

A History of Corporate Law Federalism in the Twentieth Century

*William W. Bratton**

ABSTRACT

This Article describes the emergence of corporate law federalism across a long twentieth century. The period begins with New Jersey's successful initiation of charter competition in 1888 and ends with the enactment of the Sarbanes-Oxley Act in 2002. The federalism in question describes the interrelation of state and federal regulation of corporate internal affairs. This Article takes a positive approach, pursuing no normative bottom line. It makes six observations: (1) the federalism describes a division of subject matter, with internal affairs regulated by the states and securities issuance and trading regulated by the federal government; (2) the federalism is an artifact of history rather than an instantiation or reflection of a theory of government; (3) competition for charters at the state level resulted in a stable, as opposed to a volatile legal regime; (4) just as economic contractions lead to new regulatory constraints on the conduct of business, so do economic expansions lead to increased regulatory slack; (5) even though regulation on the ground never fully adhered to the subject matter division, the division became increasingly salient over time, taking on positive normative implications; and (6) federal lawmakers came to adhere to a norm of noninterference in state regulation of internal affairs.

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* Nicholas F. Gallicchio Professor of Law Emeritus, University of Pennsylvania Carey Law School; de la Cruz/Mentschikoff Endowed Chair in Law and Economics and Senior Lecturer, University of Miami School of Law; Research Associate, European Corporate Governance Institute. This article revises and expands on William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619 (2006).

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INTRODUCTION

This Article describes the emergence of corporate law federalism across a long twentieth century. The period begins with New Jersey's successful initiation of charter competition in 1888 and ends with the enactment of the Sarbanes-Oxley Act in 2002.¹ The federalism in question describes the interrelation of state and federal regulation of corporate internal affairs. It is familiar territory, well-traversed in previous scholarship. This Article's contribution to this literature follows from its point of view. Unlike the precedent treatments, it pursues no normative bottom line, neither disparaging state law as corrupt and profit driven and recommending federal intervention nor commending state law as responsive and dynamic and recommending a presumption against federal intervention. A positive approach is taken. More particularly, the Article makes six observations: (1) the federalism describes a division of subject matter, with internal affairs regulated by the states and securities issuance and trading regulated by the federal government; (2) the federalism is an artifact of history rather than an instantiation or reflection of a theory of government; (3) competition for charters at the state level resulted in a stable, as opposed to a volatile legal regime; (4) just as economic contractions lead to new regulatory constraints on the conduct of business, so do economic expansions lead to increased regulatory slack; (5) even though regulation on the ground never fully adhered to the subject matter division, the division became increasingly salient over time, taking on positive normative implications; and (6) federal lawmakers came to adhere to a norm of noninterference in state regulation of internal affairs.

1. Pub. L. No. 107-204, 15 U.S.C. §§ 7201 et seq. (2002).

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“Federalism” is a fancy word, but there is little constitutional or otherwise highfalutin about the federalism under study here. It cannot be traced back to a founding document² or accounted for by some fundamental theory of government. It appeared and evolved in history, as an artifact of legislation (some enacted, some proposed and unenacted) and judicial decisions.

In the beginning, back in 1888, there were just the states, which occupied the field of corporate internal affairs as an incident of their performance of their role as grantors of corporate charters. Federal threats to their exclusive possession of the territory sounded thereafter, motivated by antitrust concerns. But they came to nothing. The federalism’s outlines came into view when, during the Depression, the federal government entered the closely related field of securities regulation. A pattern resulted: national regulation covered the securities markets and mandated transparency respecting firms with publicly traded securities. Internal corporate affairs were left to the states. The pattern—the federalism—persisted. The pattern was stable, but became more and more complex as the century wore on. It also took on normative implications. Eventually, there would be theories describing and justifying, or, alternatively, condemning it.

The stable pattern followed from two modes of lawmaking, one in the states and the other in the federal government.

State corporate lawmaking was heavily influenced by interstate competition for corporate charters and more particularly by Delaware’s successful capture of rents from the sale of charters, rents yielded consistently across the century. The rent-seeking strategy, when first deployed successfully by New Jersey in the late nineteenth century, caused a radical change in terms of corporate law, which shifted from mandatory to enabling. Stability followed once the shift was completed. State corporate law’s basic, enabling outline changed little during the twentieth century. Incentive alignments and regulatory results were more constant than dynamic, even as Delaware often adjusted both its code and its caselaw in reaction to events.³

Where state corporate lawmaking was economically driven, federal corporate lawmaking followed political demands. Lawmakers at the national level—Congress, the Securities and Exchange Commission, the stock exchanges, and the federal courts—reacted to events in a more

2. This does not go to say that the constitution is irrelevant. See *infra* note 11 and accompanying text.

3. Using the terminology of evolutionary game theory, state corporate law amounted to a stable equilibrium result.

volatile manner than did lawmakers in the states, traversing internal affairs both in good times and in bad as the national system of securities regulation pursued an episodic growth trajectory. When the economy was robust and the stock market was up, national lawmakers entered state territory to satisfy interest group demands, expecting no adverse political consequences. When the economy stalled and the stock market was down, they responded to more broadly-based political demands, acting to avoid finding themselves on the wrong side of voter preferences.

Either way, federal lawmakers came to adhere to a norm of federal-state cooperation when regulating internal affairs. More particularly, they never structured their interventions into internal affairs to disrupt or suppress the charter market or otherwise rend the enabling pattern of state corporate law. They left Delaware in place, along with its rents and competitive approach. In legislatures and agencies this norm of noninterference was informal—it describes a pattern of actions taken. In the courts, in contrast, it came to be articulated positively. The noninterference norm, together with the charter market and the division of subject matter, comprise the core of twentieth century corporate federalism.

The noninterference norm evolved in the wake of controversy. For much of the century, proponents pushed for just the opposite—federal intervention against the states. Their case had structural roots. State level results had national economic significance. Delaware's sales of domiciles to firms operating nationwide implicated externalities because Delaware lawmakers consistently favored management on allocational questions. It followed that a state with Delaware's incentives could not be tolerated as a *de facto* national lawmaker absent the possibility of federal preemption to reverse or modify results. At the same time, particularly when financial crises and compliance breakdowns coincided,⁴ there resulted national political demands concerning the conduct of corporate business. Delaware was disabled from responding to such demands because corporate self-regulation and kid glove treatment of management were essential components of advantage in the charter market. By default, then, the job of confronting negative shocks went to actors at the national level. This left Delaware structurally vulnerable to shifting political preferences and abrupt changes in response at the federal level.

Opposition to rent-driven lawmaking in the states was strongest during the first three-quarters of the century, when progressives claiming to represent the public interest proposed federal preemption of much of the field. But the public interest objection steadily lost political salience as

4. Price declines have been triggering governmental regulation of the securities markets for 300 years. See generally STUART BANNER, *ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS 1690–1860* (1998).

political demands moved away from early and mid-twentieth century populist concerns like corporate bigness and labor relations. Federal legislative initiatives became less and less threatening to the state system as a result. By the time the century closed, we had begun an era of shareholder capitalism in which national political demands tended to be driven by shareholder value enhancement. It was a context well-suited to both the state system and the prevailing federalism.

The public interest approach also ran into theoretical headwinds, when, during the latter part of the century, free market proponents made a case against any national corporate law, in effect proposing an irrebuttable presumption favoring state regulation of internal affairs. But the free market perspective also lacked political salience. Indeed, neither of the opposing ideological paradigms—public interest or free market—ever had much purchase with lawmakers, for whom neither wholesale preemption nor laissez-faire made sense. They instead regulated by reference to a governance agenda articulated early in the century by William O. Douglas in an article in the *Harvard Law Review*.⁵ This was a set of regulatory improvements, mostly process-based, directed to the amelioration of agency costs in publicly traded, management-dominated firms. Policymaking under the governance agenda devolved on functional questions about performance and welfare effects. Since answers tended to be cautious, they by default favored state autonomy. At the same time, the internal affairs presumption yielded quickly whenever a national political imperative presented itself.

Stability and continuity dominate this Article's account except during one period, the 1970s, a time when anti-managerial ferment and public interest thinking combined to undermine confidence in the state system. This was the era in which William L. Cary and Ralph Nader called for federal preemption and in which the Watergate-related questionable payments scandal led to a federal legislative response in the form of the Foreign Corrupt Practices Act of 1977.⁶ It was also the era in which corporate governance was born, a field that inherited and expanded upon Douglas's agenda. Preemptive initiatives found their way to the table in Congress. Even the federal courts got in on the act, experimenting with a reading of Rule 10b-5 that swept up much of state fiduciary law.

Delaware survived the threats of the 1970s and stability returned. But Delaware's approach underwent a responsive change at the hands of its judiciary. Its courts became a more even-handed mediator of disputes between managers and shareholders and came to be seen as a valuable repository of technical expertise. Delaware's reputation as a lawmaking

5. William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305 (1934).

6. Securities and Exchange Act, §§ 13(b)(2), 30A, 32, 15 U.S.C. §§ 78m(b)(2), 78dd-1-2, 78ff, added by Pub. L. No. 95-213, 91 Stat. 1494 (Dec. 19, 1977).

center, in tatters in 1975, by 1995 was the envy of the nation. At the story's close, any structural problems with corporate adjudication lay at the federal level.

The Article's organization is chronological. Part I tells the long story of state-federal relations from the beginning of charter competition in 1888, through to the emergence of Delaware as the competitive leader and the concomitant appearance of a stable enabling regime in the states, then on to the Depression and the enactment of the federal securities laws, and finally to the apogee of managerialism in the post-war era. Part II recounts the multi-sided crises that beset corporate federalism during the 1970s. Part III, taking note of the occasion for this Symposium, pauses to look in detail at a Supreme Court case, *Santa Fe v. Green*,⁷ decided at the height of the federalism crisis. *Green*, by refusing to extend Rule 10b-5 to fact patterns covered by state fiduciary law, assured continuance of the federalism. It emerges as the watershed moment in this history, for here, for the first time, federal lawmakers at the highest level enunciated a norm of non-interference. Part IV describes the emergence of Delaware as the nation's preeminent corporate lawmaker at the century's close.

I. COMPETITION AND STABILITY IN STATE CORPORATE LAW, 1888–1970

A. *The Competitive Gestalt, 1888–1929*

1. New Jersey and Delaware.

In 1888 the government of New Jersey needed new sources of revenue. James Brooks Dill, a New York lawyer, suggested to the state's politicians that significant sums could be raised if the state provided an attractive domicile for the nation's growing corporate population.⁸ The politicians countered that West Virginia already had tried this, liberalizing its corporate code, but without significant fiscal results. Indeed, in 1888 West Virginia's Secretary of State was stationed at the Fifth Avenue Hotel in New York, the seal of the state in hand, ready to sell charters but not finding many takers.⁹ Dill assured the politicians that it would be different with New Jersey. The state would not only draft a code more liberal than West Virginia's, it would market the code more successfully. Toward the latter end, Dill organized The Corporation Trust Company,¹⁰ which would serve

7. 430 U.S. 462 (1977).

