debate in recent years, questioning its very premises. Professor Mark J. Roe argues that Delaware's main competition in corporate law-making is Washington, D.C., not other states.<sup>42</sup> In many important areas of corporate law, such as securities regulation, Washington has preempted Delaware.<sup>43</sup> In other areas, such as the SEC's allowance of precatory corporate governance proposals under Rule 14a-8, encroachment is less overt but affects state law nevertheless.<sup>44</sup> Sometimes the mere threat of preemption can be linked to sudden shifts in the jurisprudence of Delaware courts, as in the case of going private transactions in the late 1970s.<sup>45</sup> Thus there is historical evidence that Washington is a more consequential competitor to Delaware than other states in making corporate law.

Data in this paper lends some support to Professor Roe's position. Delaware was tough on managers in the late 1970s, when federal preemption was a threat. During this time managers won no case against shareholders in the Delaware Supreme Court.<sup>46</sup> Reincorporations were unsurprisingly low, and Delaware's market share of NYSE firms plateaued for the only time in the past forty years. But it is worth emphasizing again that Delaware lost very few

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<sup>41</sup> Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 638 (2003) ("Federalization is thus not all negative for Delaware. It further bolsters a Delaware monopoly by insuring Delaware's stability, but not that of a minor state.").

<sup>42</sup> Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003).

<sup>43</sup> *Id.* at 610.

<sup>44</sup> *Id.* at 622.

<sup>45</sup> *Id.* at 617-18; see also John C. Coffee, *The Future of Corporate Federalism: State Competition and the New Trend toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759, 765 (1987) (explaining recent pro-shareholder decisions with reference to pressure for federal fiduciary standards).

<sup>46</sup> Douglas M. Branson, *Indeterminacy: The Final Ingredient In an Interest Group Theory of Corporate Law*, 43 VAND. L.R. 85, 106 (1990).

corporations during these “moralistic” periods, and seems able to head off a federal threat of preemption by tightening its fiduciary approach without losing any market share to other states. And the surge of corporations to Delaware in 1986 and 1987 show that there is still enough substance in state corporate law to sway the domicile choice of the largest corporations. Delaware has not yet been preempted to irrelevance, and it has substantial room to maneuver in heading off future threats of federal preemption. Delaware’s competition may indeed be with the federal government, but Delaware is a hardy competitor, and it may be able to preserve enough space for state corporate law such that variations among the states continue to be relevant for domicile choice in the future.

### C. *No Competition*

Some scholars have recently thrown cold water on the jurisdictional competition debate, arguing that it is an academic myth that bears no relation to reality. Professors Kahan and Kamar report that most states would not get much monetary benefit from attracting public corporations from other states.<sup>47</sup> They also find that states take very little action to challenge Delaware’s position. Economic entry barriers and the complexity of interest group politics in most states other than Delaware are likely to prevent any state from aggressively challenging Delaware. In a similarly vein, Professor Bebchuk and Assaf Hamdani argue that Delaware’s dominance is more secure than commonly believed, and that it does not face a significant threat from any other state.<sup>48</sup> They provide empirical evidence that the vast majority of firms either incorporate at home or in Delaware. And this dominance is unlikely to change, for Delaware has tremendous advantages in terms of depth of precedent, practitioner familiarity with its law, and institutional infrastructure. It could respond quickly and effectively to a challenge, causing the challenger to have wasted its time and money in a futile bid for charters.<sup>49</sup>

These articles raise a fundamental question: what do we mean by

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<sup>47</sup> Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002).

<sup>48</sup> Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 Yale L. J. 553 (2002).

<sup>49</sup> See *id.* at 573; Accord Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 236 (1985).

competition when we talk about states competing in the market for corporate charters? One response is that competition can only occur when each competitor has a real chance of “winning” – in this case, of overtaking or at least closely challenging Delaware. But another response is that competition can occur in the absence of the possibility of winning: my sister may imitate my basketball technique, but I know (and she should know) that there is no true competition as to who is the better player; she knows she will not win, and probably wishes merely to avoid the embarrassment of a score of zero.<sup>50</sup> Similarly, states may have a variety of reasons for imitating popular legal changes in Delaware, not least of which may simply be to avoid the perception of having an out-of-date and backward corporate code, or to avoid headlines of prominent corporations moving to Delaware where legislators presumably understand economics and business.<sup>51</sup> Professors Kahan and Kamar acknowledge that this kind of competitive imitation can occur in the absence of a genuine competition for first place.<sup>52</sup> But they do not grapple with the question of whether competition for tops or mere defensive imitation is the more relevant phenomena. Given that forty percent of NYSE companies remain in their home state,<sup>53</sup> if that state imitates—for whatever reason—popular legal changes undertaken by another state, then we have the functional equivalent of competition for corporate charters, and the question regarding the desirability of such imitation is as important (albeit indeterminate) as before.<sup>54</sup>

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<sup>50</sup> Interestingly, both of these meanings of “competition” are found in the Oxford English Dictionary, which defines competition in the context of commercial relations as follows: “To strive with others in the production and sale of commodities, or command of the market.” In this paper I adopt the first clause of the definition.

<sup>51</sup> See Alfred F. Conard, *An Overview of the Laws of Corporations*, 71 MICH. L. REV. 621, 631-32 (1973) (“A very few states have been flaunting more fun at lower prices for traveling enterprises; the rest have been grudgingly granting the minimum concessions deemed necessary to keep most of their breadwinners at home. The performance might better be called a ‘chase’ than a ‘race,’ since it is characterized by one or two starting off in the lead, and the others striving only to stay within hailing distance.”).

<sup>52</sup> Kahan & Kamar, *supra* n. 45 at 715-22.

<sup>53</sup> Lucian Arye Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003).

<sup>54</sup> Delaware is not always the innovating state, but when other states create a corporate law provision that is attractive to corporations, Delaware is the most responsive state in terms of adopting such innovations. Romano, *Law as a Product*, *supra* n. 47 at 233-40.

#### *D. Synthesis*

This paper attempts to move beyond these stylized accounts of jurisdictional competition, and to examine an important aspect of the competitive dynamic as it actually unfolded over the past forty years. The story is as follows. Delaware bides its time, awaiting an opportunity to respond to major managerial concerns with a bold revision to its corporate law. When it makes such a revision, it is flooded with reincorporations, increasing its franchise fees substantially. Other states “defensively compete” by copying the change in Delaware law—not to win incorporation business from Delaware, but to stem the flow of firms to Delaware.<sup>55</sup> And the evidence indicates that the process works, with states that rapidly imitate Delaware losing fewer firms than states that take longer to reform or fail to do so at all. The innovation diffuses, relative quiet returns, and Delaware adjusts its overall approach with an eye to federal activity. Delaware’s horizontal and vertical relationships have both been in play over the past forty years. A story of pure competition between states may indeed be a myth, but the relevance of America’s federal structure to the substance of its corporate law cannot be denied.

#### III. Overview of New Data

This paper uses a new database of NYSE reincorporations over the past forty years. Compustat currently lists 1,254 non-financial, non-foreign NYSE firms; I was able to find the incorporation history of 1,238, or 94 percent of them, from Moody’s Industrial Manual and Standard & Poor’s Stock Listing Sheets. To mitigate survivorship bias,<sup>56</sup> I then obtained a list of firms delisted from the NYSE since 1960 from the Center for Research on Security Prices. This yielded an additional 1,422 firms. Incorporation information was available for 850 of them in back issues of the above listed manuals. The result is a database of 2,088 non-financial, non-foreign NYSE firms, representing almost 80 percent of the NYSE firms in that category that existed over the forty-year period. The 20 percent gap in the data is regrettable, but there is no reason to suspect those

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<sup>55</sup> Roberta Romano, *The Need For Competition In International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387, 509 (2001).

<sup>56</sup> See QUANTITATIVE METHODS FOR INVESTMENT MANAGEMENT 300 (DeFusco et al., eds, 2001).

firms behaved in a systematically different way than the rest of the sample.<sup>57</sup>

One may question whether it is possible to draw legitimate inferences from a database that includes only NYSE reincorporations. True, NYSE firms represent but a fraction of the total firms in Delaware. Nevertheless, historically these firms have accounted for a significant proportion of Delaware's franchise taxes.<sup>58</sup> Reincorporations matter to Delaware too: about 30% of the NYSE firms currently incorporated there arrived via reincorporation. The proportion rises if calculated on the basis of market value, and remains at about a third if we include NASDAQ firms. Unless structuring corporate law to win NYSE reincorporations would alienate other types of firms—a proposition for which there is no theoretical or empirical evidence—we can expect Delaware to continue to try to win such lucrative reincorporations in the future.

The number of firms reincorporating to Delaware, as well as the number reincorporating in total, is listed for each year between 1960 and 2002 in **Appendix A**. Two surges in incorporation are visible in 1967-69 and 1986-87. Although the trend is consistent with prior reincorporation studies,<sup>59</sup> the magnitude is surprising: over 40 percent of the NYSE firms that moved to Delaware in the past 40 years did so within two years of the liability-limiting changes of 1967 or 1986.<sup>60</sup> To better depict the surges in Delaware's popularity in the late 1960s and 1980s, **Appendix B** charts the same data. The bar chart

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<sup>57</sup> Delisted and currently listed firms both migrated to Delaware in abnormal numbers in 1967-68 and 1986-87. They behaved similarly in other years as well.

<sup>58</sup> See Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 283 (1976) (citing a 1974 Report to the Governor of Delaware that found that although it had 76,000 corporations, franchise tax revenues received from the largest 950 accounted for about 80 percent of the total).

<sup>59</sup> See, e.g., Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation*, 53 J. Bus. 259 (1980) (noting surge in 1967); Demetrios G. Kaouris, *Is Delaware Still A Haven For Incorporation?*, 20 Del. J. Corp. L. 965 (1995) (documenting surge in 1986-87). For a broader historical perspective, see RALPH NADER ET AL., *CONSTITUTIONALIZING THE CORPORATION* (1976) (collecting data since 1900 and finding correlation between reincorporation flows and statutory change in Delaware).

<sup>60</sup> This calls into question statements that Delaware's corporation code is an insignificant factor in attracting corporations. Cf. William W. Bratton, *Delaware Law as Applied Public Choice Theory: Bill Cary and the Basic Course after Twenty-Five Years*, 43 Georgia Law Review 447, 450 (2000) ("Delaware's case law, judges, and speedy process figure much more prominently than its code in explanations of the success of its legal product line.")

indicates the number of NYSE firms reincorporating to Delaware each year, and the line chart indicates Delaware's market share of NYSE firms. One may be incredulous of Delaware's ascent during this time, but the data is reasonably consistent with scattered public observations.<sup>61</sup>

Throughout this paper, I generally refer to the total number of firms migrating to Delaware rather than the percentage of all reincorporations won by Delaware in a particular year. Using percentages, it seems that Delaware lapsed somewhat in 1967 and 1968, since it gained only about 90% of the reincorporations in those years as compared to 100% in 1965 and 1966. But this obscures the more important fact that Delaware prompted 33 firms to move in 1967 and 1968—over five times as many as in 1965 and 1966. One can see from the data that Delaware appears to be driving the surges in reincorporation, since it continues to win about 90% of the reincorporations in the peak years of 1967-68 and 1986-87. Because the percentages obscure the important absolute differences in reincorporation from year to year, I generally use the number of firms reincorporating in Delaware in a given time period.

Before exploring more fully the relationship between reincorporation peaks and legislative change in Delaware and other states, a preliminary question should be addressed: does economic activity strongly influence reincorporation flows? Much as mergers and acquisition volume varies with the strength of the economy, so perhaps do reincorporations. If this is the case, the peaks and troughs in reincorporations may simply reflect the business cycle and nothing more. Fortunately for the purposes of this study, empirical investigation shows very little link between economic growth and the total number of reincorporations in a given year. A regression analysis of the GDP growth rate from 1960 to 2002 as the independent variable and the total number of reincorporations in a given year yields an R-squared of .02, and a p-value for the

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<sup>61</sup> See, e.g., Cary, *supra* n. 1 at 671 (noting growth in NYSE share from about 35 to 40 percent from mid-1960s to early 1970s); Stephen M. Shapiro & Jeffrey M. Strauss, *Breathing Life into State Takeover Statutes*, 577 PLI 457, 491 (1987) (over 40% of NYSE firms incorporated in Delaware); Lyman Johnson & David Millon, *Misreading the Williams Act*, 87 Mich. L. Rev. 1862 (1989) (about 50% of NYSE firms incorporated in Delaware); Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & Econ. 383 (2003) (over 60% of NYSE firms incorporated in Delaware).



independent GDP variable of .37.<sup>62</sup> This means GDP growth tells us nothing about reincorporation rates. The same analysis with reincorporations to Delaware as the dependent variable produces similar results. Intuitively, this makes sense considering the boom in the 1990s was unaccompanied by a high volume of NYSE reincorporations; nor did the period of sustained high growth from 1976-79 see an exceptionally high number of firms changing domicile.<sup>63</sup>

#### IV. Delaware in 1967

##### A. Delaware's Dominance Challenged

Delaware has led the market for corporate charters since it overtook New Jersey in the early years of the 20th century. In 1929, forty-three percent of Delaware's state revenue came from franchise fees.<sup>64</sup> But though it stayed in the lead, Delaware did not maintain this level of dominance. Economic contractions, duplication of statutory provisions by other states, and an increased role of the federal government in corporate law contributed to a decline in Delaware's franchise taxes to 16 percent of its total revenue in 1955, and just 7 percent in 1962.<sup>65</sup> Other states such as New Jersey and Maryland agitated to "out-Delaware Delaware," and Delaware's corporate filings fell nineteen percent in the first six months of 1963.<sup>66</sup> In the early 1960s, Delaware was still the leader in NYSE charters at over 25%, with the runners up being New York at 14% and Ohio and California at 7% respectively. Nevertheless, compared to earlier in the century, Delaware's prominence "certainly had begun to slip."<sup>67</sup>

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<sup>62</sup> GDP growth rates were obtained from the U.S. Department of Commerce, Bureau of Economic Analysis, at <http://www.bea.gov/bea/dn/home/gdp.htm>.

<sup>63</sup> GDP grew at a remarkable clip of between eleven and thirteen percent during 1976-79, but there were only about five reincorporations per year on average. This is less than the average over all years of about 8 reincorporations per year.

<sup>64</sup> Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. LAW 249, 279 (1976).

<sup>65</sup> *Id.* at 280. Note that some scholars, such as Seligman in this case, report this statistic as a percentage of total revenues. Others, such as Roberta Romano, report Delaware's revenues as a percentage of total tax collected. Apparently the difference is significant, for Romano reports that Delaware's franchise revenues accounted for 14.3% of its tax revenue in 1963, as compared to Seligman's figure of 6.6% of total state revenues for this year. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN LAW* 7 (1993).

<sup>66</sup> Seligman, *supra* n. 62 at 280.

<sup>67</sup> *Id.*

Delaware was not about to lose its lucrative charter business without a fight.<sup>68</sup> The Secretary of State swung into action in 1963, appropriating \$25,000 for a committee to review and study the Delaware corporation laws.<sup>69</sup> As candidly acknowledged by one of the participants in the review process, “[t]he excellent and able committee consisted chiefly of pro-management attorneys... the only interest represented in the committee was management.”<sup>70</sup> The Committee’s goals were threefold: to update and clarify the statutory language, to simplify the mechanics for corporate action, and to make changes in substantive provisions where experience indicated improvements could be made.<sup>71</sup>

### B. Insider Liability Concerns

One area where experience indicated that improvements could be made was insider liability—a burning issue in the mid-1960s. A dramatic increase in the number of stockholders in the late 60s as well as a general business boom contributed to the fear of liability during this time.<sup>72</sup> Derivative suits became far more common.<sup>73</sup> A front-page story in the Wall Street Journal in

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<sup>68</sup> See, e.g., Richard F. Corroon, *The Proposed New Delaware Corporation Statute*, 20 J. LEGAL. EDUC. 522 (1968) (“The franchise tax dollar is very important in many states, including Delaware, and when one state hears that a corporation is thinking of transferring to Delaware, for example, but instead has go to Maryland, the state officials begin thinking of the franchise tax dollar, and frankly, that is one of the reasons for the formation of this committee—to modernize and liberalize the Delaware corporation law.”); George D. Hornstein, *Corporations*, in ANNUAL SURVEY OF AMERICAN CORPORATE LAW 45 (1967) (“This quite extensive revision, frankly designed to compete with the new corporation laws in other states, expects to retain for Delaware a leading source of revenue.”).

<sup>69</sup> S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 14 (1976).

<sup>70</sup> Folk, *Some Reflections of a Corporate Law Draftsman*, 42 CONN. B.J. 409, 411 (1968). The Delaware Corporation Law Revision Committee was chaired by Clarence A. Southerland (former Chief Justice of Delaware) and its members included: Daniel L. Herrmann, Richard F. Corroon, Henry M. Canby, Irving Morris, S. Samuel Arsht (Delaware attorneys in private practice); Alfred Jarvis and David H. Jackman (representing two leading corporation service companies); Elisha C. Dukes (Secretary of State); and Margaret S. Story (director of the Corporation Department within the Secretary of State’s office). *Id.*

<sup>71</sup> S. Samuel Arsht & Walter K. Stapleton, *Delaware’s New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 75 (1967).

<sup>72</sup> Martin J. Greenberg & David B. Dean, *Protecting the Corporate Executive: Director and Officer Liability Insurance Reevaluated*, 58 MARQ. L. REV. 556 (1975).

<sup>73</sup> See, e.g., Daniel J. Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74, 77-78 (1967) (emphasizing derivative suit’s role as a “needed policeman”).

1966 warned of the increasing risk of liability and profiled a number of corporate leaders in court.<sup>74</sup> Many companies modified their by-laws during this time, in some cases “seeking virtually to immunize management from personal liability.”<sup>75</sup> Meanwhile, the number of D&O insurance policies sold annually increased twenty-five fold from 1962 to 1966,<sup>76</sup> and the Chairman-Elect of the ABA Section on Corporations argued that greater indemnification was necessary to attract high caliber directors.<sup>77</sup> In 1968, the *Texas Gulf Sulfur*<sup>78</sup> and *BarChris*<sup>79</sup> cases gave insiders further restless nights, while the morning paper greeted them with frightening advertisements for liability insurance depicting restive and presumably litigious shareholders.<sup>80</sup>

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<sup>74</sup> Wayne E. Green, *Executives In Court: More Company Officers Are Sued for Negligence in Running Their Firms*, WALL ST.J., Jun. 29, 1966 (“Those corporate executives who have seen angry stockholders only as hecklers at annual meetings ought to be thankful. A growing number of company officers and directors are having to argue with irate shareholders in court—and if they lose the argument it can cost them not merely their composure, but big money.”).

<sup>75</sup> For example, the following firms modified their by-laws to enlarge indemnification during this time: Bethlehem Steel in 1964, Firestone, Goodyear, Monsanto and Standard Oil of New Jersey in 1965, International Harvester, Southern Pacific and Texaco in 1966, and General Motors (after being sued by Ralph Nader for \$26 million), Greyhound, McDonnell-Douglas, General Tire, Westinghouse, and Chrysler. See Note, *Law For Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969). Some of the last companies in the list were discovered independently with a press search.

<sup>76</sup> Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968). This statistic may be deceptive, however, because 1962 was the first year that D&O policies were sold, and only 2 were sold in that year. JOSEPH W. BISHOP, *THE LAW OF CORPORATE OFFICERS AND DIRECTORS* ¶6.06 (1981).

<sup>77</sup> Note, *Law For Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. Pa. L. Rev. 861 (1969) (Reporting Orvel Sebring, chairman-elect of ABA Section on Corporations, as saying: “[Indemnification] is good social policy ... because we must get the best men available to run our corporations. The lifeblood of business depends upon the quality of guidance which officers and directors can give the corporations. So there is a strong case for indemnification.”).

<sup>78</sup> 401 F.2d 833 (2d Cir. 1968) (holding misstatements in a press release violated Rule 10b-5 because they were made in connection with shareholders’ stock purchases in the open market).

<sup>79</sup> *Escott v. BarChris Construction Corporation*, 283 F.Supp. 643 (S.D.N.Y. 1968) (refusing to permit underwriters to rely in good faith on counsel’s negligent due diligence).

<sup>80</sup> For example, a full-page advertisement in the Wall Street Journal featured an angry looking shareholder, and blared in headline font: “I just might sue every company director reading this newspaper.” It continued: “I’m not a madman. This is not a joke. If you are a director of a major company, I’ve got you where I want you. At my mercy. All I have to do is own a few shares of stock in your corporation and I can sue you an every other director and officer in the company. What can I sue you for? What can’t I sue you for...”). See generally Joseph W. Bishop, *Sitting Ducks*, *supra* n. 74 at 1078.

As concern over insider liability deepened, a perception developed that fewer capable directors would be willing to serve on corporate boards. The Wall Street Journal reported, “scores of men are politely declining offers they once would have jumped at to serve on prestigious boards... There is now a real shortage of competent men willing and able to serve as directors.”<sup>81</sup> Indemnification was seen as a solution to this problem, defended “on the ground that it would enable directors of limited means to enlist the services of competent counsel on the assurance that if successful payment would be forthcoming from the corporate treasury, it would also encourage men to accept the responsibilities of the post of director, the emoluments of which would otherwise not be commensurate with the risk of loss involved.”<sup>82</sup>

### C. Legislative Response

The Committee revising Delaware’s corporate laws was attuned to these concerns. As S. Samuel Arsht, one of the drafters of the 1967 revision, reported:

During the three years of the Revision Committee’s study, no subject was more discussed among members of the corporate bar than the subject of indemnification of officers and directors. As far as Delaware law was concerned, the existing statutory provisions on the subject had been found inadequate.”<sup>83</sup>

Other members of the committee concurred in Arsht’s portrayal of the importance and centrality of the change in indemnification law.<sup>84</sup> As a

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<sup>81</sup> Wall Street Journal, p. 1., Mar. 13, 1969.

<sup>82</sup> Knepper, DIRECTOR LIABILITY 9.01, *citing* 13 Fletcher, CYCLOPEDIA OF CORPORATIONS (perm. E.) 692, § 6045.1.

<sup>83</sup> S. Samuel Arsht and Walter K. Stapleton, *Delaware’s New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 77-78 (1967). The Delaware indemnification law at the time was section 122(10), introduced in 1943, which “granted power to a Delaware corporation to indemnify its directors and officers except in relation to matters as to which any director or officer shall be adjudged... liable for negligence or misconduct in the performance of duty.” Orvel Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others*, 23 BUS. LAW. 95, 97 (1967)

<sup>84</sup> Richard F. Corroon, *The Proposed New Delaware Corporation Statute*, 20 J. LEGAL EDUC. 526 (1968) (“Now indemnification is not only of great interest to the law schools, but I would say that (footnote continued)

consequence, the Committee “completely redrafted and greatly extended the provision governing indemnification of directors, officers, employees and agents of the corporation,” and created a new provision that “[bore] almost no resemblance to the prior provision.”<sup>85</sup> The change in indemnification law was highlighted in the 1967 Annual Survey of Corporate Law as one of two changes made in 1967 that would have “major impact affecting the public-issue corporation.”<sup>86</sup>

The new statute differed from its predecessor in key ways. First, unlike the old provision, which was “solely an enabling act,” the new law created a mandatory right for reimbursement of expenses for a director successful in defense of any action or proceeding.<sup>87</sup> Second, amounts paid in third-party settlements and expenses associated with derivative settlement were explicitly covered.<sup>88</sup> The committee drafting the Model Corporation Act wanted indemnification of derivative settlement, but the Delaware committee was “very stubborn on this matter” and finally the Model Act Committee retreated to the Delaware line.<sup>89</sup> But although the drafters did not intend the provision to cover reimbursement of amounts paid in settlement, the statute did not prohibit such a result.<sup>90</sup> Third, the statute was non-exclusive, allowing corporations to go

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our new section on indemnification has received more comment from practicing lawyers and corporate counsel than any single section in the bill... [T]his is the one section that is causing a great deal of thought... We have expanded the present statute considerably.”).

<sup>85</sup> Ernest L. Folk, III, *THE NEW DELAWARE CORPORATION LAW* 97 (Corporation Service Co. 1967); *see also* Bishop, *Decoy Ducks*, *supra* n. 74 at 1081 (“The objective of the 1967 revision of the Delaware statute on indemnification is apparently not to place limits on the protection of guilty management, but to make explicit the power of management to indemnify itself in situations where, under the original artless enactment of an untutored legislature, courts and commentators had questioned the propriety of indemnification.”).

<sup>86</sup> George D. Hornstein, *Corporations*, in *ANNUAL SURVEY OF AMERICAN CORPORATE LAW* 45 (1967). The second major change was to appraisal rights. *Id.*

<sup>87</sup> Folk, *supra* n. 85 at 99.

<sup>88</sup> Orville Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers, and Others*, 23 *BUS. LAW.* 95, 104-06 (1967).

<sup>89</sup> Donald E. Pease, *Indemnification Under Section 145 of the Delaware General Corporation Law*, 3 *Del. J. CORP. L.* 160, 169 (1979).

<sup>90</sup> The authors of the Delaware Code believed that “the statute should authorize only the indemnification of litigation expenses and not of the amounts paid in satisfaction of a judgment or in settlement of a claim.” Arsht & Stapleton, *Delaware’s New General Corporation Law: Substantive Changes*, 23 *BUS. LAW.* 75, 79 (1967). Informed commentators did not believe indemnification of settlements would be allowed. *See* Bishop, *Indemnification of Corporate* (footnote continued)

beyond its provisions in their own articles or bylaws.<sup>91</sup> And finally, the statute authorized the use of insurance even in circumstances where indemnification would not be allowed.<sup>92</sup> The policy behind this “substantially enlarge[d]” statute was to encourage executives to resist meritless suits and to get “capable men to serve as corporate directors.”<sup>93</sup> Predictably, this expansive and high-profile provision drew a substantial amount of criticism from the outset.<sup>94</sup>

#### *D. Reincorporation Surge*

Delaware’s 1967 revisions led to a sharp increase in 1968 of the number of new Delaware incorporations, and a “startling number” of reincorporations into the state.<sup>95</sup> The number of incorporations rose from about 300 per month to about 800 per month, while 134 of the 1,000 largest industrial corporations incorporated or reincorporated in Delaware from 1967-74.<sup>96</sup> The New York

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*Directors, Officers and Employees*, 20 BUS. LAW. 833, 841-42 (1965). It seems that Bishop was correct. See Donald E. Pease, *Indemnification Under Section 145 of the Delaware Corporation Law*, 3 DEL. J. CORP. L. at 169 (1977) (“In a derivative suit... a director or officer is not entitled under any circumstances to indemnification for amounts paid in settlements or under judgments.”).

<sup>91</sup> Sebring, *supra* n. 86 at 105.

<sup>92</sup> *Id.*

<sup>93</sup> Folk, *supra* n. 85 at 98. See also ABA-ALI MODEL BUS. CORP. ACT, § 5, Comment (1971) (Defending change to indemnification law because “Demands for financial protection against personal attack have grown with the proliferation of derivative suits, civil and criminal actions in anti-trust matters, and actions instituted under other federal and state laws.”).

<sup>94</sup> See JOSEPH BISHOP, *THE LAW OF CORPORATE OFFICERS AND DIRECTORS* 6.06 at 6-48 (“Taken literally, the [insurance] subsection seems to mean that, as far as the Delaware lawgiver is concerned, a corporation may insure its management against any obligation to account to the corporation for profits from any of the numerous varieties of self-dealing, from usurping the corporation’s business opportunities through paying themselves excessive compensation to plain embezzlement, which stockholders typically allege in derivative suits.”); R. NADER, M. GREEN, J. SELIGMAN, *TAMING THE GIANT CORPORATION* (1976) (“As written, this [indemnification] provision permits the corporation to insulate its officers from all potential liabilities. Officers may be insured against any negligence, self-dealing, looting the corporation or embezzlement, all conflicts of interest, and deliberate statutory violations.”); Comment, *Vestiges of shareholder Rights under the New Delaware Corporation Law*, 57 GEO. L. J. 599 (1969) (“Delaware... promulgat[ed] an indemnification provision which had the object of giving management maximum freedom to indemnify itself in all but the clearest instances of misfeasance.”).

<sup>95</sup> Ernest L. Folk, III, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409, 412 (1968).

<sup>96</sup> *Id.*

Times reported the “record-breaking clip”<sup>97</sup> of chartering in Delaware, and the Wall Street Journal also reported on the trend.<sup>98</sup> This stampede of leading industrial companies was very lucrative, as Delaware’s revenues from franchise fees nearly quadrupled from \$14 million in 1966 to \$55 million in 1971.<sup>99</sup> Nor was this merely an effect of inflation or economic expansion, for the percentage of Delaware’s taxes accounted for by franchise fees more than doubled from 10.9% in 1966 to 24.9% in 1971.<sup>100</sup> By the early 1970s, commentators were again declaring Delaware the victor in corporate law, having conspicuously won the charter-selling competition, and Delaware officials enthused that “the response has greatly exceeded our expectations.”<sup>101</sup>

### *E. Imitation by Other States*

Delaware’s success led to widespread imitation.<sup>102</sup> In order to determine whether imitation had any effect on reincorporations, here I examine the responses of the 19 states in which at least 10 NYSE firms in the database were incorporated in 1966.<sup>103</sup> These states, and a summary of their responses, are listed in Appendix D. Six states duplicated Delaware’s indemnification within one year of its passage: Indiana, Maryland, Ohio, Pennsylvania, Georgia, and

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<sup>97</sup> N.Y. Times, Jan. 12, 1969.

<sup>98</sup> Roger B. May, *More Firms Adopt Delaware as Legal Home to Benefit from Liberal Incorporation Law*, WALL ST.J., Apr. 16, 1968; *Business Bulletin: Delaware Hospitality Draws Even More Companies to Wilmington*, WALL. ST. J., Nov. 21, 1968.

<sup>99</sup> ROBERTA ROMANO, *THE GENIUS OF AMERICAN LAW* 7 (1993).

<sup>100</sup> *Id.*

<sup>101</sup> Wall ST. J., Nov. 21, 1968, at 1, col. 5; *see also* George D. Hornstein, *Corporations*, 1969 ANN. SURV. AM. L. (1969) 83, 104 n. 126 (“The shift to Delaware for ‘paper’ incorporation has snowballed since United States Steel Corp. changed from New Jersey to Delaware in 1966.”).

<sup>102</sup> Twenty-seven states adopted the Delaware statute over the next fifteen years. JOHN F. OLSON, JOSIAH O. HATCH III, & TY R. SAGALOW, *DIRECTOR AND OFFICER LIABILITY: INDEMNIFICATION AND INSURANCE* ¶ 4.23 (2001). On the influence of the Model Act, which contained an identical indemnification provision as Delaware’s, *see* James J. Hanks, *Protecting Directors and Officers from Liability—The Influence of the Model Business Corporation Act*, 56 BUS. LAW. 3 (2000).

<sup>103</sup> I limit the analysis for two reasons: (1) it was difficult to collect accurate information on the data of passage of each state statute, so the limitation made the task manageable; and (2) the percentage loss for states with a very small number of firms was often 0% or 100%, and was probably more reflective of the lack of data than the true percentage of firms that moved to Delaware.