8. Christopher Grandy, *New Jersey Corporate Chartermongering, 1875–1929*, 49 J. ECON. HIST. 677, 681 (1989).

9. LAWRENCE MITCHELL, *THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY* 38 (2007).

10. The company survives as CT Corporation, a Wolters Kluwer subsidiary. For verification, consult <https://www.wolterskluwer.com/en/solutions/ct-corporation>.

as both the state's marketing arm and as a local agent for incorporating firms, providing them a physical office within the state. Dill, who made sure to put New Jersey's Governor and Secretary of State on the Corporation Trust board of directors, got his corporate code.¹¹

The regulatory approach was enabling. By 1896, most significant *ex ante* constraints on corporate actors had been stripped from New Jersey's code. Governance processes took their place. Corporations were left free to change their businesses, alter their equity capital structures, and amend their charters.¹² More importantly, the New Jersey code left them free to merge and combine in holding company structures¹³ toward the end of facilitating anticompetitive arrangements.¹⁴

New Jersey's code also held out a critical innovation respecting governance process: For the first time in any state code, the right to initiate a charter amendment was vested in the board of directors, subject to *ex post* shareholder ratification.¹⁵ This gave managers agenda control over fundamental changes, including, critically, reincorporation to another state. Previously, an agency theory of board authority had prevailed and shareholder

11. Harold W. Stoke, *Economic Influences Upon Corporation Laws of New Jersey*, 38 J. POL. ECON. 551, 570–71, 573 (1930).

Dill's strategy relied on federal constitutional law, under which corporations are treated as "persons" entitled to the constitution's protection. Under a nineteenth century judicial doctrine termed "unconstitutional conditions" it was held to that a state could not exclude corporations incorporated elsewhere. See HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836–1937*, 47–48 (1991). Under a common law conflict of laws rule that evolved during the twentieth century, other states respect the chartering state's governance of corporate internal affairs. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971). For the view that nineteenth century Supreme Court rulings did not support the proposition that states could *not* exclude foreign corporations, see Sarath Sanga, *The Origins of the Market for Corporate Law*, 24 AM. L. & ECON. REV. 369 (2022).

12. See Stoke, *supra* note 11, at 572–73.

13. The removal of agent constraints facilitated mergers. The removal of legal capital constraints made stock watering legal, which made it possible for a large corporation to buy up competitors by offering stock consideration at bargain prices. In addition, the code permitted different classes of stock to have different economic and voting rights, facilitating deal-making by making it possible to pay with nonvoting or low-voting shares. RALPH NADER, MARK J. GREEN & JOEL SELIGMAN, *CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR FEDERAL CHARTERING OF GIANT CORPORATIONS* 45 (1976).

14. New Jersey opened the door for mergers even as other states were following the federal government and enacting antitrust laws modeled on the Sherman Act. See Brian R. Cheffins, *Mergers and Corporate Ownership Structure: The United States and Germany at the Turn of the 20th Century*, 51 AM. J. COMP. L. 473, 478–92 (2003). (describing the mergers and showing that this period of acquisition activity amounted to a catalyst for diffuse equity ownership). By 1914 all but New Jersey and six other states had done so. See Stoke, *supra* note 11, at 575. See also Hovenkamp, *supra* note 11, at 266–67.

15. JAMES B. DILL, *THE STATUTORY AND CASE LAW APPLICABLE TO PRIVATE COMPANIES UNDER THE GENERAL CORPORATION ACT OF NEW JERSEY AND CORPORATION PRECEDENTS* 42–43 (1899) (New Jersey General Corporation Act § 27).

initiative had been the rule.¹⁶ There was also an innovative governance mandate: All shareholders' meetings had to be held in New Jersey, providing not only rents for the state but assuring that voting would be by proxy, making shareholder challenges less likely.¹⁷

Dill's competitive play proved successful. Half of the nation's largest corporations were domiciled in New Jersey by 1899.¹⁸ The state's deficit was wiped out. By 1905, its governor even boasted that none of the state's income was contributed by direct payments from individuals.¹⁹

Other states entered the new charter market. In 1899, Delaware's Joseph A. Marvel marked up his state's corporate code to mimic New Jersey's. (He also formed the Corporations Services Company and mailed advertisements.²⁰) Marvel's code offered fewer restrictions on the issuance of stock and lower franchise fees. It also carried the contractarian model to its logical conclusion by providing that a charter could contain any provisions not contrary to law.²¹ Delaware attracted a handful of large firms but did not threaten New Jersey's dominance.²² Even so, corporate revenues quickly constituted an important source of Delaware's revenues, rising from 7% of total revenues in 1899 to 20.5% in 1900 and 30.6% in 1906.²³ West Virginia, Maryland, Maine, and Kentucky quickly followed with revisions of their own codes.²⁴ Other states soon fell into line.

By 1912 the laws of most of the states had been revised in varying degrees to follow the enabling approach.²⁵ New Jersey's 1896 code had

16. See JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS, AGGREGATE §§ 297–99 (9th ed. 1871); 1 VICTOR MORAWETZ, TREATISE ON THE LAW OF PRIVATE CORPORATIONS §§ 243–44 (2d ed. 1888)). Delaware followed in its corporations code of 1899. See Section 135 of the Act of 1899, 21 Del. Laws, 1899, ch. 273; RUSSELL CARPENTER LARCOM, THE DELAWARE CORPORATION 11–13 (1937). These agenda control provisions diffused into the codes of other states during the subsequent decades. By 1960, 25 state codes conditioned charter amendment on board approval. See 2 MODEL BUS. CORP. ACT. ANN. 230–31 (1960). By 1970, 28 state codes did so. See 2 MODEL BUS. CORP. ACT. ANN. 2D 260–61 (1971).

17. NADER, GREEN & SELIGMAN, *supra* note 13, at 46.

18. *Id.* at 574.

19. *Id.* at 48.

20. See Note, *Little Delaware Makes a Bid for the Organization of Trusts*, 39 AM. L. REV. 418 (1899).

21. See E. Merrick Dodd, *Statutory Developments in Business Corporation Law, 1886–1936*, 50 HARV. L. REV. 27, 27 (1936).

22. See NADER, GREEN & SELIGMAN, *supra* note 13, at 503–05.

23. *Id.* at 535. The percentage figure was volatile, however. In 1908 the percentage of revenues from chartering fell to 15.7. *Id.*

24. See Stoke, *supra* note 11, at 575–76.

25. See NADER, GREEN & SELIGMAN, *supra* note 13, at 50 (noting that 42 states permitted organization for any lawful purpose; 43 had lifted limited on capitalization; 24 permitted perpetual existence; 18 permitted mergers; 40 permitted stock to be issued for noncash consideration, nine of which made the judgment of the board respecting the value of the consideration conclusive absent fraud). Even New York proved capable of innovation in the removal of agent constraints, in 1912 becoming the first state to permit no par stock. See Dodd, *supra* note 21, at 44, n. 50

become the template²⁶ for the evolution of state corporate law.²⁷ Subsequent departures from it opened new stretches of enabling territory but did not change the system fundamentally.

Even so, New Jersey backtracked on February 17, 1913, enacting a series of antitrust amendments called the “Seven Sisters.” These variously prohibited monopolization, price fixing, and other anticompetitive behavior, following an agenda set by Governor Woodrow Wilson, who was about to be inaugurated President.²⁸ The number of charters issued in New Jersey declined in succeeding years.²⁹ The state’s lawmakers then had second thoughts, removing the salient prohibitions from the corporate code in 1915 and 1917.³⁰

But it was too late. Chartering firms neither forgave nor forgot New Jersey’s defection to the antitrust side. Delaware saw a significant increase in large firm incorporations and reincorporations—its lead was clear by 1922, when it claimed 55% of the firms listed on the New York Stock Exchange.³¹ The state’s revenue yield peaked during the boom years of the 1920s.³² By 1917, 36.4% of Delaware’s revenues came from chartering; by 1929 the figure was 42.5%.³³

2. Federal Chartering.

The states competed for charters and created enabling codes against a threat of federal intervention. Federal incorporation proposals antedate the federal government itself—James Madison mooted the idea at the Constitutional Convention.³⁴ Federal incorporation, or more properly, federal licensing, went on to reach the top of the national policy agenda as a reaction to the appearance of state-level charter competition. Bills proposing federal licensing of large firms, modeled on nineteenth century corporate

26. See Richard M. Buxbaum, *Facilitative and Mandatory Rules in the Corporation Law(s) of the United States*, 50 AM. J. COMP. L. 249, 249 (2002) (noting that state codes have been facilitative since the New Jersey innovation).

27. According to Stoke, *supra* note 11, at 579, New Jersey’s code in 1929 resembled “very much the laws of 1896.”

28. *Id.* at 578.

29. *Id.* at 574 n.16, 579.

30. *Id.* at 579.

31. ADOLF A. BERLE, JR., *STUDIES IN THE LAW OF CORPORATE FINANCE* 122–25 (1928).

32. See NADER, GREEN & SELIGMAN, *supra* note 13, at 503–05.

33. *Id.* at 535.

34. See JAMES MADISON, *NOTES OF DEBATES OF THE FEDERAL CONVENTION* 638 (W. Norton & Co. ed. 1966).

codes that restricted size, lines of business, and mergers, were a staple of congressional life from 1900 until 1914.³⁵

Events during Theodore Roosevelt's administration are worth noting. The President was a key proponent of licensing. Corporate and labor leaders sat at the same political table, at which they had agenda items in common with Roosevelt. Business and labor both were being targeted under the Sherman Act and saw possible advantages in a shift away from judicial antitrust enforcement under Sherman to administrative regulation by a federal licensing agency operating under a rule of reason.³⁶ Negotiations with the administration eventually broke down, however. Business and labor wanted Sherman Act enforcement pre-empted, which Roosevelt opposed. Meanwhile, Roosevelt wanted federal oversight vested in his own hands rather than in an agency. Business and labor saw no advantage replacing federal judicial rulings under Sherman with discretionary action by TR.³⁷

Subsequent attempts fared no better. The broad-based support needed to secure passage in Congress never coalesced³⁸ and the clamor for national level corporate law reform abated after 1914.³⁹ The Sherman Act's approach to antitrust had prevailed.⁴⁰

3. State Corporate Codes in the 1920s.

State corporate law emerged fully formed during the boom years of the 1920s. It did so in a competitive environment, with Delaware enjoying the lead and others affirmatively vying for business. State actors were highly incentivized to compete, seeing tripartite payoffs in the form of a positive impact on state revenues, private rents for key state actors from stakes in service companies, and fees for the local bar.⁴¹

35. Six bills were presented between 1900 and 1907. See RICHARD N. LANGLOIS, *THE CORPORATION AND THE TWENTIETH CENTURY: THE HISTORY OF AMERICAN BUSINESS ENTERPRISE* 80 (2023). The bills were motivated by a perceived public interest in competitive production and against industry concentration. See Mitchell, *supra* note 9. See also John W. Brabner-Smith, *Federal Incorporation of Business*, 24 VA. L. REV. 159 (1937).

36. See Langlois, *supra* note 35, at 80–81. Draft legislation came from a group called the National Civic Federation, made up of top business leaders, political leaders, and labor leaders, along with lawyers and economists. *Id.*

37. *Id.* at 81.