Virginia.<sup>104</sup> Indiana made another important statutory change at the time, prohibiting the payment of dividends from paid-in surplus and authorizing it only from earned surplus.<sup>105</sup> Maryland also changed its close corporation law in that year, as well as modified its rules of corporate dissolution.<sup>106</sup> The legislature of Ohio enacted revisions of the Ohio Corporation Code effective October 31, 1967, including a revision of the section relating to indemnification.<sup>107</sup> Pennsylvania enacted an exact copy of the Delaware provision on November 30, 1967.<sup>108</sup> Georgia passed a “broad, general power to indemnify” as part of a complete code revision in 1968.<sup>109</sup> Finally, Virginia enacted a very similar provision in 1968, though its nonexclusivity clause did not apply to gross negligence or willful misconduct. Of the 166 NYSE firms incorporated in these states in 1966, only eight or less than 5% moved to Delaware by 1972. Three states in this group—Indiana, Virginia, and Georgia—were the only states in the 19-state sample not to lose a single NYSE firm to Delaware during this time.

Seven more states adopted the Delaware over the next two years: Massachusetts, Minnesota, Wisconsin, Nevada, New Jersey, Connecticut, and Florida. Massachusetts, whose earlier indemnification statute had been criticized as allowing managers to be neither accountable to shareholders nor courts,<sup>110</sup> took a further step in that direction by adopting a provision based on the Delaware model in 1969.<sup>111</sup> In the same year, Minnesota enacted a statute that “permits indemnification in a far broader area than do statutes of most other

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<sup>104</sup> George D. Hornstein, *Corporations*, 1967 ANN. SURV. AM. L.45, 48 (1967).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> Orville Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers, and Others*, 23 BUS. LAW. 95, 108 (1967).

<sup>108</sup> Note, *Law For Sale: A Study of the Delaware Corporations Law of 1967*, 117 U. PA. L. REV. 861, 892 (1969) (sarcastically crediting the Pennsylvania legislature with “stunning originality”).

<sup>109</sup> George D. Hornstein, *Corporations*, 1968 ANN. SURV. AM. L. 59, 72 (1968).

<sup>110</sup> Comment, *Corporate Indemnification of Directors and Officers: The Expanding Scope of the Statutes*, 18 CATHOLIC U.L. REV. 195 (1968); see also JOSEPH W. BISHOP, *THE LAW OF CORPORATE OFFICERS AND DIRECTORS* ¶ 6.05[3] (1981) (calling the Massachusetts indemnification provision “uniquely bad”, and continuing: “for a state that is supposed to be hot for Ralph Nader, left-liberal politics, and the tight control of big corporations, it is a startling piece of legislation.”).

<sup>111</sup> George D. Hornstein, *Corporations*, 1969 ANN. SURV. AM. L. 83, 105 n. 138 (1969).



states.”<sup>112</sup> The new Nevada statute took effect on March 4, 1969.<sup>113</sup> New Jersey, which had been working on a statutory revision since 1958, may have been galvanized to action with the departure of US Steel to Delaware in 1966.<sup>114</sup> It had its new law passed in 1969, noting hopefully in the preface to the revision that it expected the modifications to reverse the trend to Delaware.<sup>115</sup> Connecticut enacted a “commendably clear and explicit” statute in 1969 that followed Delaware and the Model Act.<sup>116</sup> Wisconsin also took action in 1969,<sup>117</sup> and Florida adopted an indemnification provision based on the MBCA in the next year.<sup>118</sup> These states did a reasonable job at keeping large firms from moving to Delaware, though they were not quite as successful as the states that acted in 1967: of the 139 NYSE firms incorporated in these states in 1966, 11 (or 8%) reincorporated in Delaware over the next five years.

Unlike the states listed above, California and New York retained the exclusivity in their indemnification statutes in the 1967 to 1972 time period. Nevertheless, both states passed legislation allowing corporations to buy liability insurance for directors. New York enacted the most restrictive provision on insurance in 1969, allowing it to be purchased only in a number of specified situations.<sup>119</sup> Only one state, Tennessee, adopted the New York approach.<sup>120</sup>

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<sup>112</sup> Note, *Indemnification of the Corporate Insider: Directors’ and Officers’ Liability Insurance*, 54 MINN. L. REV. 667, 679 (1970).

<sup>113</sup> George D. Hornstein, *Corporations*, 1969 ANN. SURV. AM. L. 83, 105 n. 138 (1969).

<sup>114</sup> Note, *Law for Sale*, *supra* n. 106 at 892.

<sup>115</sup> *Id.* The legislature also lamented: “It is clear that the major protections to investors, creditors, employees, customers and the general public have come, and must continue to come, from Federal Legislation and not from state corporation acts... Any attempt to provide such regulations in the public interest through state incorporation acts and similar legislation would only drive corporations out of the state to more hospitable jurisdictions.” Corporation Law Reform Commission of New Jersey, Report, in N.J. Stat. Ann. Tit 14A, at ix, xi (1969).

<sup>116</sup> Ernest Folk III, *Corporation Law Developments—1969*, 56 VA. L. REV. 774 (1970).

<sup>117</sup> MODEL BUSINESS CORPORATION ACT ANNOTATED 225 (1971). For an interesting discussion of the role of corporate lobbyists in the passage of Wisconsin’s first indemnification statute in 1950, see Note, *Corporations—Directors’ Reimbursement for Litigation Expenses*, 1950 WIS. L. REV. 157 (1950).

<sup>118</sup> Jack H. Chambers & Martha L. Cochran, *Florida’s Corporation Law—Problems and Proposed Revision*, 27 U. FLA. L. REV. 8, 60 n. 21 (1975).

<sup>119</sup> Martin J. Greenberg et. al, *Protecting the Corporate Executive: Director and Officer Liability Insurance Reevaluated*, 58 MARQ. L. REV. 567 (1975). The three situations are: (1) To indemnify the corporation for any obligation which it incurs as a result of the indemnification of directors and officers; (2) To indemnify directors and officers in instances in which they may be (footnote continued)

California, on the other hand, enacted a permissive insurance statute, allowing corporations to purchase insurance on behalf of any officer, director, or employee of the corporation or of a subsidiary against actual or alleged misfeasance or nonfeasance.<sup>121</sup> Unlike its indemnification provision that was explicitly exclusive, California placed no statutory limits on the circumstances in which insurance could be used.<sup>122</sup> As one commentator noted, the importance of “all the differences between the indemnification statutes [of New York and especially California versus those of other states], is severely circumscribed by provisions in both statutes permitting the corporation to purchase insurance on behalf of any agent against any liability of the agent in his corporate capacity, whether or not the corporation would have the power to indemnify against such liability under the provisions of the indemnification statute.”<sup>123</sup> Interestingly, California and New York do not appear to have been punished for their relatively more strict approach to director liability: of 205 NYSE firms incorporated in either state in 1966, only 19 or about 9% moved to Delaware in the next five years.

Four laggard states took no action during these years: Illinois, Michigan, Missouri, and Texas. Illinois simply had no indemnification statute, a distinction it shared with very few other states.<sup>124</sup> Michigan’s indemnification

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indemnified by the corporation; and (3) To indemnify directors and officers in instances in which they may not otherwise be indemnified by the corporation provided the contract of insurance covering such directors and officers provides, in a manner acceptable to the superintendent of insurance, for a retention amount and for co-insurance. *Id.*

<sup>120</sup> 1970 CORPORATE COUNSEL’S ANNUAL 73.

<sup>121</sup> Martin J. Greenberg & David B. Dean, *Protecting the Corporate Executive: Director and Officer Liability Insurance Reevaluated*, 58 MARQ. L. REV. 556, 568 (1975).

<sup>122</sup> Note, *Liability Insurance for Corporate Officers and Directors: The Search for a Model Enabling Statute*, 50 N.Y.U. L. REV. 1131 (1975) (contrasting New York and California approach to insurance). California later made it clear that insurance could be available where indemnity was not. Grover R. Heyler, *Indemnification of Corporate Agents*, 23 UCLA L. REV. 1264 (1976).

<sup>123</sup> Douglas L. Hammer et al., *Section 2115 of the New California General Corporation Law - The Application of California Corporation Law to Foreign Corporations*, 23 UCLA L. Rev. 1315 (1976); see also James H. Cheek III, *Control of Corporate Indemnification: A Proposed Statute*, 22 VAND. L. REV. 268, n. 59 (1969) (“This significant amendment eases the strict recovery burdens that exist under [the California indemnification] statute for the director and officer.”)

<sup>124</sup> Note, *Liability Insurance for Corporate Officers and Directors: The Search for a Model Enabling Statute*, 50 N.Y.U. L. REV. 1121 (1975). Idaho also did not have an indemnification statute at the time, but it is not included in the sample of states examined above because it did not have a sufficient number of NYSE firms in 1965. Marie Bifferato, *Indemnification of Corporate Officers under Section 145 of the Delaware General Corporation Law*, 2 Del. J. Corp. L. 131, n. 4 (1977).

statute, unchanged during these years, remained less lenient even than those of California or New York.<sup>125</sup> Missouri's indemnification statute, also unchanged, required court review and was much stricter than those in other states.<sup>126</sup> As late as 1971, Texas had not revised its indemnification law. Reincorporation data suggests that these laggard states paid a heavy price for their failure to follow Delaware: of the 81 NYSE firms incorporated in these states in 1966, 24 or about 30% moved to Delaware over the next five years.

Did the laggard states notice the mass departure of industrial corporations to Delaware? Those who do not believe states compete in corporate law might expect the laggards to be indifferent to the exodus of firms—after all, they could not expect to overtake Delaware. But these states did take notice of the outflow of firms, and contemplated legal change to reverse the trend. Michigan, the largest loser to Delaware in percentage terms, had had enough by 1972 and proposed a wide-ranging reform to its corporate law. The introduction to the Michigan Law Revision Commission's Report referred to several examples of corporations leaving Michigan, and the revised law was "admittedly designed to make Michigan competitive with the major commercial states in the race to attract corporate business."<sup>127</sup> Although many reasons were advanced why Delaware was more attractive than Michigan as a state of incorporation, "the most important changes in the Act appear[ed] to be in the area of officer and director indemnification... the Act is practically identical to Delaware's, which is recognized as the most permissive indemnification statute."<sup>128</sup> One sponsor of the new Michigan Corporation law described it optimistically as having "the primary purpose of providing a unified, simple code that would, in the words of some, out-Delaware Delaware."<sup>129</sup> Although it was far too late for Michigan to "out-Delaware Delaware", the belated statutory revision did stop the flow to Delaware: after the law was enacted in 1972, not a single NYSE corporation migrated from Michigan to Delaware until Delaware enacted its next major

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<sup>125</sup> J.A.C. Hetherington, *Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility*, 21 STAN. L. REV. 248, 261 n. 51 (1969).

<sup>126</sup> See James H. Cheek III, *Control of Corporate Indemnification: A Proposed Statute*, 22 VAND. L. REV. 268 (1969).

<sup>127</sup> Brian Sullivan and Donald S. Young, *Officers and Directors Symposium: Proposed Michigan Business Corporation Act*, 18 WAYNE L. REV. 951 (1972).

<sup>128</sup> *Id.*

<sup>129</sup> Downs, *Michigan to Have a New Corporation Code?*, 18 WAYNE ST. L. REV. 913, 914 (1972).

revision to insider liability in 1986.<sup>130</sup>

Other states seemed to notice the outflow too. As one commentator reasoned in the early 1970s, “Industrial growth in Texas has resulted in expansion of corporate activity... Thus, it would seem appropriate for the legislature to bring the Texas indemnification and liability insurance statutes in line with the country-wide trend.”<sup>131</sup> Kentucky also noted its loss of corporations and potential tax revenue to Delaware during this time, taking particular note of the more permissive indemnification provisions in that state.<sup>132</sup> Other states, such as Illinois, were also painfully aware of the flow to Delaware and were eager to stem it.<sup>133</sup> Thus it seems that states do become aware of outflows of their firms to Delaware, and consider such a phenomena a problem calling for legislative remedy. We will see more evidence of states reacting to an outflow of firms in the wake of Delaware’s enactment of section 102(b)(7) in 1986.

Based on the above, there appears to be a link between a state’s alacrity in copying Delaware’s indemnification and insurance provision, and that state’s ability to prevent its firms from moving to Delaware. This link can be seen more fully through a regression analysis, using the percentage of firms moving to Delaware between 1967-72 as the dependent variable. The independent variables are the number of years that elapsed between Delaware’s legislation in 1967 and the state taking action (set at 5 in the case of the laggards, to equal the last year in the time band by which they had not copied Delaware); and a dummy variable for whether the indemnification statute was exclusive, such as in the case of California and New York. Ideally, such an analysis would control for all other

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<sup>130</sup> Michigan has apparently continued to try to stay abreast of developments in Delaware law. See Cyril Moscow, *Michigan or Delaware Incorporation*, 42 WAYNE L. REV. 1897 (1996).

<sup>131</sup> William J. Knepper, *Corporate Indemnification and Liability Insurance for Corporate Officers and Directors*, 25 S.W. L.J. 240 (1971).

<sup>132</sup> Willburt D. Ham, *Kentucky Adopts a New Business Corporation Act*, 61 KY. L.J. 74 (1973).

<sup>133</sup> Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 436 (1968) (In 1967, the Office of the Secretary of State estimated that approximately 350 Illinois domestic corporations had reincorporated in other states and returned to Illinois in the past two years alone.); Thomas J. Oldham, *California Regulates Pseudo-Foreign Corporations - Trampling upon the Tramp*, 17 SANTA CLARA L. REV. 108 (1977) (“It appears that these states [California, Georgia, Ohio, Pennsylvania, Virginia, and New Jersey] were placed under a substantial amount of pressure to follow Delaware’s example regarding this controversial and important issue [of indemnification and insurance].”).

changes in state corporate law occurring at the time; unfortunately, such data is not readily available, although collecting it from various sources and conducting a full regression analysis would be a promising line of future study.<sup>134</sup>

The following table summarizes the results of the regression analysis described above.

**Table 1—1967 Regression Analysis Results**

	Coefficient	P-value	Other statistics	
Intercept	0.04	0.897	Multiple R:	0.74
Years Elapsed	0.05	<b>0.001</b>	R Square:	0.55
Exclusivity	0.01	0.853	Adj. R Square:	0.49
			Std. Error:	0.09
			Observations:	19

What this analysis shows is that a state’s speed in copying Delaware’s director liability and insurance provisions was significantly linked to its ability to keep firms from moving to Delaware in the late 1960s and early 70s. Given the “Years Elapsed” p-value of 0.001, we can reject the null hypothesis of no connection between these variables at 99% confidence. The r-square shows that, during this time period at least, speed in copying Delaware explains over half of a state’s success at keeping firms from migrating to Delaware. Further, not only does the link between duplication and retention of firms exist, but it is of reasonably strong magnitude. For each year that a state waited to copy Delaware, it suffered a loss of 5% of its NYSE firms to Delaware on average, as indicated by the coefficient on the independent “Years Elapsed” variable. The final intriguing insight is that California and New York do not appear to have been punished for restricting indemnification to what is expressly allowed in the statute. The very high p-value for the “Exclusivity” variable shows that this aspect of the statute had no meaningful statistical connection with retention of NYSE firms. This suggests that a timely legislative response to an important issue may be more

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<sup>134</sup> For example, some states, such as Pennsylvania and Virginia, implemented full code changes at the time of adopting Delaware’s indemnification provision. 1968 ANN. SURV. AM. L. 73 (1968-1969). Nevertheless, the code changes were based on the Delaware model, and the change to the indemnification and insurance provision was seen as one of the most critical change to Delaware’s law at the time. *See supra* n. 84 and accompanying text.

important to corporations than a belated but perhaps more desirable statutory revision. New Jersey's experience lends support to this theory: despite its professed desire to stem the losses to Delaware, its lengthy revision process and failure to enact new legislation until 1969 may explain its relatively poor results (it lost 12% of its NYSE firms) among states that copied Delaware's provisions during this period.<sup>135</sup>

A valid question is whether a state's passage of a "first-generation" takeover statute might better explain the above results than the speed with which it updated and liberalized its director liability provisions. Given the time frame of the above analysis from 1967-72, this is not a major concern. Only Virginia, Nevada, and Ohio enacted first-generation anti-takeover statutes during this time; the major surge in adoption of such statutes occurred in the mid-1970s.<sup>136</sup> Although the takeover statutes may have helped the three states prevent their firms from moving to Delaware, they do not explain the success of Indiana, Georgia, or any of the other states that also performed strongly during this time. Indeed, the same regression analysis as above with a dummy variable included for whether an anti-takeover statute was passed shows this variable is not significant in predicting a state's success in retaining its NYSE firms.