38. See Brabner-Smith, *supra* note 35, at 162–63.

39. See Stoke, *supra* note 11, at 579.

40. See Hovenkamp, *supra* note 11, at 247–48, 266–67.

41. The incentives of the local bar also should be noted. Charter competition was invented by a New York corporate lawyer, and from the very beginning was fully compatible with the interests of New York's corporate bar. Transactions involving New Jersey and Delaware corporations closed in New York, stage managed by New York lawyers, without any fee sharing with New Jersey or Delaware lawyers. From the beginning, lawyers in financial centers opined on due organization under New

Then, as now, the terms of affiliation of corporate agents and investors were left to be arranged through contract. Then, as now, the law imposed no significant protections for creditors or other constituents. Then, as now, ex post fiduciary review of management conduct provided the principal legal constraint. Then, as now, ultimate shareholder control had to be achieved through the exercise of governance mechanisms.⁴² The board of directors held agenda control and the proxy voting system operated as a barrier to soundings of shareholder voice,⁴³ a situation that would prevail until the first decade of the twenty-first century.⁴⁴

Legislative innovation at the state level never again reached the intensity experienced in the wake of New Jersey's competitive initiative of 1888. But some important changes were instituted during the 1920s. Corporations and their promoters, utilizing the corporate codes' allowance of nonvoting preferred and common, took advantage of the bull market to float nonvoting equity issues that carried no sacrifice of control. This excited a national level response—the first such containment in this account. The source was the New York Stock Exchange, which imposed a one share one vote rule.⁴⁵

Delaware had no way to reverse the move. But it did counter with give backs to the management interest, doing what it could to facilitate new public offerings by removing its code's remaining constraints on the issue of new equity securities. First, in 1927, it removed one last mandate respecting affiliation terms—pre-emptive rights, which became optional.⁴⁶

Jersey and Delaware law, ignoring the usual formal requisite of membership in the bar of the state law applied in the opinion. See Association of the Bar of the City of New York, Committee on Real Property Law, Subcommittee on Mortgage Loan Opinions & the New York State Bar Association, Real Property Law Section, Attorney Opinion Letters Committee, Mortgage Loan Opinion Report, 54 BUS. L. 119 (1998) (explaining that New York lawyers give Delaware law opinions); see also Scott Fitz-Gibbon & Donald W. Glazer, *Legal Opinions on Incorporation, Good Standing, and Qualification to Do Business*, 41 BUS. L. 461, 471 (1986); Committee on Corporations, *1989 Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 45 BUS. L. 2169 (1990). Delaware's famously well-compensated bar conducts a litigation practice. See Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 695 (2002) (showing that Delaware lawyers are the most highly paid in any state).

42. The appropriate citation is a "see generally" to any good corporations casebook.

43. See Dodd, *supra* note 21, at 51, for a summary of the operation of the state codes.

44. The balance of power finally shifted with the appearance of activist hedge funds. No change in the terms of state law was implicated. Shareholders simply learned how to use the proxy system already in place to register the preferences inside the management suite. See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013) (declaring the problem of separation of ownership and control to have been solved).

45. See Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 687 (1987).

46. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 43 (1982).

Secondly, in March 1929, it amended its code to permit blank check stock charter provisions,⁴⁷ which allowed corporations to waive shareholder ratification respecting the terms of new senior stock issues and thereby enhanced managements' freedom of action respecting equity capital structure.⁴⁸ Thirdly, and also in March 1929, it sanctioned the issue of stock option warrants, facilitating the distribution of bargain purchase rights to insiders even in a world of one share one vote.⁴⁹

4. Observations.

We emerge from this survey with two observations. First, legislative innovation at the state level tended to enhance management's freedom of action by expanding the enabling envelope.⁵⁰ Second, management-friendly innovation tended to coincide with a strong stock market.⁵¹

B. The Depression and the New Deal

Questions about the desirability of the zone of discretion accorded to management by state corporate law were asked in the wake of the 1929 stock market crash and ensuing economic depression.⁵² The forthcoming answers, although unfavorable to the states, would not trigger any root and branch federal intervention. But they would provide corporate law with a conceptual framework that prevailed for the rest of the century. Meanwhile, federal chartering did return to the policy table, and, indeed, found its way into law for a brief period.

1. Berle and Means and the Trust Principle.

When, during the early twentieth century, those in charge of the big corporations had made themselves rich, public investors had been

47. *Id.* at 43.

48. See NADER, GREEN & SELIGMAN, *supra* note 13, at 56–57. Delaware also added a loophole in its legal capital provisions in the late 1920s—the “nimble dividend.” *Id.*

49. *Id.*

50. No claim is being made that all states matched Delaware in providing menus of enabling terms. For a survey of some residual mandates and an empirical showing of their contribution to outward migration, see Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?* 22 J. L. ECON & ORG. 340, 348–63 (2006).

51. Concerns about legitimacy and federal intervention may have had something to do with this—rising stock prices provide air cover for concessions to the management interest. Marketing also mattered. Corporations tended bring reincorporation proposals to their shareholders in the wake of abnormal run ups in their stock prices. See Michael Bradley & Cindy Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 67 (1989); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: “Unhealthy Competition” Versus Federal Regulation*, 53 J. BUS. 259, 272–78 (1980). The competitive state struck while the iron is hot, drawing attention to its product line to focus management's attention on the benefits of reincorporation.

52. Justice Brandeis offered his famous “race to the bottom” characterization in 1933. See *Liggett v. Lee*, 288 U.S. 517 (1933) (Brandeis, J., dissenting).

delighted to go along for the ride.⁵³ Now they became aggrieved claimants looking for redress. Adolf Berle and Gardiner Means took up their case in *The Modern Corporation and Private Property*,⁵⁴ published in 1932. Berle and Means mounted a full scale assault on corporate bigness, deployed with the objective of laying the ground for direct regulation of management's business decisions.

Due to dispersed share ownership, said Berle and Means, the managers who ran the big corporations exercised unified control over the wealth under their charge. This presented problems of competence and responsibility absent in an ideal, classical capitalist world inhabited by self-employed individual producers.⁵⁵ Corporate law played a role in investing management power,⁵⁶ thereby becoming implicated in the creation and perpetuation of an unsatisfactory separation of ownership and control. It followed, said Berle and Means, that corporate property should no longer be deemed private property.⁵⁷ That assertion in turn supported a presumption favoring new regulation of corporate internal affairs.

Berle and Means also focused on management cupidity. The enabling system, they said, tolerated rampant self-dealing. Corporate insiders were writing their own contracts, with immunity clauses and waivers of shareholder rights allowing much diversion of corporate profit to managers' pockets.⁵⁸ The law would do a better job if it were rewritten to follow basic principles of trust law. Synthesizing a large collection of cases, Berle and Means concluded that there should be a pervasive equitable limitation on powers granted to corporate management (or any other group within the corporation) by the enabling system: Power should be exercisable only for the ratable benefit of all the shareholders.⁵⁹ We will refer to this as the trust principle.

Apart from this pitch for tougher fiduciary law, *The Modern Corporation* offered no specific law reform proposals to follow up its diagnosis of excessive management power. Yes, management needed to be taken down. But, instead of making specific recommendations, Berle and Means

53. See Langlois, *supra* note 35, at 214.

54. ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (rev. ed. 1967).

55. *Id.* at 3–10. In the classical model, market competition effectively controlled the producers, constraining both the incompetent and the greedy and legitimating private economic power. But corporate mass production on a large capital base had broken those parameters, with firms taking on significant attributes and powers, social as well as economic. *Id.* at 3.

56. *Id.* at 4, 131.

57. *Id.* at 219.

58. *Id.* at 128, 220, 312.

59. *Id.* at 220. Berle and Means had in mind an overarching standard that would constrain the enabling system *ex post*: No language in a corporate charter could deny or defeat the fundamental equitable control of the court. *Id.* at 242.

gestured vaguely in the direction of a corporatist political system, looking toward the displacement of management power over the economy by a benevolent national government.⁶⁰

One might have expected a call for federal incorporation. But Berle and Means found things worth preserving in the state system and so stopped short of that. They drew a distinction between state corporate codes and fiduciary enforcement in state courts. As they saw it, charter competition had infected only the codes. Common law enforcement of fiduciary duties was the one area of corporate law that remained robust: “Flexible and realistic” judges, “if untrammelled by statute,” could be expected to find solutions when fiduciary breaches demanded a remedy.⁶¹

This conclusion comes as a surprise. Why, if fiduciary law needed to be reformulated and expanded, were the courts articulating it exempted from the critique? Decades later, Berle and Means’s conceptual heirs would show no hesitation in this regard and excoriate the Delaware judiciary for failing to follow the trust principle.⁶²

An answer to the question lies in an unexpected place—the Supreme Court’s 1938 decision of *Erie Railroad Co. v. Tompkins*.⁶³ When Berle and Means published in 1932, federal courts still brought federal common law to bear in deciding diversity cases. A corporate law fiduciary plaintiff who could establish diversity got to choose between not only state and federal venues but state and federal common law. The case law synthesis in *The Modern Corporation and Private Property* includes federal common law cases as well as state cases, without noting any distinction between the two.⁶⁴ Given an independent, parallel federal judiciary pronouncing on fiduciary principles in corporate cases, Berle and Means’s benign view of the judicial role was not unreasonable.⁶⁵ Even as Delaware

60. *Id.* at 309–13.

61. *Id.* at 197, 295.

62. *See infra* text accompanying notes 159–189.

63. 304 U.S. 64 (1938).

64. *See* *Handley v. Stutz*, 139 U.S. 417 (1891); *Barclay v. Wabash Ry. Co.*, 30 F.2d 260 (2d Cir. 1929); *Atlantic Ref. Co. v. Hodgman*, 13 F.2d 781 (3d Cir. 1926); *Jones v. Missouri-Edison Elec. Co.*, 144 F. 765 (8th Cir. 1906); *Yoakam v. Providence Biltmore Hotel Co.*, 34 F.2d 533 (D. MI. 1929); *Barnes v. Andrews*, 298 F. 614 (S.D.N.Y. 1924); *Brown v. Pa. Canal Co.*, 229 F. 444 (E.D. Pa. 1916); *cf. Strong v. Repide*, 213 U.S. 419 (1909) (deciding dispute respecting corporation doing business in the Philippines). All of these cases follow the same practice respecting citations of authoritative cases. Reference is made indiscriminately to other federal corporate law decisions and to state court decisions, principally from New York and New Jersey. No special recognition is accorded the case law of the state of incorporation.

65. Federal courts in corporate cases where jurisdiction was based on diversity did not ignore the chartering state and its law completely. The internal affairs doctrine also came to bear with the result that a federal court in diversity not located in the chartering state might decline to take jurisdiction and remit the parties to courts in the state of incorporation. But where assets and parties had only

took the charters and legislated a management-favorable code, plaintiffs could circumvent its courts and case law by going to federal court. For Berle and Means, then, the key point was that common law fiduciary duties lay outside of the enabling pattern that dominated the state codes. *Erie* negated this assumption by according the Delaware judiciary an authoritative voice over Delaware fiduciary law for the first time.

2. Douglas and the Governance Agenda.

Federal legislative intervention finally came with the Securities Act of 1933⁶⁶ and the Securities Exchange Act of 1934.⁶⁷ There resulted a nascent pattern of corporate law federalism.⁶⁸ The new federal regime supplemented rather than displaced the state law regime, filling in a large gap in state law with a system of disclosure mandates applying to public issuance and public trading of securities. Internal affairs were left undisturbed, subject to a single exception in section 14 of the 1934 Act, which accorded the enforcing agency, the new Securities and Exchange Commission (SEC), the power to regulate proxy solicitations in connection with shareholders meetings.⁶⁹

Some thought the new federal regime to be too restricted in scope. In 1934, William O. Douglas, then still a Yale law professor, published an

nominal contacts with the chartering state, it was deemed expedient to take jurisdiction provided the relief requested did not implicate "visitorial" powers. Once jurisdiction was obtained, the case was decided as a matter of federal equity. *Williamson v. Missouri-Kansas Pipe Line Co.*, 56 F.2d 503, 507-10 (7th Cir. 1932) (taking jurisdiction over a Delaware corporation the assets and parties of which resided in Illinois). See also *Rogers v. Guaranty Trust Co. of N.Y.*, 288 U.S. 123 (1933) (holding that a federal court should decline jurisdiction over a shareholder suit implicating internal affairs where convenience efficiency and justice pointed to the courts of the chartering state). State courts reasoned analogously, despite the internal affairs doctrine. See JOSEPH HENRY BEALE, JR., BEALE ON FOREIGN CORPORATIONS § 305, 312 (1904) (noting that in the case of a "quasi public corporation" with nominal contacts with its chartering state, the courts of the shareholders' state will take equitable jurisdiction to prevent theft).

66. Pub. L. 73-22; 48 Stat. 74.

67. Pub. L. 73-291; 48 Stat. 881.

68. Securities law federalism is separate topic. Here the new federal legislation entered a field already occupied by many states, which enacted Blue Sky laws in the second and third decades of the century. See Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347 (1991); Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J. L. & ECON. 229 (2003). Dual occupation of the field resulted.

69. William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1316 (1934), commented as follows:

An attempt to give stockholders some protection against abuses of the proxy machine has been made in various drafts of the National Securities Exchange Act by prohibiting the use of the mails or agencies of interstate commerce or any facility of any national securities exchange to solicit proxies in respect to any registered security unless, pursuant to rules and regulations of the commission, certain disclosures relative to the solicitor and the proxyholders be made. Such a provision may result in some control, but it does not proceed very far.

article in the *Harvard Law Review* in which he described the shortcomings of the about-to-be enacted federal statute.⁷⁰ He played the scandal card, pointing to sordid goings on that had come to light in the aftermath of the Great Crash, variously involving secret loans, undisclosed profit sharing plans, self-dealing contracts, and insider trading.⁷¹ Disclosure mandates would not be enough, he said. More in the way of regulation was needed to prevent the repeat of such sorry spectacles in the next cyclical market rise.⁷² Douglas grounded his analysis in Berle and Means—the problem lay in the separation of ownership and control and the trust principle should be implemented.⁷³ But he then struck out in a different direction, talking law reform and detailing the basic terms of a governance agenda, an agenda to which corporate law reformers have been looking ever since.⁷⁴ Control of the board of directors needed to be taken out of management’s hands and placed in those of an independent director majority. He proposed a monitoring model—a board made up of independent shareholder representatives who supervised the managers from a position of power.⁷⁵ He also wanted more disclosure of conflict of interest transactions and maybe even a per se prohibition of loans to officers.⁷⁶ The present legal structure, said Douglas, did little to move corporate governance in the desired direction.

Douglas was flexible about means to the end of improvement. Federal incorporation was a possibility. But he did not insist on it. Self-help by the shareholders (given a federally instituted organizational base on which to solve collective action problems), or improvement of state law, also could move things in the right direction.⁷⁷

3. Federal Chartering—Legislative Initiatives.

The National Industrial Recovery Act of 1933 (NIRA)⁷⁸ famously addressed the nation’s economic collapse with industry associations and

70. See generally *id.* See also William O. Douglas & George E. Bates, *Some Effects of the Securities Act upon Investment Banking*, 1 U. CHI. L. REV. 283 (1933); William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171 (1933).

71. See Douglas, *supra* note 70, at 1306.

72. *Id.*

73. *Id.* at 1323.

74. For a later, more thorough-going, exposition of points on the agenda, see MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 137–211, 316–20 (1976).

75. See Douglas, *supra* note 69, at 1314–16. In a later address he would add boards should be smaller, salaries should be adequate, and outsider directors should acquire a thorough knowledge of the firm. See Seligman, *supra* note 46, at 207.

76. See Douglas, *supra* note 70, at 1323–25.

77. *Id.* at 1329.

78. 73d Cong., P.L. No. 67 (June 16, 1933).

codes of fair competition.⁷⁹ It also granted employees the right to organize and bargain collectively.⁸⁰ The notion was that wages and prices needed a reset, a result best achieved through supervised planning and cooperation rather than competition.⁸¹ Thus directed, the NIRA bumped up against the antitrust laws, and, indeed, contained a provision that suspended their application.⁸² The NIRA also provided for federal licensing of corporations as an enforcement contingency,⁸³ finally realizing the progressive goal of the early years of the century. The licensing regime lasted only two years, however. It went down when with the ship in 1935 when the Supreme Court held the NIRA unconstitutional in *A. L. A. Schechter Poultry Corporation v. United States*.⁸⁴

The second Roosevelt administration moved away from planned pricing and enforced cooperation to embrace management control through competition and, in consequence, antitrust enforcement.⁸⁵ But federal chartering stayed on the front burner. Roosevelt himself was a proponent, as was Douglas, now his third SEC Chairman.⁸⁶ They were joined by Senators Joseph O'Mahoney and William Borah, who promoted the idea in Congress. Borah and O'Mahoney wanted to make federal incorporation the vehicle for an omnibus assault on management discretion. O'Mahoney proposed a bill in 1938.⁸⁷ It revived old antitrust agenda items, adding to them Berle and Means's rule of trusteeship and items from the governance agenda. O'Mahoney also included a labor agenda, mandating compliance with the National Labor Relations Act as an internal corporate duty.⁸⁸

79. National Industrial Recovery Act of 1933, § 3.

80. *Id.* § 7 (a).

81. See Langlois, *supra* note 35, at 227–28.

82. National Industrial Recovery Act of 1933, § 5.

83. The licensing requirement was contingent, applying to companies in industries that failed to cooperate:

Whenever the President shall find that destructive wage or price cutting or other activities contrary to the policy of this title are being practiced in any trade or industry or any subdivision thereof, and, after such public notice and hearing as he shall specify, shall find it essential to license business enterprises in order to make effective a code of fair competition or an agreement under this title or otherwise to effectuate the policy of this title, and shall publicly so announce, no person shall, after a date fixed in such announcement, engage in or carry on any business, in or affecting interstate or foreign commerce, specified in such announcement, unless he shall have first obtained a license issued pursuant to such relations as the President shall prescribe.

See *id.* § 4(b)

84. 295 U.S. 495 (1935).

85. See Langlois, *supra* note 35, at 268–73.

86. See Seligman, *supra* note 46, at 205. Douglas followed Joseph P. Kennedy and James M. Landis.

87. S.B. No. 10, 75th Cong., 1st Sess.

88. See Brabner-Smith, *supra* note 35, at 164.

Unfortunately for O'Mahoney, prominent actors in the administration, including Douglas, opposed an all-encompassing approach.⁸⁹ The best that O'Mahoney could get from Congress was the formation of a study committee, the Temporary National Economic Committee. This brought together six members of Congress and six agency representatives under O'Mahoney's chair. The committee held hearings but never got behind O'Mahoney's omnibus approach. Its final report in 1941 had no impact.⁹⁰

C. The Post-War Period

1. The Management Era.

Although Adolf Berle is remembered for having problematized corporate power in *The Modern Corporation*,⁹¹ his post-war writings stood for a contrasting proposition, depicting corporate managers playing a constructive role in the political economy. Berle perceived no inconsistency, for, in his view, the New Deal had effected a realignment, bequeathing a political economy in which corporate power had been rendered benign.⁹² He described an "American economic republic"⁹³ in which the state and the economy were interdependent, with the state taking ultimate responsibility for economic results and exercising a higher level of power⁹⁴ than did private actors and entities. The old economic order and its private property persisted.⁹⁵ Incentivized by the profit motive, it did the producing.⁹⁶ The national government intervened sparingly. It sought only to stabilize the economic order's organizational lines and performance,⁹⁷ exercising its directive power only negatively and rarely insisting on a positive program.⁹⁸ More thoroughgoing intervention had proved unnecessary, but only because sophisticated private actors had learned to moderate their

89. See Seligman, *supra* note 46, at 207–08.

90. *Id.* at 209–10. The bundling of the labor agenda has been accorded a causal role in the failure of the O'Mahoney initiative. *Id.* at 211.

91. See generally BERLE & MEANS, *supra* note 54.

92. ADOLPH A. BERLE, *THE AMERICAN ECONOMIC REPUBLIC* 91 (1963) [hereinafter BERLE, REPUBLIC].

93. *Id.* at 82.

94. *Id.* at 95, 99, 169.

95. *Id.* at 99.

96. See ADOLPH A. BERLE, JR., *POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY* 94 (1959) [hereinafter BERLE, POWER].

97. See BERLE, REPUBLIC, *supra* note 93, at 99.

98. See BERLE, POWER, *supra* note 96, at 94.

conduct, restraining their own power's exercise for the sake of its own preservation.⁹⁹

Berle described a benign equipoise amongst strong organizations, an equipoise constrained by a wider public consensus that empowered the central government in the role of welfare maximizer—he saw a state that guided and pushed markets to the right result with the cooperative engagement of interested parties.¹⁰⁰ Managers, whether they liked it or not, were caught between the regulatory state and the public consensus. Failure to satisfy the public meant new regulation; avoidance of new regulation meant satisfying the public. Since public duties could not, as a practical matter, be avoided, and managers emerged playing a role as economic and social allocators, actively assuming public functions.¹⁰¹ In effect, they were quasi-public servants.¹⁰²

Changes on the ground backed Berle's vision. In the 1950s, while other countries were instituting national health systems and generous state pension schemes for senior citizens, in the United States the corporations took on the great part of the welfare burden.¹⁰³ This was in part an accident of history—pensions and medical benefits found their way into a high-profile settlement between General Motors and its unions in 1948, a settlement that was copied across the industrial landscape and modified over time to labor's advantage as industries went from settlement to settlement.¹⁰⁴

Those years were, not coincidentally, the golden age of American management. Commentators described a new economy that had evolved past Adam Smith's atomistic free market strivers so that forward motion came from innovative technocrats in management suites.¹⁰⁵ Shareholders played no active role in this governance picture. Berle explained why. All they did was passively collect dividends and then consume or save. As such they played no productive role in the economy. Stock market controls were thought to be largely irrelevant. Corporations in need of capital retained earnings or borrowed.¹⁰⁶ The function of the stock market was to

99. See BERLE, REPUBLIC, *supra* note 93, at 169.

100. *Id.* at 88.

101. ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 59, 172–73 (1954) [hereinafter BERLE, 20TH CENTURY].