## V. Delaware in the Late 1970s

### A. Delaware's Lenience Draws Attention

By the mid-1970s, Delaware had attracted a great deal of attention for its success in the market for charters, the perceived lenience of its corporate law, and from the widely postulated relationship between the two. In 1968, Ernest Folk wrote that the "key movement in corporation law revisions is toward ever greater permissiveness," with the new statutes "exclusively concerned with only one constituent of the corporate community—management."<sup>137</sup> Moreover, he

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<sup>135</sup> Although in some cases widely anticipated legal change may be as good as the passage of actual legislation for a number of years, this probably was not the case for indemnification and insurance legislation in the late 1960s. During these years, directors felt they could be sued at any moment and probably wanted actual as opposed to potential statutory protection immediately.

<sup>136</sup> See Wilner & Landy, *The Tender Trap: State Takeover Statutes and their Constitutionality*, 45 FORDHAM L. REV. 1, n. 2 (1976).

<sup>137</sup> Ernest Folk, *Some Reflections of a Corporate Law Draftsman*, 42 CONN. BAR. J. 409, 419 (1968).

prophesied, “state efforts to go against such deep-seated dispositions, even if desired, would be futile.”<sup>138</sup> By 1972, Folk proclaimed that state corporation law has “seen its day” because the statutes had “become so broad and sweeping that they let a corporation do just about anything it wants.”<sup>139</sup> He concluded that states had abdicated their responsibility, and a “massive infusion” of federal legislation was necessary.<sup>140</sup> Despite occasional pro-shareholder decisions,<sup>141</sup> many commentators concurred in Folk’s analysis,<sup>142</sup> leading up to Cary’s scathing indictment in 1974.<sup>143</sup>

### B. Federal Encroachment and Threat of Preemption

As the perception grew that state law was inadequate to protect shareholders, federal law began to fill the gap. As early as 1968, former SEC Chairman Manuel Cohen highlighted the relationship between the two bodies of law:

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<sup>138</sup> *Id.*

<sup>139</sup> Ernest Folk, *Does State Corporation Law Have a Future?*, 1972 J. GA. S.B. 311, 312 (1972).

<sup>140</sup> *Id.*

<sup>141</sup> See, e.g., *Schnell v. Chris-Craft*, 285 A.2d 437 (1971). Delaware did sometimes consider and reject pro-management changes in the corporation laws of other states as incompatible with the long-term interests of the stockholders and managers of Delaware corporations. For example, eleven states, led by Ohio and Virginia, did enact “first generation” antitakeover statutes as discussed above. Such legislation was viewed favorably by management and reportedly led to many new incorporations in Virginia. But similar proposals designed to aid management in tender offer battles were considered and rejected by the Delaware revision committee as not in the interest of shareholders. S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 20 (1976).

<sup>142</sup> See, e.g., Detlev Vagts, *The Governance of the Corporation: The Options Available and the Power to Prescribe*, 31 BUS. L. 929, 931 (1976) (“Recall that with respect to most corporations, management is quite free to structure itself as it deems best. State corporation law, after prescribing that corporations are to be managed by their board of directors, has very little to say.”); Richard W. Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991, 998 (1976) (comparing various cases to show erosion in fiduciary duties, and concluding that “state substantive law of fiduciary obligations, traditionally an area exclusively within the sphere of state law, has fallen into desuetude.”); Stanley A. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. L. 883, 889 (1976) (“I share the view that Delaware has diligently engendered a corporate climate too favorable to management, primarily in its terms of statutory provisions though, I believe, in its judicial decisions as well.”)

<sup>143</sup> William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

The history of state corporation laws over the past decade... has been one of reducing protections for shareholders and expanding the discretion of corporate management. To some extent, this simply reflects the inability of any single state to exercise effective control over a corporation whose operations and shareholders are spread across the nation. In any event, it has necessitated the development of a body of law which some observers have described as a "federal corporation law" to fill the gap."<sup>144</sup>

Securities laws expanded in the 1970s in keeping with Cohen's prediction. Rule 10b-5 was used to protect purchasers and sellers from persons who improperly trade on the basis of insider information, to provide relief to participants in transactions involving misleading corporate publicity, and to relax the reliance requirement in cases of nondisclosure.<sup>145</sup> Noting the more shareholder-friendly jurisprudence emerged under the federal securities laws, Professor Jennings wrote in 1976 that "no shareholder in his right mind will litigate a shareholder grievance in a Delaware state court if some other forum is available... Nor is a litigant likely to bring suit in another state court if a federal forum can be found."<sup>146</sup> The scope of the securities laws continued to expand until 1977, when the Supreme Court put a stop to the expansion in *Santa Fe v. Green*.<sup>147</sup>

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<sup>144</sup> Manuel Cohen, *Introduction*, in E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL XV (1968). Interestingly, some saw the development of federal corporation law as a justification for states to favor the interests of managers. See Ferrara & Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980); Ralph C. Ferrera et al., *Interplay Between State Corporation Law and Federal Securities Laws: Santa Fe, Singer, Burks, Maldonado, Their Progeny, & Beyond*, 7 DEL. J. CORP. L. 3, 31 (1982) ("state inaction in the field of corporate malfeasance may have been due in part to perceptions that the federal government was largely responsible for the protection of shareholders... As the Delaware Supreme Court implicitly noted in Singer, there may well be new pressure on the states to provide for the protection of investors, as the federal courts may no longer be perceived as the primary source of regulation.").

<sup>145</sup> Ferrera, *supra* n. 142.

<sup>146</sup> Richard W. Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991, 997 (1976); see also Stanley A. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. L. 883, 893 (1976) ("There is a general impression among members of the bar that the federal law of fiduciary obligation is more solid and more effective than state law... Many counsel, moreover, have the suspicion, despite announced judicial professions concerning fiduciary doctrine, that state court judges may in reality be somewhat less receptive and less likely to enforce fiduciary doctrine to its fullest extent and are somewhat more likely to manipulate findings of fact in such a fashion that the doctrine does not apply broadly.").

<sup>147</sup> 430 U.S. 462 (1977) (holding that § 10(b) and Rule 10b-5 do not reach breaches of fiduciary duty, absent deception or manipulation).



### C. Delaware Responds

Scholars have noted that Delaware adopted a tougher stance toward managers at about the time of this federal threat, presumably as a way to convince federal legislators that shareholder interests were safe in Delaware and that intervention was not required.<sup>148</sup> The timing of this reaction is interesting, as it is usually seen to have begun with the surprising holding in *Singer v. Magnavox*<sup>149</sup> that freeze-out mergers required a business purpose beyond ridding the corporation of minority shareholders.<sup>150</sup> This case was decided in 1977—the very year that *Santa Fe v. Green* put a severe brake on the federal incursion into fiduciary duty. Nor was it the last in the pro-shareholder line, as it was broadened two years later to require independent business purpose in short-form mergers.<sup>151</sup> The year of 1977 also saw the case of *Lynch v. Vickers Energy Corp.*<sup>152</sup>, where the Delaware Supreme Court held directors to a “remarkably high standard of candor”<sup>153</sup> when communicating with their shareholders. Given the fit between the duty of candor and the securities laws, the *Lynch* decision was

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<sup>148</sup> See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003) (finding chronology of Delaware decisions in late 1970s fit pattern of “awareness, pressure, and reaction.”); see also ROBERT C. CLARK, CORPORATE LAW at 520-21 (1986); William W. Bratton, *Delaware Law as Applied to Public Choice Theory: Bill Cary and the Basic Course After 25 Years*, 34 GA. L. REV. 447, 464 (2000) (“The story told at the time was that the brush with preemption at the hands of the federal judiciary and the critical atmosphere provoked by Cary and others prompted the Delaware Supreme Court to reverse its direction so as better to accommodate the interests of investors...”); David Charny, *Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the “Race to the Bottom” in the European Communities*, 32 Harv. Int’l Law Journal 423, 447 n. 59 (1991) (“The Delaware courts’ sharp tightening of fiduciary norms in the late 1970s... is sometimes attributed to fears of an SEC crackdown on Delaware’s lax rules governing mergers among affiliated corporations.”); Park McGinty, *The Twilight Of Fiduciary Duties: On The Need For Shareholder Self-Help In An Age Of Formalistic Proceduralism*, 46 EMORY L.J. 163, n. 9 (1997) (noting Delaware’s “sporadic thrusts to give greater force to fiduciary duties,” in order to “protect [its] franchise as the premier state of incorporation until the coast is clear.”).

<sup>149</sup> 380 A.2d 969 (Del. 1977).

<sup>150</sup> Victor Brudney & Marvin a. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978) (calling *Singer* a “new development” in Delaware law); see also Randolph Godshall & Douglas Hendricks, *Singer v. Magnavox Co.: Delaware Imposes Restrictions on Freezeout Mergers*, 66 CAL L. REV. 118 (1978).

<sup>151</sup> *Roland Intern. Corp. v. Najjar*, 407 A.2d 1032 (Del., 1979).

<sup>152</sup> 383 A.2d 278 (Del. 1977).

<sup>153</sup> Mark J. Lowenstein, *Delaware as Demon: Twenty-Five Years After Professor Cary's Polemic*, 71 U. COLO. L. REV. 497, 511 (2000)

particularly suggestive of federal influence.<sup>154</sup> Like *Singer*, *Lynch* was also expanded in the ensuing few years before it was reversed. Finally, the Delaware Supreme Court again surprised the legal community in 1981 with *Zapata v. Maldonado*,<sup>155</sup> where it rejected application of the business judgment rule to a special litigation committee's decision to dismiss a derivative suit, and adopted a new—and often criticized—test.<sup>156</sup> *Zapata* was a particularly surprising decision in light of the receding federal threat, for the court expressly refused to follow more permissive federal precedent in rendering its decision.<sup>157</sup> Encapsulating this pro-shareholder bias in Delaware law in the late 1970s and early 1980s is the following interesting statistic: Between 1976 and 1982, shareholder interests prevailed over those of managers in every case in which they confronted one another in the Delaware Supreme Court.<sup>158</sup> This lag effect of federal encroachment is interesting, and is perhaps explained by judges wishing to avoid any appearance of pro-management bias amid the high-profile criticisms of Cary and others.<sup>159</sup>

By the early 1980s, commentators detected the change in Delaware's jurisprudence from pro-management to more pro-shareholder.<sup>160</sup> In 1982, for example, two commentators wrote that many of the "race-to-the-bottom" theorists would "now have to admit that Delaware, above all states, as come a

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<sup>154</sup> See Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Federal Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Securities Laws*, 70 U. CINCI. L. REV. 475(2002).

<sup>155</sup> *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787-88 (Del. 1981). Some have detected a similar move in favor of shareholders during this time in other state courts. See Note, *The Encroachment of Rule 10b-5 on State Corporation Law*, 29 ME. L. REV. 224 (1977), citing *Concord Fabrics*, 83 Misc. 2d 120 (N.Y. up. Ct. 1975), and *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36 (1975).

<sup>156</sup> Thomas P. O'Malley, Comment, *The Zapata Two-Step—Will Corporations March Out of Delaware?: Zapata Corp v. Maldonado*, 55 ST. JOHN'S L. REV. 759 (1981). See also Dennis J. Block and H. Adam Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?*, 37 BUS. LAW. 27, 75 (1981) ("The Zapata decision ushers in a new era in the eternal warfare between the corporation and the derivative plaintiff.").

<sup>157</sup> Ralph C. Ferrera et al., *The Interplay Between State Corporation Law and Federal Securities Laws: Santa Fe, Singer, Burks, Maldonado, Their Progeny, & Beyond*, 7 DEL. J. CORP. L. 3, 22 (1982).

<sup>158</sup> Douglas M. Branson, *Indeterminacy: The Final Ingredient In an Interest Group Theory of Corporate Law*, 43 VAND. L. REV. 85, 106 (1990).

<sup>159</sup> See generally Thibaut, Walker & Lind, *Adversary Presentation and Bias in Legal Decisionmaking*, 86 HARV. L. REV. 386, 390-401 (1972).

<sup>160</sup> See, e.g., Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982).

long way toward protecting the rights of shareholders and promoting the fundamental concept of corporate accountability.”<sup>161</sup> Like some before them, these observers accounted for the change not with regard to “state corporation law but the United States Supreme Court and lower federal courts.”<sup>162</sup> Professor John Coffee argued that Professor Cary had been vindicated, for the federal government had articulated minimum standards via the securities laws and Delaware had reacted by becoming more solicitous toward the interests of shareholders.<sup>163</sup> Indeed, Professor Coffee recalled hearing corporate lawyers at the time recommending Texas rather than Delaware as a state of domicile, because the Delaware judges had become too “moralistic.”<sup>164</sup>

#### *D. Delaware Suffers Little in the Market for Corporate Charters*

Contrary to any inference that might be drawn from Professor Coffee’s overheard conversations, however, Delaware appears to have suffered very little penalty for its increasing toughness toward managers in the late 1970s. In the midst of Delaware’s age of moralism, a Delaware official reported the “good news” that “the increase in companies incorporating in Delaware is going right through the roof.”<sup>165</sup> He said that the rate of increase of new incorporations had reached “record levels,” although most of the increase was due to small corporations.<sup>166</sup> From 1975 to 1985, a grand total of four NYSE firms left Delaware, one of which decided to move back to Delaware when it enacted section 102(b)(7) in 1986. Granted, Delaware did fare poorly during these years at generating reincorporations: only about 4 firms per year moved to Delaware between 1975 and 1982, and 1981 was the only year in the past 40 years when not a single NYSE firm moved to Delaware. Moreover, Delaware’s franchise fees as a percentage of its total tax fell from 16.4 percent in 1975 to 12.9 percent in 1982.<sup>167</sup>

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<sup>161</sup> Ralph C. Ferrera et al., *Interplay Between State Corporation Law and Federal Securities Laws: Santa Fe, Singer, Burks, Maldonado, Their Progeny, & Beyond*, 7 DEL. J. CORP. L. 3 (1982).

<sup>162</sup> *Id.*

<sup>163</sup> John C. Coffee, Jr., *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759, 768 (1987).

<sup>164</sup> *Id.*

<sup>165</sup> *Seminar on Delaware Corporation Law Today—Opening Remarks*, 6 DEL. J. CORP. L. at 431 (1981).

<sup>166</sup> *Id.*

<sup>167</sup> This was due more to robust economic growth growing the total revenues rather than a decline in franchise fees. Between 1975 and 1982, GDP grew at a geometric average rate of 10%, while franchise fees only grew at a geometric average rate of 5%. GDP growth rates were (footnote continued)

But large companies were not going anywhere else, for Delaware won 85% of the small number of reincorporations during 1975 to 1982. Thus, it appears that Delaware has substantial flexibility to “coast” in the market for corporate charters, while getting tough on managers and heading off a threat of federal encroachment or preemption.

As the federal threat abated, Delaware’s approach gradually changed back in favor of managers. Shareholders lost their winning streak in the Delaware Supreme Court in the early 1980s,<sup>168</sup> and the state began to relax its strict pro-shareholder approach at the beginning of the decade. In 1983, the Delaware Supreme Court squarely overruled *Singer v. Magnavox* in *Weinberger v. UOP*.<sup>169</sup> In 1984, it softened *Zapata* by requiring a derivative plaintiff to make particularized allegations of directorial bias in order to excuse demand, rather than assuming directorial bias as it had done in *Zapata*.<sup>170</sup> In 1985, managers may have felt they were in the clear as the Delaware court upheld the use of poison pills in *Moran v. Household International*,<sup>171</sup> and created a relatively moderate standard of review for defensive tactics in *Unocal Corp. v. Mesa Petroleum Co.*<sup>172</sup> Despite a reduction in overall economic activity in the early 1980s, these decisions seem to have prompted an increase in Delaware reincorporations during this time. After no NYSE firm reincorporated to Delaware in 1982, 11 did in 1983, 3 did in 1984, and 14 did in 1985.

By the mid-1980s, Delaware was in ascendancy and the federal threat seemed to have passed. As one observer noted at the time, state law “[was] not only flourishing but at the cutting edge of corporation law... State courts and legislatures are... where the action is and where the action is likely to be for the

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obtained from the U.S. Department of Commerce, Bureau of Economic Analysis, at <http://www.bea.gov/bea/dn/home/gdp.htm>. Franchise fees were obtained from ROMANO, THE GENIUS OF AMERICAN LAW 7 (1993).

<sup>168</sup> Douglas M. Branson, *Indeterminacy: The Final Ingredient In an Interest Group Theory of Corporate Law*, 43 VAND. L. REV. 85, 106 (1990).

<sup>169</sup> 457 A.2d 701, 713 (Del.1983).

<sup>170</sup> *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). See also Park McGinty, *The Twilight Of Fiduciary Duties: On The Need For Shareholder Self-Help In An Age Of Formalistic Proceduralism*, 46 Emory L.J. 163, n. 9 (1997).

<sup>171</sup> 490 A.2d 1059 (Del. Ch.1985).

<sup>172</sup> 493 A.2d 946 (Del.1985).

foreseeable future. Federal law is now static or declining.”<sup>173</sup> Delaware’s *Van Gorkom* decision 1986 also prompted some to argue that the race-to-the-bottom theory was disproved, and that states were just as able as the federal government to protect shareholders.<sup>174</sup> The main lesson of Delaware’s shift in jurisprudence in the late 1970s is that it was able to swing significantly from a pro-management to a pro-shareholder approach and most of the way back with virtually no loss of corporations to other states.<sup>175</sup> Like a superhero dueling with multiple foes, Delaware seems to be able to hold off its state competitors while it takes on the federal government for the better part of a decade. In sum, it is a wily and hardy competitor for the federal government with substantial room to maneuver, and it may be able to survive future threats to its authority with similar jurisprudential shifts, while maintaining its status as the leading state of corporate domicile.

## VI. Delaware in 1986

### A. Insider Liability Concerns

In the mid-1980s, concerns over insider liability rose to a level never seen before.<sup>176</sup> Coverage expanded in the early 1980s, but starting in about 1984

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<sup>173</sup> Robert W. Hamilton, *State of State Corporation Law: 1986*, 11 DEL. J. CORP. L.1, 8 (1986).

<sup>174</sup> *Id.* (“The Delaware Supreme Court has clearly come a long way from the image created of it by Professor Cary in his famous article of twelve years ago.”).

<sup>175</sup> Companies may conclude that Delaware is the best place to be even if it is undergoing an anti-management phase, because any truly disruptive legal changes would more likely draw federal action than those of any other state. Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588, 638 (2003).

<sup>176</sup> See generally Dennis J. Block, et. al., *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L.J. 130, 130-31 (1986) (“The market for directors and officers liability insurance is currently in a state of crisis. Premiums are skyrocketing, deductibles are increasing at an extraordinary rate, coverage is shrinking, and more and more companies are terminating their D&O programs.”); Jay L. Kanzler, Jr., *A Look at the Director and Officer Liability Insurance Crisis: Insuring a Balance of Interests*, 19 N. KY. L. REV. 489 (1992); Ronald E. Mallen & David W. Evans, *Surviving the Directors and Officers Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439 (1987) (“The availability, price, and extent of coverage of D&O insurance has undergone a dramatic, if not revolutionary, change in the last two years.”); Galante, *The D&O Crisis: Corporate Boardroom Woes Grow*, Nat’l Law Journal, Aug. 4, 1986, at 29, col. 3; THE CRISIS IN DIRECTORS’ AND OFFICERS’ LIABILITY INSURANCE 3 (Law & Bus. 1986).

premiums skyrocketed, deductibles increased, and coverage was reduced.<sup>177</sup> According to a survey done by the Wyatt Company in 1985, premiums increased by about 190% between 1984 and 1985, and deductibles increased by almost 300%.<sup>178</sup> The median policy limit was reduced from \$25 million to \$15 million.<sup>179</sup> Overall, the total cost of a dollar of D&O insurance coverage was estimated to have risen by 500% between 1984 and 1985.<sup>180</sup> Worse than mere cost, however, was the fact that coverage was simply unavailable in some cases.<sup>181</sup> And sometimes insurers simply canceled a company's D&O policy if it feared it might be the target of a hostile takeover and subject to litigation.<sup>182</sup>

The cause of the crisis was an increase in both the amount of shareholder lawsuits as well as the cost of dealing with those suits. Shareholder derivative suits increased fourfold between 1984 and 1985.<sup>183</sup> In 1985, there were 500 claims of \$1 million or more against corporate directors, compared with only 2 in 1970.<sup>184</sup> By 1986, it was reported that managers of large firms ran a 20% chance of being named in a lawsuit in 1986.<sup>185</sup> And the cost of defending such suits also increased, as shareholders won increasingly large judgments under the federal securities laws<sup>186</sup>, state Blue Sky laws, and the "newly discovered" RICO

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<sup>177</sup> Roberta Romano, *What Went Wrong With Directors' And Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1 (1989); Ross L. Bennett, *Protecting Corporate Directors and Officers: Insurance and Other Alternatives*, 40 VAND. L. REV. 775 (1987).

<sup>178</sup> Romano, *supra* n. 175.

<sup>179</sup> Newport, *Protecting Directors Suddenly Gets Costly*, FORTUNE, Mar. 18, 1985, at 61.

<sup>180</sup> Taravella & Shapiro, *Psst... Do You Know a D&O Insurer?*, BUS. INS., Jul. 29, 1985, at 1.

<sup>181</sup> Ronald E. Mallen & David W. Evans, *Surviving the Directors and Officers Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439, 440-41 (1987); Hilder, *Liability Insurance Is Difficult to Find Now Directors, Officers*, WALL ST. J., Jul. 10, 1985 at 1, col. 6.

<sup>182</sup> This occurred, for example, when Unocal's insurer believed it would be the subject of a hostile takeover. Galante, *The D&O Crisis: Corporate Boardroom Woes Grow*, NAT'L LAW J., Aug. 4, 1986.

<sup>183</sup> Roberta Romano, *What Went Wrong With Directors' And Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1 (1989). See also Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 68 (1991) ("Litigation frequency did rise dramatically during the D&O insurance crisis years. More important, payouts increased in real terms over this period.").

<sup>184</sup> Michael A. Verespej, *Boardroom Roulette: Who's Ready to Risk His Personal Wealth to Sit on a Corporate Board?*, INDUSTRY WK., Aug. 10, 1987, at 48.

<sup>185</sup> Laurie Baum, *The Job Nobody Wants: Outside Directors Find That the Risks and Hassles Just Aren't Worth It*, Bus. Wk., Sept. 8, 1986, at 56.

<sup>186</sup> See Schropp et. al, *Liability for Insider Trading Under the Federal Securities Law*, in DIRECTORS AND OFFICERS LIABILITY 1986: A REVIEW OF THE BUSINESS JUDGMENT RULE 159, 171 (PLI 1986).

statute that allowed recovery for treble damages as well as attorney fees.<sup>187</sup> The average cost of paid claims rose from \$877,361 in 1980, to \$1,306,000 in 1984, to \$1,988,200 in 1986.<sup>188</sup> Average defense costs rose from \$318,255 in 1980, to \$461,000 in 1984, to \$592,000 in 1986.<sup>189</sup> Both types of cost far outpaced inflation.<sup>190</sup> Moreover, the increase in major corporate transactions in the late 1980s ensured that lawsuits against directors would continue. In addition to these direct causes, some pinned part of the blame on the structure of the insurance industry.<sup>191</sup>

Just as in the late 1960s,<sup>192</sup> fear spread that capable directors would refuse to serve on corporate boards.<sup>193</sup> Observers speculated that relatively modest director compensation—less than \$25,000 per year on average in 1985<sup>194</sup>, or about \$40,000 in 2002 dollars<sup>195</sup>—would not be sufficient to outweigh the risk of personal liability. And indeed, the number of independent directors on boards decreased.<sup>196</sup> Directors at several companies resigned, citing concern over

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<sup>187</sup> Ronald E. Mallen & David W. Evans, *Surviving the Directors and Officers Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439, 443 (1987); Roberta Romano, *What Went Wrong With Directors' And Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 7 (1989).

<sup>188</sup> Romano, *supra* n. 185 at 8.

<sup>189</sup> *Id.*

<sup>190</sup> An average defense cost of \$318,255 in 1980 would equal \$455,444 in 1986. The actual cost of \$592,000 was 33% higher. For a handy on-line inflation calculator, see <http://www.westegg.com/inflation/infl.cgi>.

<sup>191</sup> Romano, *supra* n. 185; *Insurance Industry, Courts Share Blame for Crisis: Report*, 132 CHI. DAILY L. J., Apr. 29, 1986 at 1, col. 2.

<sup>192</sup> See, e.g., Alfred Conard, *A Behavioral Analysis of Director's Liability for Negligence*, 1972 DUKE L.J. 895, 903 (1972) ("If the available indemnification procedures and insurance coverage do not provide a sense of security, people may refuse to serve as directors.").

<sup>193</sup> Dennis J. Block, et. al., *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L.J. 130, 131 (1986) (noting that D&O liability insurance may not be available to the corporation, causing such companies to 'go naked,' the result being that the directors may choose to resign rather than risk liability.); *Financial Boards Say It's Harder to Attract Qualified Directors*, 162 J. ACCT 39 (1986); *Director Roundtable: The D&O Crisis and Board Liability*, 10 DIRECTORS AND BOARDS 8 (1986).

<sup>194</sup> The average director of an industrial company earned \$24,624 in 1985; the average director of a financial organization was paid \$21,290. Barker, *Director Compensation: Board Fees and Benefits 1986*, 10 DIRECTORS AND BOARDS, Spring 1986, at 37.

<sup>195</sup> Scaled at Consumer Price Index 1985-2002. See *supra* n. 188.

<sup>196</sup> The Wall Street Journal reported that the percentage of outside directors on corporate boards of the largest 1,000 industrial corporations dropped from 63.2 percent to 57.5 percent in 1985. Wall St. J., March 24, 1987 at 1.

potential legal liability.<sup>197</sup> One executive search firm noted that only 2 out of 5 director candidates would accept invitations to serve on a board in 1985, down from about 4 at the beginning of the decade;<sup>198</sup> other studies found similar results.<sup>199</sup> By 1986, Business Week proclaimed on its cover that a corporate directorship was the “job nobody wants.”<sup>200</sup> The article concluded that for the first time “since the mid-1960s,” the make-up of boards was shifting to company insiders.<sup>201</sup> Much as today, the issue was not only director liability but also that the job had become more strenuous than before.<sup>202</sup> Some predicted “an exodus of talented individuals from corporate service.”<sup>203</sup>

Against this backdrop, the Delaware Supreme Court’s decision in *Smith v. Van Gorkom*<sup>204</sup> was a stunning additional setback for management. In

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<sup>197</sup> Laurie Baum, *The Job Nobody Wants: Outside Directors Find That the Risks and Hassles Just Aren’t Worth It*, Bus. Wk., Sept. 8, 1986, at 56; *Crutcher’s Chairman and 3 Directors Quit; Lack of Insurance Cited*, WALL ST. J., Feb. 12, 1986, at 21, col. 2; Lewin, *Director Insurance Drying Up*, N.Y. TIMES, Mar. 7, 1986 at D1, col. 3 (“Just in the last six months, the Control Data Corporation, the Continental Steel Corporation, the Lear Petroleum Corporation, South Texas Drilling and Exploration Inc., and Sykes Datatronics have all lost directors when their insurance ended.”); Fowler, *Scarce Corporate Directors*, N.Y. Times, Jan. 7, 1986, at D20, col. 1; Stevenson, *Is it Safe to be a Bank Director?*, BANKERS MONTHLY, Jun. 15, 1986, at 13; Michael A. Verespej, *Boardroom Roulette: Who’s Ready to Risk His Personal Wealth to Sit on a Corporate Board?*, INDUSTRY WK., Aug. 10, 1987, at 48; Schatz, *Corporate Boards Aren’t What They Used to Be*, L.A. DAILY J., Dec. 18, 1985 at 1, col. 1.

<sup>198</sup> Baum, *supra* n. 195.

<sup>199</sup> IRRIC, *Limiting Director Liability*, CORP. GOVERNANCE SERVICE 1-3 (1986) (“A recent survey indicated that in one of every five companies a qualified candidate refused to join the board, the highest rate that had been reported in recent years.”).

<sup>200</sup> Baum, *supra* n. 195 (reporting 10 instances of mass resignations of outside directors from corporate boards since 1984 because of inability to secure liability coverage).

<sup>201</sup> Baum, *supra* n. 195.

<sup>202</sup> R. Link Newcomb, *The Limitation of Directors’ Liability: A Proposal For Legislative Reform*, 66 TEX. L. REV. 411, 433 n. 122 (1987) (reporting a survey showing that as a reason for resignation, time demands increased to 26% in 198 from 16% in 1985).

<sup>203</sup> Dennis J. Block, et. al., *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L.J. 130, 132 (1986).

<sup>204</sup> 488 A.2d 858 (Del. 1985). Other decisions at the time also challenged directors’ judgment in connection with a merger. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (holding directors may not consider interests of non-shareholder stakeholders when sale or breakup of company becomes inevitable); *Hanson Trust PLC v. MCSCM Acquisition Inc.*, 781 F.2d 264, 273 (2d Cir. 1986) (holding that reliance on Goldman Sachs fairness opinion held not sufficient to satisfy requirements of business judgment rule); *Edelman v. Fruehauf Corp.*, 798 F.2d 882 (6th Cir. 1986) (following Revlon).



this case, a 3-2 majority of the Supreme Court held that Trans Union's directors breached their duty of care in approving a cash-out merger proposal, even though the court acknowledged they acted in good faith and the premium was between 39-62% over the current market price.<sup>205</sup> Also startling was that shareholder ratification of the deal provided no protection, for the court found the directors violated their fiduciary duty of candor by failing to disclose their deficient deliberative procedures.<sup>206</sup> What is more, five of the ten Trans Union directors were independent, with four experienced CEOs and one a former dean of a prominent business school.<sup>207</sup> Nevertheless, Van Gorkom's fast-and-loose style—he arranged the merger in haste, chose a price per share with little if any analysis, and executed the agreement at the Chicago Lyric Opera—overwhelmed the mitigating factors in the eyes of the majority.<sup>208</sup>

The dissent vigorously criticized the court's holding given the elements of the case that traditionally called for judicial deference, and derided the opinion as a comedy of errors.<sup>209</sup> The insurance company in Van Gorkom was required to contribute \$10 million, the policy limit, and the directors were responsible for the remainder of the \$23.5 million settlement.<sup>210</sup> The case made it clear that the business judgment rule would not provide complete protection from personal liability for breaches of the duty of care, regardless of the good faith of the directors involved. Not surprisingly, Van Gorkom generated a deluge of criticism.<sup>211</sup> After Van Gorkom, concern over the ability to attract

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<sup>205</sup> 488 A.2d 858 (Del. 1985); Stephen A. Radin, *The Directors' Duty of Care Three Years After Van Gorkom*, 39 HASTINGS L. J. 707 (1988).

<sup>206</sup> 488 A.2d 858 (Del. 1985).