102. BERLE, POWER, *supra* note 96, at 8.

103. GERALD F. DAVIS, THE VANISHING AMERICAN CORPORATION: NAVIGATING THE HAZARDS OF A NEW ECONOMY 42 (2016).

104. *Id.*

105. Edward S. Mason, *The Apologetics of "Managerialism"*, 31 J. BUS. 1, 3, 10 (1958).

106. See BERLE, 20TH CENTURY, *supra* note 101, at 36–37 (noting that during the preceding six years 64% of invested capital had been financed by retained earnings and only 6% from new equity); see also BERLE, POWER, *supra* note 96, at 45 (noting that 10–15% of new capital came from pension funds and insurance companies and 20% from bank borrowing).

hold out liquidity for the benefit of the rich grandchildren of the entrepreneurs who had founded the great companies. Monitoring had gravitated over to the hands of government authorities,¹⁰⁷ which mediated between producing companies and the markets. The shareholder franchise was likewise irrelevant, the annual vote for the board of directors having degenerated into a meaningless ritual.¹⁰⁸ As rich consumers, shareholders did play a role in social welfare enhancement: They supported their families, they supported social welfare programs as taxpayers, and they supported charities as donors.¹⁰⁹ They were thereby entitled to society's thanks, but not its political solicitude.¹¹⁰

2. Decline and Revival in Delaware.

The Depression disrupted the operation of the charter market to Delaware's disadvantage. New incorporation activity in Delaware slowed substantially. Delaware did not equal the dollar amount of its 1929 chartering revenues until 1952.¹¹¹ Even given that, 1952 in no sense equalled 1929 so far as concerned Delaware's public fisc. The portion of its revenues contributed by chartering remained under 10% of the total until after 1967. Worse, during the 1950s and early 1960s, reincorporation to Delaware continued only at the diminished pace set during the Depression.¹¹²

By 1963, revenues from chartering had declined to 7% of Delaware's total tax draw, and its lawmakers began to fear competition from New Jersey and Maryland. The legislature accordingly organized a law revision commission to review the code.¹¹³ A round of innovation followed, with the amendments becoming effective in 1967. These added an enabling section liberalizing indemnity of officers and directors found liable for breaches of fiduciary duties.¹¹⁴ The amendments also significantly narrowed the class of shareholders accorded merger appraisal rights,¹¹⁵

107. Adolf Berle, *Property, Production and Revolution: A Preface to the Revised Edition*, in BERLE & MEANS, *supra* note 54, at xxvii, xxxiii (rev'd ed. 1967) [hereinafter BERLE, 1967 INTRODUCTION].

108. See BERLE, POWER, *supra* note 96, at 104–05.

109. See BERLE, REPUBLIC, *supra* note 93, at 51–52.

110. The shareholder interest would emerge as a legitimate force in society, said Berle, only when shareholder wealth was so widely distributed as to benefit every American family. See BERLE, 1967 INTRODUCTION, *supra* note 107, at xxxv. Only in such a distributive utopia could the shareholder interest serve as a proxy for social welfare and thus hold out political economic salience.

111. See NADER, GREEN & SELIGMAN, *supra* note 13, at 535.

112. *Id.*

113. *Id.* at 60–61.

114. DEL. CODE ANN. tit. 8, § 145 (2023).

115. *Id.* § 262(b).

facilitating acquisitions by large firms.¹¹⁶ It was a return to the pattern of the 1920s, with Delaware shifting to an aggressive, competitive posture and modifying its code further to enhance the zone of management discretion. As in the 1920s, a bull market provided air cover, this time the 1960s “go go” stock market in which the Dow Jones Industrial Average finally reached the 900 level.¹¹⁷

Delaware’s initiative yielded palpable rewards. Incorporations and reincorporations of large firms increased markedly in 1966 and continued through 1971 at levels not seen since the 1920s.¹¹⁸ Even though other states quickly copied the new provisions, Delaware’s market share recovered to one-third of NYSE companies.¹¹⁹ Delaware thereafter increased that market share: By 1977, 40% of publicly traded companies were organized in Delaware;¹²⁰ in 1981 the figure was 44%;¹²¹ the 50% figure was reached again by 1991.¹²²

3. A Federal Incursion at Management’s Behest.

Delaware wasn’t the only place where management procured favorable legislation during the “go go” years. The rising market encouraged hostile takeover activity, as conglomerates expanded by force. The management interest put on a full court political press in response, securing antitakeover amendments of state corporate codes. And, in a reversal of the usual pattern, management also went to Congress, there to get an extension of the Securities and Exchange Act of 1934 to cover takeover bids, in the form of the Williams Act of 1968.¹²³

The Williams Act modified what previously been a state law zone of free contract between arm’s length buyers and sellers of shares. The Act

116. Comment, *Law for Sale: A Study of the Delaware Incorporation Law of 1967*, 117 U. PA. L. REV. 861, 863–72 (1969). See also Ernest L. Folk III, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. BAR J. 409, 411–419 (1968), for a realistic description of the influences that came to bear on the revision.

117. There were two market peaks. The first was reached in December 1965, at the end of which the DJIA closed at 969. The second came in January 1969 which ended with the DJIA at 948. *Dow Jones Industrial Average History*, FEDPRIMERATE.COM, <https://www.fedprimerate.com/dow-jones-industrial-average-history-djia.htm> [<https://perma.cc/A9QU-GD4G>].

118. See NADER, GREEN & SELIGMAN, *supra* note 13, at 505.

119. See Comment, *supra* note 116, at 891–92.

120. See generally Dodd & Leftwich, *supra* note 51.

121. See Stephanie S. Rojo, *Delaware Versus Texas Corporate Law: How Does Texas Compare?*, 3 HOUS. BUS. & TAX L.J. 290, 291 (2003).

122. See Martin Lipton & Steven A. Rosenblum, *A New System for Corporate Charters: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 190 n.6 (1991). Fifty percent remains Delaware’s share of publicly-traded companies in 2023. But that 50% includes 64% of the Fortune 500. See *Why Do Business in Delaware?*, DEL. COUNSEL GRP. LLC, <https://delawarecounselgroup.com/why-do-business-in-delaware/> [<https://perma.cc/SDZ2-5UJ2>].

123. Pub. L. No. 90-439 (codified in 15 U.S.C. §§ 78m(d)-€; 78n(d)-(f) (2004)).

reduced the contracting space with process constraints on the conduct of tender offers. It should be described as management protective: Its minimum duration period strengthened the hand of target management, importing a window of opportunity in which to employ defensive tactics.¹²⁴

The Act stemmed from concern over the increasing impact of “corporate raiders,” and was conceived as a device to curb cash tender offers.¹²⁵ Senator Harrison Williams introduced the legislation in 1965,¹²⁶ making clear his management protective motive, speaking of “white collar pirates” who took advantage of the “leniency of our laws” to loot “proud old companies.”¹²⁷ But Williams’ pro-management draft failed to attract support from the SEC and therefore failed to gain traction in the Senate.¹²⁸ Then, as later, views on takeovers conflicted.

Williams tried again in 1967, with a less stringent draft.¹²⁹ This time he emphasized that the bill was not meant to discourage tender offers *per se*. Reflecting the view of SEC Chairman Manuel F. Cohen,¹³⁰ Williams assured that the bill was neutral towards both bidders and targets.¹³¹ Narrow policy networks were having an impact: The final Act’s more modest compass stemmed in no small part from suggestions of the securities industry and academics, who took the bidder’s part.¹³² With support secured from the SEC¹³³ and the stock exchanges, the bill passed easily by a series of voice votes.¹³⁴

124. See David D. Haddock, Jonathan R. Macey & Fred S. McChesney, *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701, 741 (1987); see also Jonathan Macey & Jeffrey Netter, *Regulation 13D and the Regulatory Process*, 65 WASH. U. L.Q. 131, 157–58 (1987) (arguing that rules requiring disclosure of bidders’ intentions serve no public interest benefiting lawyers, accountants, and investment bankers in addition to defending managers).

125. See Lyman Johnson & David Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1891 (1989).

126. *Id.*

127. RALPH C. FERRARA, MEREDITH M. BROWN & JOHN M. HALL, *TAKEOVERS II: A STRATEGIST’S MANUAL FOR BUSINESS COMBINATIONS IN THE 1990S* 8 (2d ed. 1993).

128. See Johnson & Millon, *supra* note 125, at 1891.

129. The Williams Act, as eventually passed, had reduced proration periods and limited withdrawal periods compared to those initially considered. See W. Brewster Lee III, *SEC Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance*, 68 CORNELL L. REV. 914, 925 (1983); see also Johnson & Millon, *supra* note 125, at 1893 (describing the Act as a compromise between pro and antitakeover views).

130. *Id.*

131. See Allen E. Kelinsky, Comment, *Promoting Shareholder Equality in Stock Accumulation Programs for Corporate Control*, 36 AM. U. L. REV. 93, 95 (1986).

132. See Johnson & Millon, *supra* note 125, at 1897; Lee, *supra* note 129, at 926–27.

133. The SEC accepted the Williams Act as passed due to its desire for a bill that neither favored nor disfavored corporate takeover activity through tender offers. See Richard W. Stevenson, *Securities Bill Emerges in House as G.O.P. Drops Some Demands*, N.Y. Times, Mar. 8, 1996, at D1.

134. See 113 Cong. Rec. 24,664 (1967); 114 Cong. Rec. 21,483–21,484 (1968); 114 Cong. Rec. 21,954 (1968).

Significantly, the Williams Act, like its predecessor securities laws, left the charter market undisturbed even as its system of process and disclosure rules displaced state law from an historical zone of operation.

D. The Emergence of Corporate Law Federalism

Corporate federalism emerged as an artifact of the federal state back-and-forth of the New Deal and post-war eras. Simply, internal affairs remained with the states while the national government regulated the national markets. There was an important, and potentially invasive corollary: to the extent that effective market regulation required federal intervention respecting internal affairs, no barrier of principle or policy deterred such intervention. Thus did federal rules respecting proxy solicitation come to eclipse the state law respecting shareholders' meetings and voting in practical importance and policy salience. And thus did federal process rules on tender offers materially impact the balance of power in corporate boardrooms.

State corporate law fell back from the policy margin as a consequence. Indeed, it came to be viewed as a backwater. In 1962, Bayless Manning, one of the era's prominent corporate law academics, pronounced corporate law dead as a field of intellectual effort, a dry as dust doctrinal inheritance lacking in policy salience.¹³⁵

It comes as no surprise that Manning's dismissal came at a time when Delaware's fortunes were at a low ebb. An observer in 1962 might also have noted, fairly, that the era of charter competition appeared to be coming to an end. State law no longer seemed to matter much, therefore there was no motivation for either governance-related migration by large firms or competitive innovation at the state level. Delaware, moreover, loomed less large as a code drafter than formerly—the American Bar Association had entered the field in 1950 with the Model Business Corporation Act.¹³⁶ But, as we have seen, the observation would have been premature. Delaware successfully reasserted itself, jump starting its competitive position with the 1967 reform of its code. In so doing it very much followed the historical pattern in which competitive initiative meant new concessions to the management interest.

Meanwhile, Douglas's governance agenda remained on the table as a standing invitation to the federal government to break out of the market regulation framework and extend its regulatory reach to internal affairs. Were the governance agenda finally to rise to political salience as a source

135. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n. 37 (1962).

136. See Ray Garrett, *History, Purpose and Summary of the Model Business Corporation Act*, 6 BUS. LAW. 1 (1950)

of mandatory initiatives, it held out a clear potential for confrontation with Delaware in its revived role as national corporate lawmaker.