<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

<sup>210</sup> Sara R. Slaughter, *Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis*, 63 IND. L.J. 181, 184 (1988). The acquiring company ended up relieving the directors from some of the burden of liability. *Id.*

<sup>211</sup> See, e.g., Moskin, *Trans Union: A Nailed Board*, 10 DEL. J. CORP. L. 405 (1985); Borden, *First Thoughts on Decision in Delaware on Trans Union*, N.Y.L.J., Feb. 25, 1985, at 1, col. 3; Burgman & Cox, *Corporate Directors, Corporate Realities and Deliberative Process: An Analysis of the Trans Union Case*, 11 J. CORP. L. 311(1986); Chittur, *The Corporate Director's Standard of Care: Past, Present, and Future*, 10 DEL. J. CORP. L. 505 (1985); Kirk, *The Trans Union Case: Is It Business Judgment as Usual?*, 24 AM. Bus. L.J. 467 (1986); Middleton, *Merger Decision Lawyers See Warning in Court's View of Business Judgment Standard*, 23 NAT'L L.J., Feb. 18, 1985, at 8, col. 1; Prickett, *An Explanation of Trans Union To "Henny-Penny" and Her Friends*, 10 DEL. J. CORP. L. 451 (1985); (footnote continued)

qualified candidates to serve on corporate boards reached new heights,<sup>212</sup> and the State of Delaware had a golden opportunity to come to the rescue of nervous directors and profit handsomely in the market for corporate charters.

### B. Legislative Response

In response to *Van Gorkom* and the D&O crisis, in 1985 a Council of the Corporate Law Section of the Delaware State Bar Association was appointed to consider legislative solutions.<sup>213</sup> In devising its proposal, the Council considered the importance of outside directors, the need to offer insurance to attract competent directors, the crisis in the D&O insurance market, and the overall threat to the quality and stability of corporate governance in Delaware.<sup>214</sup> It considered and rejected certain ideas: imposing a statutory cap on damages was seen as unfair to directors of lesser means; while indemnification in derivative judgments or settlements would allow circular payments and wasteful litigation.<sup>215</sup> Eventually the Council agreed that allowing the corporation to limit liability was the most direct response to the problem, and in June 1986 it submitted what is now section 102(b)(7) of the Delaware Code as proposed

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Quillen, *Trans Union, Business Judgment, and Neutral Principles*, 10 DEL. J. CORP. L. 465 (1985); Schwartz & Wiles, *Business Judgment Rule Clarified by Delaware's Trans Union Decision*, Nat'l L.J., July 8, 1985, at 42, col. 3; Veasey, *Further Reflections on Court Review of Judgments of Directors: Is the Judicial Process Under Control?*, 40 BUS. LAW. 1373 (1985); Veasey & Seitz, *The Business Judgment Rule in the Revised Model Act, The Trans Union Case and the ALI Project—Strange Porridge*, 63 TEX. L. REV. 1483 (1985); Note, *Corporations Directors Who Approve Sale of Corporation Without Sufficient Deliberation Not Entitled to Protection Afforded by Business Judgment Rule—Smith v. Van Gorkom*, 16 SETON HALL L. REV. 242 (1986); Comment, *Mining the Safe Harbor? The Business Judgment Rule After Trans Union*, 10 DEL. J. CORP. L. 545 (1985); Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW 1 (1985).

<sup>212</sup> See, e.g., Rock, *Will The Liability Crisis Undo The Corporate Board?*, DIRECTORS AND BOARDS 2 (Winter 1986); Lynne A. Whited, Note, *Corporate Directors—An Endangered Species?*, 1987 U. ILL. L. REV. 495 (1987).

<sup>213</sup> Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 914 (1990).

<sup>214</sup> R. Frank Balotti & Mark J. Gentile, *Elimination Or Limitation Of Director Liability For Delaware Corporations*, 12 DEL. J. CORP. LAW 5, 10 (1987).

<sup>215</sup> Veasey, Finkelstein & Bigler, *Responses to the D&O Insurance Crisis*, 19 REV. SEC. & COMM. REG. 263 (1986). Derivative suits may be circular and wasteful nevertheless. Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 72 (1991) (finding derivative suits a “weak, if not ineffective” constraint on directors due in part to indemnification and insurance buffering directors from personal liability).

legislation to the General Assembly.<sup>216</sup> A synopsis accompanying the proposal emphasized that it was a direct response to the crisis in D&O insurance,<sup>217</sup> contemporaneous commentary by the Chair of the Corporate Law Section of the Delaware bar indicated that *Van Gorkom* was also a target.<sup>218</sup> On June 18, the Governor of the State of Delaware signed into law Senate Bill No. 533 which amended section 102 of the Code to add a new subsection (b)(7). Other minor amendments were also made to Section 145 governing indemnification.<sup>219</sup>

Section 102(b)(7), effective July 1, 1986, authorized the inclusion of a provision in the certificate of incorporation eliminating the personal liability of directors to the corporation or its stockholders for monetary damages for breach of the fiduciary duty of care.<sup>220</sup> Not only does the statute benefit directors by shielding them from monetary liability, but it also protects them from the significant distraction and reputational harm associated with many lawsuits.<sup>221</sup> Still, certain conduct is exempt from the statute's protective ambit, including breaches of duty of loyalty, acts or omissions not in good faith, intentional misconduct, knowing violations of law, and acts for which a director gains improper personal benefit.<sup>222</sup> Nor does it apply to officers, employees, or agents, who were not thought by the drafters to be as likely to leave a corporation due to the fear of legal liability as directors unable to secure liability insurance.<sup>223</sup> Although 102(b)(7) did not solve the problem of attracting capable directors,<sup>224</sup>

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<sup>216</sup> Unusually, there was some controversy in the Delaware Bar Association about the new law. See Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 Del. J. Corp. L. 914 (1990) (prominent corporate attorney Bruce Stargatt opposed the proposal).

<sup>217</sup> See DEL. CODE ANN. tit. 8, § 102 (amended 1986) (Synopsis).

<sup>218</sup> See Gilchrist Sparks III, *Delaware's D&O Liability Law: Other States Should Follow Suit*, LEGAL TIMES, Aug. 18, 1986, at 10, col. 1.

<sup>219</sup> Stacy D. Blank, *Delaware Amendment Relaxes Director' Liability*, 44 WASH. & LEE L. REV. 111 (1987) (corporations may adopt general policy of advancing litigation expenses rather than approving expenses case-by-case, and nonexclusivity clarified so that it was clear that expenses could be advanced on terms other than those in statute).

<sup>220</sup> DEL CODE STAT ANN tit. 8, § 102(b)(7).

<sup>221</sup> Sara R. Slaughter, *Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis*, 63 IND. L.J. 181, 184 (1988).

<sup>222</sup> DEL CODE STAT ANN 8, § 102(b)(7).

<sup>223</sup> Sparks, *Delaware's D&O Liability Law: Other States Should Follow Suit*, Legal Times, Aug. 18, 1986, at 10, col. 1.

<sup>224</sup> *Once-Coveted Directors' Posts Go Begging*, USA TODAY, June 27, 1990 at B1 (the former "dream job" is being rejected by many. "Now some firms are being forced to approach five to ten potential board members before they find one to take the job.")

and drew its share of criticism,<sup>225</sup> it was warmly welcomed by corporations and set off what was probably the largest migration of firms to Delaware in absolute terms in its history.

### C. Reincorporation Surge

Several years after it was passed, Section 102(b)(7) was called “a new weapon to protect Delaware’s position in the market for corporate franchises.”<sup>226</sup> The weapon was potent indeed.<sup>227</sup> The years of 1986 and 1987 saw 66 NYSE firms reincorporate into Delaware, or over 20% of the total number of NYSE reincorporations to Delaware in the past 40 years. Delaware’s market share of NYSE firms rose from about 40% in the early 1980s to over fifty percent by 1988.<sup>228</sup> Delaware increased its share of new incorporations as well, with the number of new incorporations jumping 28% in the six months following the new provision’s enactment.<sup>229</sup> This alone was estimated to account for \$1.4 million in additional franchise fees, but the large NYSE firms probably contributed far more to the Delaware’s treasury.<sup>230</sup> In 1983, Delaware’s was collecting about \$80 million in franchise taxes; in 1987 it collected almost double that amount, bringing in over \$150 million in such fees.<sup>231</sup> In addition to the firms moving to Delaware, hundreds of corporations already incorporated in Delaware amended or their charters in order to add exculpatory provisions and benefit from the new

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<sup>225</sup> Slaughter, *supra* n. 219 (“These statutory responses are overprotective, and they diminish the deterrence normally imposed by the threat of liability... The law strips shareholders of their traditional right to seek monetary damages from directors who breach their duty of care.”); Diane L. Saltoun, *Fortifying the Directorial Stronghold: Delaware Limits Director Liability*, 29 B. C. L. REV. 481 (1988).

<sup>226</sup> Mark A. Sargent, D&O LIABILITY HANDBOOK i (1990).

<sup>227</sup> See, e.g., Dennis R. Honobach, *All That Glitters: A Critique Of The Revised Virginia Stock Corporation Act*, 12 J. CORP. L. 433, 471 at n. 230 (1987) (“Many Delaware corporations apparently have found [102(b)(7)] attractive; many non-Delaware corporations have indicated their intention to reincorporate in Delaware to avail themselves of the protection afforded their directors by the section.”)

<sup>228</sup> See Appendix B.

<sup>229</sup> Franklin, *D&O Dilemma: NY, Other States Grapple With Liability Issue*, N.Y.L.J., Jan .23, 1987 at 6, col. 2.

<sup>230</sup> *Id.*

<sup>231</sup> ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 7 (1993) (the share of total tax revenues represented by franchise taxes also grew by almost 20% during this time).

law.<sup>232</sup> The cause of this surge of incorporations was of course no secret to Delaware; one observer commented that the state “is boasting that its new law... has attracted business like bees to honey.”<sup>233</sup>

Unlike in the migration to Delaware in the late 1960s, it is far more clear that a main purpose of reincorporation for corporate boards was to avail themselves of the protections of section 102(b)(7). Unlike in the 1960s, section 102(b)(7) was by far the most important legal change made by Delaware in 1986—it was a targeted response to a particular problem rather than an overall code revision. Another reason, however, is direct evidence: one study of 32 migrating firms found that fully 28, or 88%, referred to section 102(b)(7) specifically in their proxy statements as a reason for the move.<sup>234</sup> This same study found that more than half of the migrating firms came from California, which had developed a much stricter approach to indemnification in code revisions in the mid-1970s.<sup>235</sup> Given that managers would likely exercise some discretion in trumpeting their desire to dodge lawsuits from shareholders, this level of disclosure is surprising and suggests that section 102(b)(7) was a driving motivation for the decision of many firms to reincorporate in Delaware at this time.

#### *D. Imitation by Other States*

Anyone could see that Delaware was on to something, and many other states took very little time to duplicate its provision or to go even further in

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<sup>232</sup> James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1216 (1988) (citing as examples Archer-Daniel-Midland Co.; Baker Int'l Corp.; Chrysler Corp.; Coca-Cola Co.; Control Data Corp.; Crown Books Corp.; Delta Air Lines; Fort Howard Corp.; General Motors Corp.; General Mills; Harper & Row, Publishers; Outboard Marine Corp.; Pillsbury Co.; USX Corp.). R. Link Newcomb, *The Limitation Of Directors' Liability: A Proposal For Legislative Reform*, 66 TEX. L. REV. 411, 438 (1987) (“Of the corporations that have presented or plan to present charter provisions to shareholders under the new Delaware law, initial signs indicate that nearly ninety percent have opted for no-liability provisions.”).

<sup>233</sup> Franklin, *D&O Dilemma: NY, Other States Grapple With Liability Issue*, N.Y.L.J., Jan .23, 1987 at 6, col. 2.

<sup>234</sup> Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 66 (1989).

<sup>235</sup> *Id.*

responding to the director liability crisis.<sup>236</sup> As the 1988 Survey of American Corporate Law aptly summarized:

Subsequent to Delaware's enactment of this and related statutes, more than two-thirds of Delaware's corporations have indicated their desire to implement this amendment. In addition, many corporations organized outside Delaware are considering reincorporating there. This potential corporate flight spurred other state governments to pass similar legislation.<sup>237</sup>

Although few if any states likely believed they were "competing" with Delaware in the sense of having a chance to unseat it as the dominant state for corporate charters, legislative change was nonetheless imperative as a defensive matter to stem the flow of firms to Delaware.<sup>238</sup> In this section, as in the analysis of the 1967 changes, I limit the analysis to the states in which over 10 NYSE firms were listed as incorporated in 1985. There were 21 such states in 1985. Four states took steps to address the liability crisis with Delaware in 1986; thirteen moved in Delaware's direction by 1987; and four failed to match Delaware during this time. These responses are summarized in Appendix E. As we saw in the late 1960s, those states that acted quickly lost the least companies to Delaware, while laggards were punished for their lack of responsiveness: those that acted in 1986 lost less than 3% of their firms to Delaware; those that acted in 1987 lost 8 percent; and those that failed to keep up to Delaware lost over 20 percent.<sup>239</sup> In this section, I describe the legislative changes in the three categories of states noted above, before conducting statistical tests to confirm the significance of the observed relationships.

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<sup>236</sup> See Karen Leigh Chapman, *Statutory Responses to Boardroom Fears*, COLUM. BUS. L. REV. 1987 ("The seemingly constant battle between the states for corporate charters has produced another round of amendments to many state statutes."); see also *Delaware's Limit on Director Liability: How the Market for Incorporation Shapes Corporate Law*, 10 HARV. J. L. & PUB. POL'Y 665 (1987).

<sup>237</sup> James E. Kaye, *Corporate Law: Statutory Developments in Directors' Liability--State Responses to Smith v. Van Gorkom*, 1988 ANN. SURV. AM. L. 429, 453 (1988).

<sup>238</sup> Diane L. Saltoun, *Fortifying the Directorial Stronghold: Delaware Limits Director Liability*, 29 B. C. L. REV. 481 (1988) ("States that do not want to lose their corporate business to Delaware have rushed to propose similar amendments to their respective corporation laws.").

<sup>239</sup> This is consistent with data showing that states that are most responsive in updating their corporate laws gain the most charter revenue as a percentage of their total revenues. See *Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985).

The four states in the sample to take action on director liability in the same year as Delaware were Indiana, Ohio, Pennsylvania, and Massachusetts.<sup>240</sup> Indiana not only implemented its statute slightly earlier in 1986 than Delaware, but also made it self-executing to apply to all Indiana corporations without a shareholder vote and without the possibility of opt-out.<sup>241</sup> The Indiana Supreme Court has characterized the statute as a “strongly pro-management version of the business-judgment rule.”<sup>242</sup> Ohio took a similar approach, passing an emergency amendment on November 22, 1986 that automatically limited director liability for money damages for duty of care violations by requiring the plaintiff to show “clear and convincing” evidence of deliberate intent or reckless disregard of the best interests of the corporation.<sup>243</sup> Pennsylvania’s “Corporate Director Liability Act” was signed into law a week later on November 28; unlike Indiana and Ohio, it followed Delaware in giving corporations the option to limit liability, though it allowed corporations to do so in the bylaws rather than only the charter.<sup>244</sup> Massachusetts adopted Delaware section 102(b)(7) nearly verbatim on December 24, 1986.<sup>245</sup> Reincorporation data show that the alacrity of these states paid off. Of the 138 NYSE firms in these states in 1985, only 4 firms (less than 3% of the total) moved to Delaware in the years of 1986 and 1987.<sup>246</sup> Perhaps because it

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<sup>240</sup> Tennessee also passed a charter-option statute in this year, but it hosted only 7 NYSE firms in 1985 and so is not included in the analysis.

<sup>241</sup> See 1988 SURVEY OF AMERICAN LAW 449 (1988). On the Indiana statute, see generally Simcox, *The Indiana Business Corporation Law: Tool for Flexibility, Simplicity and Uniformity*, 20 IND. L. REV. 119, 129-30 (1987); Cox, *The Indiana Experiment in Corporate Law: A Critique*, 24 VAL. U. L. REV. 185 (1990). Four other states adopted a self-executing statute along the lines of Indiana’s in 1987: Ohio, Wisconsin, Florida, and Maine. *Id.*

<sup>242</sup> *G&N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 238 (Ind. 2001).

<sup>243</sup> See generally Deborah Cahalane, *1986 Ohio Corporation Amendments: Expanding the Scope of Director Immunity*, 56 U. CIN. L. REV. 663 (1988). The D&O LIABILITY HANDBOOK 473 (2004) calls this “an unusual and very broad self-executing liability limitation.” The Ohio Legislative Committee cited the legal innovation in Delaware as a reason immediate change was necessary. See Cahalane, *supra* n. 241 (citing Committee Comment (1986) § 1701.59).

<sup>244</sup> Karen Leigh Chapman, *Statutory Responses to Boardroom Fears*, 1987 COLUM. BUS. L. REV. 762 (1987) (citing *D&O Liability: New Pennsylvania Law Permits Limits on Directors’ Liability*, LIABILITY & INSURANCE BULLETIN, Dec. 8, 1986, at 1.).

<sup>245</sup> Survey, *Selected Developments in Massachusetts Law*, 30 B.C. L. REV. 601, 748-50 (1989).

<sup>246</sup> Although these states all eventually adopted anti-takeover statutes, neither Pennsylvania nor Ohio had amassed them significantly before 1988 (Pennsylvania had one such statute). See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002). The relevance of antitakeover statutes is tested more formally below, and they are found not to be a statistically (footnote continued)

had already amassed 4 antitakeover statutes by 1987, Indiana lost not a single firm to Delaware during this time.

Many more states enacted legislation exceeding or at least equaling Delaware in 1987. Four states – Florida, Wisconsin, Texas, and Nevada—followed Indiana and Ohio’s aggressive approach by adopting self-executing provisions that shielded directors from liability without shareholder approval.<sup>247</sup> The Wisconsin legislature, like Indiana, chose to make the liability limitation self-executing but unlike Indiana allowed corporations to opt-out through an amendment to the articles of incorporation.<sup>248</sup> Florida made a similar choice in 1987, granting directors immunity from personal liability for money damages in respect to “any statement, vote, decision, or failure to act, regarding corporate management or policy,” unless there is a breach of duty by the director and the breach constitutes one of five circumstances paralleling the exceptions in Delaware.<sup>249</sup> Virginia enacted a one-of-a-kind approach combining a self-executing limitation on liability and an absolute cap on money damages.<sup>250</sup> Eight other states in the sample were less creative, implementing substantial duplicates of Delaware’s 102(b)(7) in 1987; these were: Colorado, Georgia, Maryland, Michigan, Minnesota, New Jersey, New York, and North Carolina.<sup>251</sup> Reincorporation data indicates that these states also shielded the great majority of their firms from the migration to Delaware, though they did not do as well as

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significant predictor of a state’s ability to prevent firms from moving to Delaware during this time.

<sup>247</sup> See FLA. STAT. ANN. § 607.1645 (West. Supp. 1988); ME. REV. STAT. ANN. tit. 13-A, § 716 (Supp. 1989); WIS. STAT. ANN. § 180.307 (West Supp. 1989).

<sup>248</sup> R. Link Newcomb, *The Limitation Of Directors’ Liability: A Proposal For Legislative Reform*, 66 TEX. L. REV. 411, 439 (1987).

<sup>249</sup> Riah R. Seuradge, *Note: The Personal Liability of Directors in Florida: Whose Corporation Is It Anyway*, 15 NOVA L. REV. 1390 (1991).

<sup>250</sup> 1988 SURVEY OF AMERICAN LAW 453-54 (“This novel approach comes closest to extending the concept of shareholder limited liability to directors and officers.”). See generally Dennis R. Honabach, *All That Glitters: A Critique Of The Revised Virginia Stock Corporation Act*, 12 J. CORP. LAW 433, 443 (1987).

<sup>251</sup> COLO. REV. STAT. § 7.2-102, 7-3-101(1)(u) (Supp. 1988); GA. CODE ANN. § 14-2-202(b)(4) (Supp. 1988); MICH. COMP. LAWS § 450.1209 (Supp. 1988); MINN. STAT. ANN. § 302A.111(4)(v), 302A.251(4) (West Supp. 1989); Act of Mar. 18, 1987, ch. 28, § 2(1), 1987 Nev. Stat. 80; N.J. STAT. ANN. § 14A:2-7(3) (West Supp. 1988); N.Y. BUS. CORP. LAW § 402(b)(1) (McKinney Supp. 1989); North Carolina, N.C. GEN. STAT. § 55-7(11) (Supp. 1988); TEX. CORPS. & ASS’NS CODE ANN. § 1302-7.06(B) (Vernon Supp. 1989).



their more enthusiastic counterparts. Of the 389 NYSE firms headquartered in these states in 1985, 30 (about 8%) reincorporated in Delaware in 1986 or 1987.

Evidence indicates that these states didn't merely stumble into preventing so many firms from moving to Delaware; instead, stemming the outflow was a key motivation for the passage of such laws.<sup>252</sup> A Michigan Legislative Service Report made the call for action in 1987 bluntly: "Unless Michigan acts, a number of Michigan corporations may find it necessary to reincorporate in Indiana or Delaware in order to retain and attract directors of quality."<sup>253</sup> A legislative report in Virginia sounded a similar theme, warning that liability-limiting legislation in other states was superior to that in Virginia, and "enhances the attractiveness of these states as sites for incorporation."<sup>254</sup> The Minnesota Bar Association submitted a report to the legislature that supported duplicating Delaware's section 102(b)(7) in order to "lessen the risk that corporations will reincorporate in Delaware."<sup>255</sup> A Florida Senate

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<sup>252</sup> The phenomenon of reincorporation in Delaware was not a secret at the time. *See generally* Herzel, *Law Should Allow Indemnity for Derivative Suits*, LEGAL TIMES, Mar. 31, 1986, at 11, col. 1 ("as directors and officers have become more exposed to a large degree of liability, corporations are reincorporating in states which offer the greatest amount of liability protection in an effort to retain an attract talented directors"); *see also Delaware's Limit on Director Liability: How the Market for Incorporation Shapes Corporate Law*, 10 HARV. J. L. & PUB. POLY 665 (1987) ("[Section 102(b)(7)] enhances managerial discretion while reducing shareholder influence in the corporation and will thereby promote the continued choice and use of Delaware as a corporate domicile.").

<sup>253</sup> Link R. Newcomb, *Limitation of Directors' Liability: A Proposal for Legislative Reform*, 66 TEX. L. REV. 439 (1987) (citing Michigan Legis. Serv. Bureau, Section by Section Comments on Proposed Bill To Amend Provisions of Michigan Business Corporation Act Relating to Director Liability and Officer and Director Indemnification 2 (1987) (unpublished report)). *See also* Megan M. Maher, *Director Liability: Michigan's Response to Smith v. Van Gorkom*, 33 WAYNE L. REV. 1039, 1042 (1986) ("modification of the Michigan Act is necessary to protect directors from personal liability, to keep qualified directors on corporate boards, and to prevent Michigan corporations from reincorporating in states that have more accommodating liability, indemnification, and insurance statutes.").

<sup>254</sup> *See* Newcomb, *supra* n. 251 at 439 (citing A PROPOSAL TO REFORM THE LAW OF DIRECTORS' AND OFFICERS' LIABILITY IN VIRGINIA 10 (1986) (unpublished report) (noting that "either the New York or the Delaware approach to liability affords the director greater protection against personal financial losses than is currently the case in Virginia," and warning of possible outflow of corporations).

<sup>255</sup> *See* Paul E. Overson, *Limited Liability of Corporate Directors under Minnesota Statute 302A.251, Subdivision 4*, 11 HAMLIN L. REV. 372 (1987) (citing Legislative Position of the Section on (footnote continued)

Committee justified its self-executing statute by citing the need to encourage incorporations in Florida.<sup>256</sup> Virginia noted a similar motivation.<sup>257</sup> New York felt the pressure too. New York State Assemblyman Genovesi, writing in support of a 1987 bill to limit director liability, warned of an impending “exodus” of firms from New York:

Unless some measures are taken by the legislature to limit the circumstances under which company managers can be sued, this crisis will continue. Faced with a choice of remaining in New York or moving to one of a number of jurisdictions where the standard of liability has been modernized, many large and small companies will... exit the state to take advantage of what logically will follow from the modernized standard—lower insurance risk and therefore lower insurance premiums. In fact, there is already evidence of such an exodus.<sup>258</sup>

What is more, this sentiment was not limited to states that boasted a fair number of public companies. Even Utah, which probably had less than a 1% share of the market for NYSE charters in 1985, and was thus an insignificant player from Delaware’s perspective, cited the need to retain corporations as a reason to limit director liability.<sup>259</sup> Scholars who believe there is no competition for corporate charters might point to a state like Utah as evidence of a lack of

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Corporation, Banking, and Business Lawyers of the Minnesota State Bar Association, Nov. 15, 1986).

<sup>256</sup> Riah R. Seuradge, *Note: The Personal Liability of Directors in Florida: Whose Corporation Is It Anyway*, 15 NOVA L. REV. 1390 (1991) (citing FLA. SENATE. STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT 7-8 (1987)).

<sup>257</sup> Dennis R. Honabach, *All That Glitters: A Critique Of The Revised Virginia Stock Corporation Act*, 12 J. CORP LAW 433, 443 (1987).

<sup>258</sup> Jeffrey S. Rosenberg, *Of Synergies of Evidence and Section 402(b)(1): Hanson Trust, Revlon, Van Gorkom, and the Imminent Demise of the First Wave of Corporate Director Liability Statutes*, 52 ALB. L. REV. 559 (1987) (citing Memorandum of Assemblyman Anthony Genovesi in Support of S.4138.) *See also id.*, citing Memorandum of Senator Schermerhorn in Support of S.4138, at 4, in Bill Jacket Accompanying Act of July 23, 1987, ch. 367, 1987 N.Y. Laws 2250 (urging New York to remain “in step” with other states with respect to liability-limiting legislation).

<sup>259</sup> *See, e.g.*, James D. Gilson, *Utah’s Statute Permitting Limits on Corporate Director’s Liability: A Guide for Lawyers and Directors*, 1988 UTAH L. REV. 848 (1988) (“Some Utah legislators also argued that legislation limiting director liability would help the state remain competitive in retaining and attracting businesses,” citing Floor Debate, remarks by Sen. Paul Rogers and Sen. Haven Barlow, 47th Utah Leg., Gen. Sess. (Feb. 2-3, 1987) (Sen. Recording Nos. 42 side 1, 43 side 2)).

objective competition. In fact, however, state legislators there have been sensitive to losing corporations to other states and have modified their legislative behavior accordingly.

These pressures did not persuade every legislature to act though, and there are a handful of laggards that either took no action or passed liability-limiting laws of far lesser force than Delaware's section 102(b)(7). There are four states in the sample in this category: California, Connecticut, Illinois, and Missouri.<sup>260</sup> The latter three states took no action during this time, but California did make a legislative change in 1987. The reason California is excluded from the 1987 cohort is that the statute passed in 1987 did little if anything to prevent directors from being held liable in a future *Van Gorkom* situation in that state. California made exceptions in its statute for recklessness and for patterns of inattention, forms of negligence not expressly exempt from the Delaware statute.<sup>261</sup> As one treatise on indemnification law maintains, these exceptions were seen as "particularly troublesome given the increased attention being paid to the director's duty to monitor."<sup>262</sup> The California statute also restricted its coverage to actions brought "by or in the right of the corporation," excluding actions—such as that in *Van Gorkom*—brought directly by shareholders, and thus *Van Gorkom* could happen in California despite its statute.<sup>263</sup> California also included a highly unusual cross-reference in its statute such that liability could only be limited where the director's conduct satisfied an explicit standard calling for good faith and the care of an ordinary person in a like position in similar circumstances.<sup>264</sup> When these exceptions and statutory cross-references are taken together, it can fairly be said that as a statutory matter (leaving aside the judicial business judgment rule), California allowed liability

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<sup>260</sup> The following other states, not in the sample, had not enacted a director liability statute by 1992: Alabama, Mississippi, North Dakota, South Carolina, Vermont, and West Virginia. Sondra J. Thorson, *Protecting Shareholders: Illinois Needs a Director Liability Statute*, 26 J. Marshall L. Rev. 105 (1992).

<sup>261</sup> See DIRECTOR & OFFICER LIABILITY HANDBOOK 66 (2004) (finding these exceptions "particularly troublesome given the increased attention being paid to the director's duty to monitor.").

<sup>262</sup> DIRECTOR & OFFICER LIABILITY HANDBOOK 66 (2004).

<sup>263</sup> See COX & HAZEN ON CORPORATIONS 10.08 (2003) (highlighting this as a "notable difference" between the California approach and that of other states).

<sup>264</sup> JOSEPH BISHOP, LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE § 7:27 (2004).

for ordinary negligence even after it adopted its statute in 1987.<sup>265</sup> Directors worried about a future *Van Gorkom* would find very little to comfort them in California's statute.

Reincorporation data indicate the laggards paid a heavy price for their inaction. In 1986 and 1987, over 1 in 5 of the NYSE firms that were incorporated in these states in 1985 reincorporated in Delaware; if we look at 1986-1990, the number rises to over 1 in 4 NYSE firms moving to Delaware.<sup>266</sup> This compares to an average migration rate of fewer than 1 in 12 NYSE firms during this time for all other states. This is despite the fact that some states, such as Missouri and Illinois, enacted significant antitakeover legislation during this time.<sup>267</sup> Illinois, for example, lost half of its 32 public firms in 1985 to other states by 1992 despite having enacted an "other constituency" statute and a fair price statute in 1985, and a pill validation and business combination statute in 1989.<sup>268</sup> Given this exodus of firms from Illinois, whose legislature had rejected a proposal to limit liability in 1989,<sup>269</sup> it is no wonder that calls arose in the early 1990s to take action on director liability.<sup>270</sup>

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<sup>265</sup> See Carol Seidler, *Assessing the Wisdom of the Business Judgment Rule in Corporate Control Contests: Is It Time to Make Shareholders' Interests Paramount*, 23 LOY. L. A. L. REV. 923 (1990) ("California's standard for director conduct... is framed in more rigorous terms than Delaware's or Indiana's because director liability may be based on a showing of ordinary negligence.").

<sup>266</sup> Leaving California aside, the three other states lost 17% of their NYSE firms to Delaware in 1986 and 1987 and 21% by 1990.

<sup>267</sup> See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1828 (2002). Illinois enacted an "other constituency" statute and a fair price statute in 1985, and a pill validation and business combination statute in 1989. Missouri enacted a constituency state, business combination statute, and fair price statute in 1986 and a control share acquisition statute in 1987. *Id.*

<sup>268</sup> *Id.*

<sup>269</sup> LEGIS. SYNOPSIS & DIG., 85th Ill. Gen. Assembly, 1988 Sess., at 268 (No. 11, Vol. I) (1988); 1 J.H.R. 778 (1988).

<sup>270</sup> Sondra J. Thorson, *Protecting Shareholders: Illinois Needs A Director Liability Statute*, 26 J. MARSHALL L. REV. 105 (1992). For a similar request of Alabama, see Marc W. Macoy, *A Call for Statutory Limitation of Director Liability in Alabama*, 42 ALA. L. REV. 195 (1991) ("Similar statutes [to Delaware's] have also been adopted by a majority of states. Alabama, however, has yet to adopt a statute permitting the limitation of director liability. This Comment... proposes the adoption of a statute permitting the limitation of director liability.").