II. CORPORATE FEDERALISM IN DISARRAY IN THE 1970S—POLICY AND LEGISLATION

Conflicts did simmer under the surface during the 1960s. They became manifest during the 1970s, triggering the collapse of Berle's American economic republic. People stopped looking at the state as a benevolent maximizer and lost confidence in the effectiveness of corporate managers. Anti-managerialism returned to the fore, bringing along with it what we now call "corporate governance" and problematizing corporate federalism. The most salient federal entries into internal affairs since the Depression would follow.

A. The Anti-Managerial Resurgence and the Appearance of Corporate Governance

The economic background was unstable. The "go go" years came to an ugly end in 1972 and 1973, when the stock market collapsed¹³⁷ and the economy went into a severe recession aggravated by the mid-east oil crisis.¹³⁸ The stock market didn't really recover until August of 1982—a whole decade in which there was no money to be made long in stocks even as inflation rose steeply.¹³⁹ The malaise was called "stagflation" and undermined the economic assumptions of the managerial golden age.¹⁴⁰ The appearance of international competition in manufactured goods added to the stock of chronic problems.¹⁴¹ We were no longer a closed continental economy in which domestic corporations competed only against one another.

At the same time, the New Deal political coalition that created and maintained the strong regulatory state fell apart. Managers, formerly cooperative in the face of overwhelming state power, now defected, playing a hostile game against regulatory initiatives. Simply, they were no longer afraid of non-compliance.¹⁴² A subset of managers even found their business models under direct attack: A deregulatory movement had sprung up,

137. On Jan. 2, 1973, the DJIA was at a peak of 1032. On Jan. 2, 1974, it stood at 855.32. On Jan. 2, 1975, it stood at 632. *Dow Jones Industrial Average History*, *supra* note 117.

138. *See* Davis, *supra* note 103, at 47.

139. *See* Langlois, *supra* note 35, at 418 (describing a decade of negative real returns of equities, adjusted for inflation).

140. *See* Davis, *supra* note 103, at 55.

141. *Id.* at 55–56.

142. *See* Elliott J. Weiss, *Social Regulation of Business Activity, Reforming the Corporate Governance System to Resolve an Institutional Impasse*, 28 UCLAL. REV. 343, 347–48 (1981) (describing corporate noncooperation).

disrupting cozy, corporatist settlements in several industries¹⁴³—securities trading,¹⁴⁴ railroads, trucking, shipping, air transport, and broadcasting.¹⁴⁵ The movement had a progressive cast. We tend to associate a turn to liberal economic thinking with the Reagan administration, but most *de jure* de-regulation occurred during the Carter administration with Senator Edward Kennedy playing the lead role in the Congress.¹⁴⁶

People asked questions about how well managers were doing their jobs,¹⁴⁷ questions that began with the collapse of the once great Penn Central Railroad in 1970¹⁴⁸ and intensified as bad results accumulated. Questions gave way to accusations when widespread corruption came to light during the Watergate investigations of 1973 and 1974. The special prosecutor discovered corporate political slush funds that evaded normal accounting controls.¹⁴⁹ Payments included illegal domestic political contributions and bribes to officials abroad—termed “questionable foreign payments”—made in connection with the sale of American goods and services.¹⁵⁰ In March 1974, the SEC announced a voluntary disclosure program, asking companies to admit to any questionable payments to foreign officials.¹⁵¹ There resulted admissions by over 450 companies implicating over \$400 million in payments.¹⁵² The public, already disgusted with corruption in government and agitated by the media, demanded a cleanup of corporate America.¹⁵³

The conceptual framework surrounding corporations changed substantially as a result. Unbridled management power, problematized by Berle back in 1932, came back to the forefront as a problem in need of solution. Corporate governance was invented to take on the job—the phrase “corporate governance” had its first published appearance only in

143. See Michael L. Wachter, *Labor Unions: A Corporatist Institution in a Competitive World*, 155 U. PA. L. REV. 581, 628–30 (2007).

144. See Langlois, *supra* note 35, at 420.

145. See *id.* at 460–77.

146. *Id.* at 460.

147. *Id.* at 56.

148. STAFF REPORT OF THE SECURITIES AND EXCHANGE COMMISSION TO THE SPECIAL SUBCOMMITTEE OF INVESTIGATIONS, THE COLLAPSE OF THE PENN CENTRAL COMPANY (1972).

149. See GEORGE C. GREANIAS & DUANE WINDSOR, THE FOREIGN CORRUPT PRACTICES ACT 63 (1982).

150. See Roberta Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 86–87 (2005).

151. See Daniel Pines, *Amending the Foreign Corrupt Practices Act to Include a Private Right of Action*, 82 CALIF. L. REV. 185, 187–188 (1994).

152. The lead item was the revelation of \$22 million of bribes abroad by Lockheed Aircraft. *Id.* at 187–188.

153. See DONALD R. CRUVER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT 5 (2d ed. 1999).

the early 1970s.¹⁵⁴ The first fully developed text on the subject, Melvin Eisenberg's book *The Structure of the Corporation*,¹⁵⁵ followed in 1976. Eisenberg expanded on Douglas's governance agenda, synthesizing and advancing a generation of thinking about deficiencies of the received legal model of the corporation. Like Douglas, he turned to the moribund board of directors for a corrective mechanism. If we scaled down the demands we placed on the board and successfully required it to monitor management performance (as opposed to taking a leadership role in hands on management), corporate performance would improve. This monitoring function in turn required independent directors and a committee structure keyed to monitoring functions.

The coalescence of this mature governance agenda energized anti-managerialists. All of a sudden, something could be *done* about management empowerment. The new corporate governance thing held the key, with best practices the focal points in the attack. Expectations ran high, higher than a bland list of best practices would seem to justify.

Additional pressure against management came from farther to the political left, which aspired to enlist corporations in policy initiatives. Progressives, who in the 1970s still considered themselves the country's natural ruling group,¹⁵⁶ had become manifestly frustrated with the regulatory process—they were dissatisfied with the level of new regulation and outraged by corporate non-co-operation even as they despaired of marshalling political backing for new regulatory initiatives. “Corporate social responsibility” needed to be instilled to cut the slack. It was hoped that the new governance thing could be the means to the end: If we only could get the shareholders to wake up, appreciate the political stakes, and elect truly independent directors, corporate social responsibility would follow.¹⁵⁷

Unfortunately, these progressive hopes were dashed rather quickly. A well-publicized attempt to use proxy solicitation to cram down controls on managers proved unsuccessful.¹⁵⁸ Shareholders were not acting like citizens, instead remaining supportive of corporate leaders. If corporate

154. See Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. Corp. L. 359, 362–63 (2016).

155. MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* (1976). Eisenberg's monitoring model of the board of directors has ever since been the main focus of legal corporate governance.

156. This is as the Author remembers it.

157. See Victor Brudney, *The Independent Director-Heavenly City or Potemkin Village?* 95 HARV. L. REV. 597, 603–04 (1982).

158. In 1970 a group of public interest lawyers launched a proxy contest at GM in an attempt to elect three progressives to the board of directors. “Campaign GM” received three percent of the votes. See Donald E. Schwartz, *Proxy Power and Social Goals: How Campaign GM Succeeded*, 45 ST. JOHN'S L. REV. 764, 764–66 (2012).

communities would do nothing to correct irresponsible corporate policies, stronger medicine would be needed.

B. Federal Chartering

Stronger medicine meant federal chartering. It stood at the top of the era's law reform agendas, both in the policy sphere and in Congress.

1. Policy Initiatives.

The most famous federal chartering recommendation came from William L. Cary, of the Columbia Law faculty. Cary had come out of the SEC, where he had been a Douglas acolyte.¹⁵⁹ His indictment of Delaware was published in the *Yale Law Journal* in 1974.¹⁶⁰

Cary had several bones to pick with Delaware's code, particularly the liberal indemnity terms included in the 1967 revision.¹⁶¹ He also worried about incursions on the shareholder franchise and on shareholder power more generally, condemning process provisions that accorded management the power to promulgate bylaws¹⁶² and management's use of its legislative power to promulgate antitakeover provisions.¹⁶³

But the thrust of Cary's attack addressed not the code but the courts. Recall that during the early twentieth century, critics of charter competition focused only on corporate codes. The competing states, moreover, did not have control over fiduciary standards until *Erie* was decided in 1938.¹⁶⁴ The Delaware courts took advantage of their newfound primacy during the post-war period. They thereby found their way into the charter competition story. During the late twentieth century, observers explaining why no other state had wrested a significant market share from Delaware included Delaware's courts with its code in the account of the state's advantages.¹⁶⁵ The courts gave Delaware's product line features not easily copied by a potential competitor—the accumulated stock of precedent along with the courts'

159. See A.C. PRITCHARD & ROBERT B. THOMPSON, A HISTORY OF SECURITIES LAW IN THE SUPREME COURT 130 (2023).

160. See William L. Cary, *Federalism and Corporate Law: Reflections on Delaware*, 83 YALE L.J. 663 (1974).

161. *Id.* at 669–70, 686.

162. *Id.* at 669. He feared a broader shift in the conceptual framework against the shareholders—a Delaware Supreme Court ruling that shareholders have no inherent legislative power absent prior approval by the board. *Id.* at 684–85.

163. *Id.* at 685. Shareholders meetings mattered to him too—he criticized the allowance of shareholder action without a meeting. *Id.* at 669.

164. See *supra* text accompanying notes 63–65.

165. See Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 276–77 (1985); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1925–27 (1998).

reputation for competence.¹⁶⁶ The results of cases also mattered. As Sam Arsht, a dean of the Delaware bar, put it, corporations considered Delaware the most favorable forum available.¹⁶⁷

Cary did not disagree, delivering a multi-count indictment. He accused the Delaware courts of monolithic fidelity to management interests. A cluster of cases were held out as evidence: (1) *Chef v. Mathes*,¹⁶⁸ which permitted management “with impunity” to spend corporate money to entrench itself against tender offers;¹⁶⁹ (2) *American Hardware Corp. v. Savage Arms Corp.*,¹⁷⁰ which refused to enjoin a shareholders’ meeting called on short notice or to act respecting a proxy statement acknowledged to be incomplete; (3) *Federal United Corp. v. Havender*,¹⁷¹ which permitted firms to use charter amendments effected through common shareholder voting power to strip preferred stockholders of contract rights and first articulated the doctrine of independent legal significance;¹⁷² (4) *Hariton v. Arco Electronics, Inc.*, which extended the doctrine of independent legal significance to mergers and acquisitions so as to assure a literal rather than purposive and policy-driven reading of the code;¹⁷³ (5) *Sinclair Oil Corp. v. Levien*¹⁷⁴ and *Getty Oil Co. v. Skelly Oil Co.*,¹⁷⁵ both of which left the burden of proof on complaining minority shareholders in conflict of interest situations;¹⁷⁶ and (6) *Graham v. Allis-Chalmers Manufacturing Co.*, which absolved management of a duty of care respecting subordinates’ criminal conduct absent actual knowledge.¹⁷⁷

Cary concluded that Delaware had “no public policy left . . . except the objective of raising revenue.”¹⁷⁸ To Cary, the “public policy” at stake was the integrity and effectiveness of corporate managers—he wanted business conducted “fairly, honestly, and competently.”¹⁷⁹ Rent seeking had led a single state to “grant management unilateral control untrammelled by other interests,”¹⁸⁰ thereby sacrificing the national public interest. The relationship between Delaware and the chartering firms meant that

166. Kamar, *supra* note 165, at 1927–39.

167. See Comment, *supra* note 116, at 893–94.

168. 199 A.2d 548 (Del. 1964). 199 A.2d 548 (Del. 1964).

169. See Cary, *supra* note 160, at 673–77.

170. 136 A.2d 690 (Del. 1957).

171. 11 A.2d 331 (Del. 1940).

172. See Cary, *supra* note 160, at 677–78.

173. 188 A.2d 123 (Del. 1963).

174. 280 A.2d 717 (Del. 1971).

175. 267 A.2d 883 (Del. 1970).

176. See Cary, *supra* note 160, at 679.

177. 267 A.2d 883 (Del. 1970).

178. See Cary, *supra* note 160, at 684; see also Marvin A. Chirelstein, *Towards a Federal Fiduciary Standards Act*, 30 CLEV. ST. L. REV. 203 (1981).

179. See Cary *supra* note 160, at 671.

180. *Id.* at 697, 698.

corporate law addressed only the interests of a narrow class of management consumers, causing it to be more and more removed from the public interest.

Cary recommended a preemptive federal regime of fiduciary standards. There was no mention of federal charters or licenses, but the hoped for result occupied the same field. Instead of wiping out state corporate law (as applied to big publicly traded companies), Cary sought to materially diminish its salience, thereby enervating the charter market. Cary's regime would have removed fiduciary lawmaking to the federal courts, destroying Delaware's body of case precedents and displacing its judiciary from the front line of corporate lawmaking. Given the gradual convergence of corporate codes, Delaware's customers thereupon might have reappraised the costs and benefits of domicile in the state.¹⁸¹

In the policy context of the time, Cary's intervention amounted to an opening bid. Its focus, relatively speaking, was narrow. It looked primarily to vindication of the trust principle, touching on the governance agenda only incidentally and remaining silent on social responsibility. Reformers who linked the conduct of corporate business to a range of social problems¹⁸² would bring a broader perspective to bear on the topic of federal chartering.

Thus did Ralph Nader, Mark Green, and Joel Seligman substantially raise Cary's bid two years later.¹⁸³ They called for federal incorporation of nonfinancial companies with 10,000 or more employees and sales revenues exceeding \$250 million.¹⁸⁴ Once a company was federally incorporated the governance agenda would be imposed mandatorily. Chartered companies would have independent full-time directors nominated by shareholders unaffiliated with the managers.¹⁸⁵ Nor would the governance agenda function as a limit: the independent directors would be charged with protecting the interests of other constituents in addition to assuring

181. While Berle and Means limited the trust paradigm's class of beneficiaries to the corporation's shareholders, many of the paradigm's subsequent proponents expanded the zone of beneficiary to include other corporate constituents and the public interest. The "public" characterization in *The Modern Corporation and Private Property* invited the extension. So did the book's emphasis on managerial power: To mid-twentieth century anti-managerialists, power implied responsibility and, given the separation of ownership and control, responsibility needed to be imposed in law, federal law. See RALPH NADER, JOEL SELIGMAN & MARK GREEN, *TAMING THE GIANT CORPORATION* 1, 7 (1976); see also ROBERT A. DAHL, *GOVERNING THE GIANT CORPORATION IN CORPORATE POWER IN AMERICA* 2 (Ralph Nader & Mark Green eds., 1972).

182. See generally RALPH NADER, MARK J. GREEN & JOEL SELIGMAN, *TAMING THE GIANT CORPORATION* (1976); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L. REV. 545, 548-49 (1984).

183. See NADER, GREEN & SELIGMAN, *supra* note 182, at 16.

184. *Id.* at 118-31, 240.

185. *Id.* at 128.

profitable operation.¹⁸⁶ Nader, Seligman, and Green did not stop there. Like the proponents of federal chartering early in the century, they folded in the broader progressive agenda to cover antitrust law and employee rights.¹⁸⁷

Subsequent commentators pushed the envelope out even farther. Hardwiring the governance agenda into federal law would not necessarily assure proper progressive results. You needed to be certain that the right sort of people would be nominated and elected to the “independent” board of directors. It followed that corporations should be required to nominate their directors from a centrally qualified list populated only by sound progressive types.¹⁸⁸

These radical proposals reflected the era’s progressive *zeitgeist*. The political arrangements that had satisfied previous generations, whether benign pluralist responsiveness or Berle’s quasi-corporatism, were thought no longer to deliver the goods. Legislative results were not protecting the public interest. The explanation was simple: business had overwhelming political influence. Under a theory in circulation at the time, business did not even need to lobby aggressively to get results; politicians automatically backed anything that encouraged investment because they were terrified of the political consequences disinvestment during economic downturns.¹⁸⁹ What could not be achieved directly with targeted legislation accordingly needed to be accomplished indirectly—through tight control over corporate internal affairs.

2. Legislative Initiatives.

The public interest agenda came in from the cold when news of improper political contributions and foreign payments made management’s conduct of business a national political issue in the post-Watergate environment.¹⁹⁰ Federal chartering returned to the political stage along with it. Congressional hearings occurred in 1976 and 1977.¹⁹¹

186. *Id.* at 1125.

187. *Id.* at 71.

188. See Weiss, *supra* note 142, at 426–32.

189. See CHARLES LINDBLOM, *POLITICS AND MARKETS: THE WORLD’S POLITICAL-ECONOMIC SYSTEMS* ch. 13 (1977). Alternatively, it was argued that the regulatory state had become dysfunctional even as corporate externalities remained a critical problem. See Weiss, *supra* note 142, at 347–55, 422–26 (suggesting imposition of a norm of “altruistic capitalism”).

190. See Schwartz, *supra* note 182, at 548–49.

191. See Joel Seligman, *A Sheep in Wolf’s Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEO. WASH. L. REV. 325, 337–38 (1987). Jimmy Carter supported federal chartering in his successful presidential campaign of 1976. *Id.* at 339.

Three proposed bills mandating federal chartering materialized between 1975 and 1980.¹⁹² The first, the Corporate Citizenship and Competition Act of 1975,¹⁹³ would have established a federal corporate chartering commission performing information gathering functions. The bill, like its twentieth century predecessors, stepped out of the bounds of corporate governance to direct the reorganization of three concentrated industries, motor vehicles, petroleum, and steel.¹⁹⁴ The second bill, the Corporate Democracy Act of 1980,¹⁹⁵ imposed a list of governance mandates—a majority independent board and independent supervisory and public policy board committees, along with SEC supervision of the nomination process and expense subsidies for candidates.¹⁹⁶ Following Cary, it also provided for a federally-based duties of loyalty and care. There was bundling once again—this time protective provisions from labor’s legislative wish list.¹⁹⁷ Only the third bill, Senator Howard Metzenbaum’s Protection of Shareholders Rights Act of 1980,¹⁹⁸ followed Douglas’s subject matter template and limited itself to agenda items related to the trust principle and governance agenda. Like the Corporate Democracy Act, it imposed federal fiduciary standards.¹⁹⁹ It then added a series of process mandates including an independent director board majority,²⁰⁰ audit and nominating committees entirely made up of independent directors,²⁰¹ a shareholder nomination mechanism,²⁰² and cumulative voting.²⁰³

The Corporate Democracy Act of 1980 and the Protection of Shareholders Rights Act of 1980, with their new, federally-based fiduciary standards, would have radically changed the litigation pattern, channeling private actions alleging breaches of the duty of loyalty and the duty of care from the state courts (under state law) to the federal courts (under federal law). The pre-*Erie* pattern of shared responsibility for fiduciary lawmaking would have been reinstated to some extent and competitive advantage

192. Corporate Citizenship and Competition, H.R. 7481 (introduced May 22, 1975) (reintroduced as H.R. 9076, July 29, 1975); Democracy Act of 1980, H.R. 7010 (introduced April 2, 1980); Protection of Shareholder Rights Act of 1980, S. 2567 (introduced April 16, 1980).

193. Corporate Citizenship and Competition, H.R. 7481 (introduced May 22, 1975) (reintroduced as H.R. 9076, July 29, 1975).

194. *Id.* The antitrust agenda of the day resulted in the Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435.

195. Democracy Act of 1980, H.R. 7010 (introduced April 2, 1980).

196. *Id.*

197. *Id.* (titles III and IV).

198. Protection of Shareholder Rights Act of 1980, S. 2567 (introduced April 16, 1980).

199. *Id.* § 4.

200. *Id.* § 5.

201. *Id.* §§ 6, 7.

202. *Id.* § 8.

203. *Id.* § 9.

accruing to Delaware by virtue of its caselaw and judicial venues would have been lost.

Unfortunately, both the Corporate Democracy Act of 1980 and the Protection of Shareholders Rights Act of 1980 were mooted late in the game. The time for anti-managerial politics was running out. The federal political agenda would shift when the Reagan administration came in the following year. Decades would pass before a call for federal chartering would again be heard on Capitol Hill.²⁰⁴

C. New Regulation Pursuant to the Governance Agenda

Even as federal chartering stalled and disappeared, the governance agenda shaped successful initiatives both at the SEC and in Congress during the 1970s. These featured piecemeal impairments of state control over internal affairs without going so far as to institute a parallel chartering regime.

1. The Governance Agenda at the SEC.

The SEC took up the items on the governance agenda in 1977, holding public hearings. It was looking toward majority independent boards and committees, but, unfortunately, had no statutory authorization to mandate them. Aside from Section 14 of the 1934 Act,²⁰⁵ which authorizes the SEC proxy rules, the agency could only mandate disclosure. The SEC accordingly went for half a loaf, working the items from the governance agenda into new disclosure rules concerning board and committee membership and structure. It wanted each director tagged as independent or affiliated, but did not get it. Management pushed back hard and forced the SEC to settle for less specific means of getting governance information into the public filings.²⁰⁶

One mandate did make it into law. In 1977, the SEC successfully pressured the New York Stock Exchange to amend its rules to require an audit committee comprised solely of independent directors.²⁰⁷ Putting the proxy rules to one side, this amounted to the first national level mandatory push into internal affairs pursuant to the governance agenda. But, as has often been the case with the governance agenda, the practice was well

204. This would come in the form of Elizabeth Warren's Accountable Capitalism Act, introduced in 2018. Warren's bill would require a federal charter for all companies with gross receipts exceeding \$1 billion, a charter that would require the board to pursue the public benefit and to perpend to stakeholder interests. The proposal goes on to grant the franchise to elect 40% of board seats to employees. Accountable Capitalism Act §§ 2, 5, 6, S.3348 (115th Congress 2017–2018).

205. 15 U.S.C. § 78n.