The differences between these groups of states may be interesting, but are they statistically meaningful? To review, we have seen that states that took action in 1986 lost less than 3% of their firms to the Diamond State in 1986 and 1987; those that followed Delaware in 1987 lost just about 8 percent of their firms to Delaware during that time; and states that did not follow Delaware by 1987 lost 24 percent of their firms in the same time period. The following table summarizes the data:

	# of States	Mean Loss Rate <sup>271</sup>	Standard Deviation
Early Adopters	4	2.9%	1.9%
1987 Adopters	13	7.7%	4.8%
Laggards	4	24.5%	10.1%

We can use basic statistical analysis to test the null hypothesis that these samples are drawn from populations with the same underlying mean.<sup>272</sup> Here I make no assumption that the underlying variance of the populations are the same, and instead use the sample standard deviations in calculating the degrees of freedom.<sup>273</sup> The following table summarizes the t-test for each pair of categories, and shows that the null hypothesis that the underlying populations means are equal can be rejected between each pair of state categories at the 95% level of confidence.

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<sup>271</sup> Weighted average.

<sup>272</sup> The approach is explained in QUANTITATIVE METHODS FOR INVESTMENT ANALYSIS 333-337 (DeFusco et. al, eds., 2001). The test statistic is calculated using the following formula:

$$\frac{(\bar{x}_1 - \bar{x}_2) - (\mu_1 - \mu_2)}{\left(\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}\right)^{1/2}}$$

Where  $\bar{x}$  is equal to the sample mean of each sample,  $\mu$  is equal to the hypothesized population means (here the difference is the null hypothesis of zero),  $s$  is equal to the sample standard deviation, and  $n$  is equal to the number of observations in each sample.

<sup>273</sup> See *id.* at 335.

	1987 Adopters	Laggards
1986 Adopters	t-stat: 2.98 DF <sup>274</sup> : 16 RP <sup>275</sup> : <b>2.120/2.921</b>	t-stat: 4.21 DF: 4 RP: <b>2.776/4.604</b>
1987 Adopters		t-stat: 3.22 DF: 5 RP: <b>2.571/4.032</b>

Bold = null hypothesis rejected at (95% confidence/99% confidence)

Based on the above analysis, we can say with statistical rigor that there is strong evidence of a real difference in the ability of early states, middle states, and laggard states to stem the flow of firms to Delaware in 1986 and 1987.<sup>276</sup>

Still, we may have a case of correlation but not causation. Perhaps laggards and early adopters differed in other areas of corporate law that mattered more than director liability, and perhaps these differences caused the difference in results that we observe. The obvious rival explanation for the differing performance of states is the adoption of antitakeover statutes, which have been shown to have an effect on incorporation choice.<sup>277</sup> We can examine

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<sup>274</sup> This is the degrees of freedom where the variance of the underlying populations is not assumed equal. It is used to look up the rejection point on a t-table, making it more difficult to reject the null hypothesis if the sample variances are high or the number of observations in the sample is low. It is calculated with the following formula:

$$df = \left( \frac{\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}}{\frac{(s_1^2/n_1)^2}{n_1} + \frac{(s_2^2/n_2)^2}{n_2}} \right)$$

<sup>275</sup> This is the rejection point: the value that the t-statistic must be greater than in order for the null hypothesis of equal population means to be rejected. The first number is the rejection point at 95% confidence; the second is the rejection point at 99% confidence. As can be seen, the null hypothesis that the underlying means are equal can always be rejected at the 95% level; between the early adopters and 1987 adopters, it can also be rejected at the 99% level.

<sup>276</sup> See INVESTMENT ANALYSIS 321 (rejection at the 90% level constitutes *some evidence*; at the 95% level constitutes *strong evidence*; and at the 99% level constitutes *very strong evidence*).

<sup>277</sup> See Guhan Subramanian, *supra* n. 265 (2002); Bebchuk, *Decisions, supra* n. 3 (2003).

this question statistically with a regression analysis, using the percentage of firms lost to Delaware from each state as the dependent variable. Independent variables are two dummy variables for whether the state took action in 1986 or 1987, a dummy variable indicating whether the state implemented a self-executing provision rather than a charter option (the latter are usually seen as more extreme), and a variable indicating how many antitakeover statutes the state had amassed by 1987.<sup>278</sup> The resulting are reported below, with bold text where the independent variable is significant at the 99% level.

	Coefficient	P-value	Other statistics	
Intercept	0.19	0.000	Multiple R:	0.76
Action in 1986	- 0.15	<b>0.003</b>	R Square:	0.58
Action in 1987	- 0.13	<b>0.001</b>	Adj. R Square:	0.48
Self-Executing	- 0.03	0.424	Std. Error:	0.06
Antitakeover Index	0.00	0.931	Observation:	21

**Bold**=significant at 99% confidence

These results show that what is important in explaining the migration to Delaware is whether a state acted quickly to copy Delaware, not whether it amassed antitakeover statutes during this time. By acting in 1986, a state could prevent an average of 15% of its firms from moving to Delaware; by acting in 1987, it could prevent an average of 13% of its firms from moving to Delaware. Moreover, the insignificance of antitakeover statutes makes sense considering that states such as Pennsylvania and Colorado did very well in retaining firms despite not having any antitakeover laws by 1987, and Illinois and Missouri losing a great deal of their firms despite having amassed a number of such statutes in the relevant time frame. Companies may have felt their ability to ward off takeovers in Delaware was satisfactory, since the state had validated the poison pill in 1985 in *Moran v. Household International*,<sup>279</sup> and no court had yet found a board's refusal to redeem a pill a violation of fiduciary duty.<sup>280</sup> It is also interesting that it mattered little whether a state went further than Delaware by enacting a self-executing statute; in this time frame at least, companies seemed to value timely duplication over creativity.

<sup>278</sup> Caution is exercised not to specify too many dummy variables, lest the regression become defective. See INVESTMENT ANALYSIS 439-445.

<sup>279</sup> 500 A.2d 1346 (1985).

<sup>280</sup> This happened for the first time in 1998. See *City Capital Associates Ltd. P'ship v. Interco, Inc.*, 551 A.2d 787 (Del. Ch. 1988).

## VII. Conclusion

This paper has sought to make contributions to the procedural and substantive aspects of the enduring race debate in corporate law. On the procedural question of the nature of jurisdictional competition, it has tried to show how states really have competed defensively—at least periodically—to prevent an embarrassing outflow of firms to Delaware. It has shown that corporations really do react to some changes in corporate law, and that states know this and use it as a justification to duplicate popular provisions from Delaware. This paper has also shown that Delaware has the strength to change course in the face of a federal threat without much worry about losing its position vis-à-vis other states. On the substantive question of what states can do to make themselves attractive to corporations, the paper tenders evidence suggesting that an important thing they can do is protect directors from liability. Delaware’s two big jumps in its ascent to dominance occurred when it did this, and states that followed suit suffered the least in terms of corporate outflow to Delaware. This adds to evidence that states with antitakeover statutes do moderately better in the competition for charters; taken together, it appears that states with a managerial focus will be most popular as jurisdictions of domicile.

It is dangerous to make predictions, but current patterns in Delaware law seem to be consistent with the trends identified in this paper. Feeling encroached upon by the federal government, Delaware courts have come down with surprisingly tough decisions against managers in recent years.<sup>281</sup> Once federal legislators lose interest in corporate law and Delaware is left to its own devices, perhaps we will see another bold innovation along the lines of its actions in 1967 and 1986. Directors continue to feel threatened by liability, and courts have not lost the ability to innovate in this area.<sup>282</sup> In all events, the complex interplay between the federal government, Delaware, as well as other states will continue to make a deep imprint on American corporate law.

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<sup>281</sup> See, e.g., *In re Walt Disney Co.*, 825 A.2d 275, 289 (Del. Ch. 2003) (finding breach of duty of care); *Hollinger Int’l v. Black*, 2004 WL 360877 (Del. Ch. 2004) (finding breach of duty of loyalty); Hillary A. Sale, *Enron and the Future of U.S. Corporate Law and Policy*, 89 Cornell L. Rev. 456, 457 (2004) (finding “movement afoot” in Delaware fiduciary law).

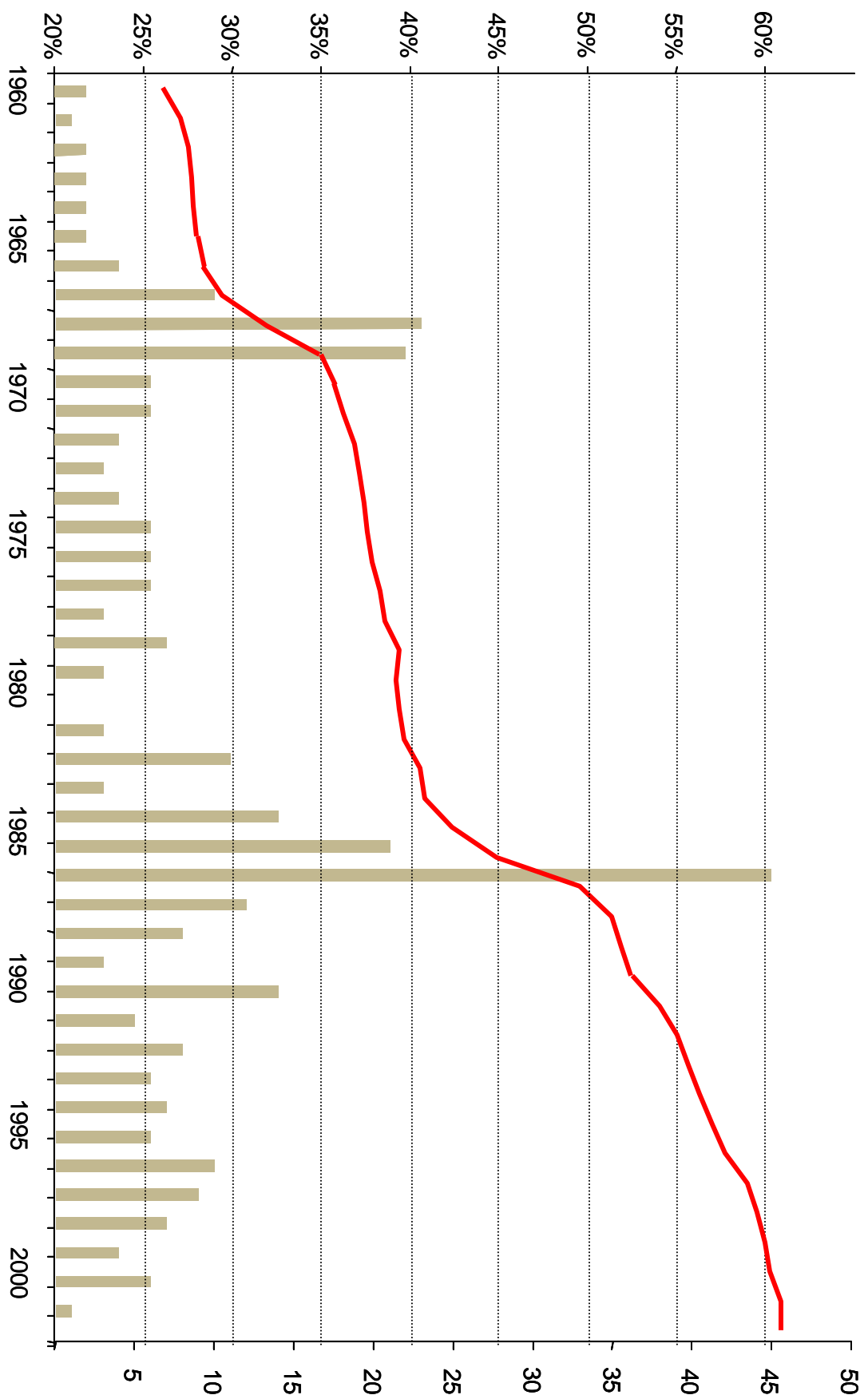
<sup>282</sup> Laurie P. Cohen, *Adding Insult to Injury: Firms Pay Wrongdoers’ Legal Fees*, WALL ST. J. (Feb. 17, 2004) (describing “unprecedented” decision of Delaware Chancery Court to allow Rite Aid executive to collect corporate advance for criminal defense fees).



## Appendix A – NYSE Reincorporations into Delaware

Year	Delaware	Total	%	Year	Delaware	Total	%
1960	2	2	100	1982	3	3	100
1961	1	3	33	1983	11	12	92
1962	2	2	100	1984	3	3	100
1963	2	2	100	1985	14	18	78
1964	2	3	67	1986	21	24	88
1965	2	2	100	1987	45	46	98
1966	4	4	100	1988	12	15	80
1967	10	11	91	1989	8	12	67
1968	23	25	92	1990	3	3	100
1969	22	22	100	1991	14	17	82
1970	6	6	100	1992	5	7	71
1971	6	8	75	1993	8	13	62
1972	4	7	57	1994	6	14	43
1973	3	3	100	1995	7	8	88
1974	4	4	100	1996	6	11	55
1975	6	7	86	1997	10	15	67
1976	6	7	86	1998	9	14	64
1977	6	7	86	1999	7	8	88
1978	3	3	100	2000	4	6	67
1979	7	7	100	2001	6	8	75
1980	3	3	100	2002	1	2	50
1981	0	3	0	<b>Total</b>	<b>327</b>	<b>400</b>	<b>82</b>

Appendix B: Chart of Delaware NYSE Reincorporations and Market Share



## Appendix C – NYSE Reincorporations Out of Delaware

Year	Number of Firms	Year	Number of Firms
1960	0	1982	0
1961	1*	1983	2
1962	0	1984	0
1963	0	1985	1
1964	0	1986	2
1965	0	1987	1
1966	0	1988	1
1967	0	1989	1
1968	0	1990	0
1969	0	1991	1
1970	0	1992	2
1971	1	1993	4
1972	0	1994	5
1973	0	1995	1
1974	0	1996	2
1975	0	1997	3
1976	0	1998	2
1977	0	1999	1
1978	0	2000	1
1979	0	2001	1
1980	0	2002	0
1981	1*	<b>Total</b>	<b>34</b>

\* returned to Delaware in 1986

## Appendix D – State Indemnification Legislation 1967-71

State	Provision Enacted	Exclusive?	NYSE Corps in 1966	Loss to Del 1966-72	Percent Reduction
Indiana	1967	0	13	0	0%
Pennsylvania	1967	0	50	3	6%
Maryland	1967	0	16	1	6%
Ohio	1967	0	60	4	7%
Virginia	1968	0	15	0	0%
Georgia	1968	0	12	0	0%
California	1968	1	69	7	10%
Massachusetts	1969	0	27	1	4%
Minnesota	1969	1	14	1	7%
Wisconsin	1969	0	13	1	8%
Connecticut	1969	1	13	1	8%
New York	1969	1	136	12	9%
New Jersey	1969	0	42	4	10%
Nevada	1969	0	10	1	10%
Florida	1970	0	20	2	10%
Texas	1972	0	21	2	10%
Missouri	1972	0	15	3	20%
Illinois	1972	0	26	10	38%
Michigan	1972	0	19	9	47%

## Appendix E – State Liability-Limiting Legislation 1986-87

State Name	Copied Delaware	Self-Executing?	Takeover Statutes 1987	NYSE Corps in 1985	Departures to Delaware 86-87	Percent Reduction
Indiana	1986	1	4	15	0	0%
Pennsylvania	1986	0	0	47	1	2%
Massachusetts	1986	0	1	26	1	4%
Ohio	1986	1	3	50	2	4%
Georgia	1987	0	1	14	0	0%
Minnesota	1987	0	3	18	0	0%
North Carolina	1987	0	2	13	0	0%
Virginia	1987	1	0	23	0	0%
Wisconsin	1987	1	4	13	0	0%
Michigan	1987	0	2	17	1	6%
New Jersey	1987	0	2	45	3	7%
Maryland	1987	0	1	29	2	7%
Florida	1987	1	2	27	2	7%
Colorado	1987	0	0	12	1	8%
Nevada	1987	1	1	29	3	10%
Texas	1987	1	0	54	6	11%
New York	1987	0	4	95	12	13%
Connecticut	-	0	1	13	1	8%
Missouri	-	0	4	13	2	15%
Illinois	-	0	2	16	4	25%
California	-	0	0	68	20	29%