206. See Karmel, *supra* note 150, at 88–89.

207. See *id.* at 92.

ahead of the mandate: 90% of public companies already had made the change.²⁰⁸

2. Corrupt Managers and Congress.

Exposés of management defalcations incident to the Watergate scandal led to Congressional action in the form of The Foreign Corrupt Practices Act of 1977 (FCPA).²⁰⁹ The FCPA grew out of a presidential investigation and spate of committee hearings conducted in 1976, an election year. There was significant political disagreement. The Ford Administration backed a disclosure-based statute; Democratic senators and their presidential candidate, Governor Jimmy Carter, wanted direct constraints and criminal penalties. The Senate unanimously passed a weak bill before the election, but the House recessed before taking up the matter.²¹⁰ When the new Congress convened in 1977, Carter had won and the new administration backed a strong bill. The strong version passed unanimously by the end of the year.²¹¹

The statute prohibited bribery of foreign officials, making the “questionable” payments illegal. More importantly for present purposes, it amended the 1934 Act to go deeply into internal affairs, imposing record-keeping and internal control requirements on reporting firms.²¹² The FCPA also gave the SEC oversight over the formulation of accounting principles. It was said to amount to the most extensive application of federal law to the regulation of corporations since 1934.²¹³

The FCPA’s compliance mandates would have been inconceivable in the state law framework. Compliance systems were not even on the states’ formal enabling menu, and the enabling approach clearly foreclosed the possibility of mandates. Compliance with law did fall within the ambit of fiduciary review, at least in theory.²¹⁴ In practice, however, there was no state-level enforcement commitment.²¹⁵

208. See Seligman, *supra* note 191, at 338.

209. Securities Exchange Act of 1934, §§ 13(b)(2), 30A, 32, 15 U.S.C. §§ 78m(b)(2), 78dd-1-2, 78ff, added by Pub. L. No. 95-213, 91 Stat. 1494 (Dec. 19, 1977).

210. See GREANIAS & WINDSOR, *supra* note 149, at 60–65.

211. *Id.* at 63, 71; Daniel L. Goelzer, *The Accounting Provisions of the Foreign Corrupt Practices Act—The Federalization of Corporate Recordkeeping and Internal Control*, 5 J. CORP. L. 1, 17–18 (1979).

212. See Walter Perkel, *Foreign Corrupt Practices Act*, 40 AM. CRIM. L. REV. 683, 683 (2003).

213. See GREANIAS & WINDSOR, *supra* note 149, at 1.

214. The classic case is *Miller v. Am. Tel. & Telegraph Co.*, 507 F.2d 759 (3d Cir. 1974) (discussing New York law).

215. The classic citation is *Graham v. Allis Chalmers*, 188 A.2d 125 (Del. 1963) (declining duty of care review of antitrust compliance breakdown). See generally Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1384 (1998).

D. Management Responses

Managers felt threatened in the political climate of the 1970s. They played a defensive game. First came post-Watergate house cleaning, accomplished with their lawyers at their elbows.²¹⁶ Then came the new corporate governance thing, which they attempted to capture for themselves. They made preemptive concessions to stave off more intrusive initiatives.²¹⁷ The need for monitoring boards populated by independent directors was conceded even as new federal governance mandates were vigorously opposed.²¹⁸ Even the Business Roundtable (BRT), the club comprised of the CEOs of the 200 (or so) largest companies, pronounced in favor of independence and monitoring.²¹⁹ Its members figured that so long as incumbent CEOs could use their influence to secure appointment of cooperative “independent” types, any threat was minimal.²²⁰

Management’s strategy changed abruptly when Reagan came in in 1981. It no longer saw any benefit deriving from cooperative play with the forces of governance reform. A new obstructionist strategy was deployed in respect of the reformers’ next initiative, the American Law Institute’s (ALI’s) Corporate Governance Project (the Project), launched in 1978.

The Project was supposed to yield a focal point statement of the meaning and content of corporate governance, taking a middle ground perspective. Its initiators saw it as a continuation and extension of the corporate community’s preemptive response to the political pressures of the late 1970s. The idea was to get the cutting edge of corporate governance law-making out of the hands of Congress and the SEC and place it into the hands of a benign private legal organization, there to defuse regulatory threats by pursuing private solutions.²²¹

Tentative Draft No. 1 (TD No. 1),²²² which appeared in 1982, took the mode of model legislation. Most of its sections began with a pronouncement that “corporate law should provide,” signaling mandates as

216. See Seligman, *supra* note 191, at 335.

217. Statement of the Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083, 2085, 2089, 2093 (1978).

218. The corporate committee of the American Bar Association (ABA) got into the game also, putting out a guidebook for effective board monitoring. See American Bar Association Committee on Corporate Laws, Section of Corporate, Banking and Business Law, *The Corporate Director’s Guidebook*, 32 BUS. LAW. 1595 (1978).

219. See Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083 (1978).

220. See Brudney, *supra* note 157, at 610–12 (describing the pattern of cooperation and management control of appointments).

221. See William W. Bratton, *Special Interests at the Gate: The ALI Corporate Governance Project, 1978–1992*, in *THE AMERICAN LAW INSTITUTE: A CENTENNIAL HISTORY* 319 (Andrew S. Gold & Robert W. Gordon eds., 2023).

222. See ALLI, *PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS*, TENTATIVE DRAFT NO. 1 (April 1, 1982) [hereafter TD No. 1].

the outcome in view. More particularly, there should be (1) a majority independent board,²²³ (2) audit²²⁴ and nominating²²⁵ committees made up entirely of independent directors, and (3) a majority independent compensation committee.²²⁶ TD No. 1 also contained aggressive formulations of the duty of care and the business judgment rule.²²⁷

The BRT came out swinging.²²⁸ The chair of its corporate governance task force requested its members to oppose the ALI's proposals.²²⁹ He spoke with surprising frankness. The Project stemmed from the 1970s effort to deflect federal incorporation proposals. Any such threat had dissipated. Therefore, there was no further need to cooperate. In fact, it was time to back track: The BRT should shelve its own previous pronouncements on the composition and structure of boards; they were no longer needed and always could be pulled down and dusted off in case of a resurgence of anti-managerial activism.²³⁰ A bill of particulars²³¹ followed—a 70-page take-down of TD No. 1 prepared at the BRT's behest by a team at the law firm of Weil, Gotshal & Manges under the leadership of the firm's crack litigator, Dennis Block, and its high-level advisor to boards of directors, Ira M. Milstein.²³² The Weil team went for the jugular, recommending that the Project be abandoned in its present form.²³³

A ten-year back and forth followed. The *Principles*, as eventually approved, were much enervated.²³⁴

E. A Theoretical Development

As we have seen, academic commentaries on Delaware and charter competition had long reflected public interest thinking. That changed

223. *Id.* § 3.03, at 72.

224. *Id.* § 3.05, at 82–84.

225. *Id.* § 3.06, at 97–98.

226. *Id.* § 3.07, at 106–08.

227. *Id.* § 4.01, at 140–41.

228. On the politics of the ALI proceedings, see Jonathan R. Macey, *The Transformation of the American Law Institute*, 61 GEO. WASH. L. REV. 1212 (1993); Victor Brudney, *The Role of the Board of Directors: The ALI and Its Critics*, 37 U. MIAMI L. REV. 223, 228 (1983).

229. *Id.*

230. *Id.*

231. See THE BUSINESS ROUNDTABLE, STATEMENT OF THE BUSINESS ROUNDTABLE ON THE AMERICAN LAW INSTITUTE'S PROPOSED "PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS" (1983).

232. See Kenneth R. Andrews, *Corporate Governance Eludes the Legal Mind*, 37 U. MIAMI L. REV. 213, 214 n.3 (1983).

233. See Business Roundtable, *supra* note 231, at 67.

234. See Bratton, *supra* note 221, at 334–35. Mandatory independent board structure was proposed in the first draft of the Project, but was cut back to precatory status in later versions. Compare TD No. 1, *supra* note 222, § 3.03 (T.D. No. 1 1982) (mandatory majority of independent directors), with 1 ALI, PRINCIPALS OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3A.01 (1994) (majority of independent directors as practice suggestion).

during the 1970s, when the academy handed Delaware the basis for a principled defense. It came from a new economically-based description of corporate organization. This substituted markets for hierarchies and thereby rebutted both Berle and Means's description of separated ownership and control and their call for regulation. Under the new paradigm, the imperfections targeted by the trust principle reemerged under the denomination "agency costs," costs that firms had every incentive to minimize due the free market's competitive force.²³⁵ Managers were no longer seen as empowered actors and responsibility and accountability no longer were seen as a problem: When managers failed, they got removed,²³⁶ the firm with a high agency cost base failed to survive in the product market, and poor managers failed to survive in the management labor market. Their incentives accordingly were focused on long run productive success for the firm.²³⁷ Given the accumulation of market deterrents, a powerful presumption arose against regulatory intervention.²³⁸

The economic paradigm went on to counter Cary's denunciation of Delaware. It drew on public choice theory to debunk the public interest ideal of regulatory motivation. Quite the contrary—regulators should be expected to behave no differently than actors in private economic relations.²³⁹ It followed that there was nothing suspicious about the sale of charters. This point, coupled with the story of market deterrence and well-aligned agent incentives, reversed the race to the bottom into a race to the top.²⁴⁰ In the race to the top description, state corporate codes and judicial venues were viewed as products consumed by corporations. Competition for the legal business of firms forced the states to adapt corporate law to the dynamic conditions in which the firms operate. State lawmaking emerged as a trial-and-error process suited to the accurate identification of optimal corporate arrangements.²⁴¹ Delaware, far from being a policy problem, was a law-making exemplar.

235. See generally Michael Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 310 (1976). For a review of the literature, see William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 404, 420 (1989).

236. This point originated in Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

237. See Bratton, *supra* note 235, at 417–18.

238. See William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 NW. U. L. REV. 180, 186–90 (1992).

239. See Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J. L. ECON. & ORG. 167, 168–69 (1990).

240. See Ralph W. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254–62 (1977).

241. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 6 (1993).

F. The State of the Federalism

Let us pose a question: How should we best describe the state of corporate federalism at the end of the tumultuous 1970s? The answer is simple and surprising: The federal-state balance on internal affairs ended the decade in more or less the same place at which it began it.

We have seen that during the previous seven decades Congress made repeated incursions onto the states' subject matter territory without thereby suppressing or chilling charter competition or disabling the states' enabling regime. We also noted that, prior to 1970, federal interventions targeted the securities markets, which from the perspective of state corporate law (if not state securities law) was unoccupied territory; internal affairs were left alone for the most part. Not that there had been no federal incursions on internal affairs—there had, most notably in the form of the federal proxy rules. But even these added to state law without displacing it.

The pattern continued during the 1970s. There was a significant new incursion into internal affairs the form of the FCPA. But once again the territory was unoccupied—the states did not *do* compliance with law. (They do now, of course, Delaware having belatedly entered the field with its *Caremark* decision in 1996.²⁴²) The FCPA accordingly did not take anything away from them. Nor did it otherwise impair the operation of the state system. Charter competition continued as before, as did the enabling *status quo*.

The decade's special salience for corporate federalism lies in its *failed* reform initiatives. It was the time when Doulgas's governance agenda finally came to the fore, ripening into "corporate governance" in the form of a long list of best practices. Corporate governance captured the *zeitgeist* and influenced the composition and structure of corporate boardrooms, but on a largely voluntary basis. There was very little in the way of mandatory law reform, despite the favorable political favorable winds whipped up by one of the greatest corporate scandals in the country's history. The SEC, while it made a governance push, lacked the structural and political wherewithal to do much more than dent the state system, in the end resorting to the stock exchange for a mandated result. Progressives in Congress upped the ante with federal chartering proposals targeting the Delaware courts' control over fiduciary law. But, as in the past, federal chartering lacked the necessary political traction.

By the decade's end, the corporate governance reform machine had moved on to the private precincts of the ALI, its threat to Delaware diminishing accordingly. The *ALI Principles*, as eventually approved in 1992,

242. In re *Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

make no mention of Delaware,²⁴³ apparently having been crafted and justified on the assumption that Delaware and charter competition did not matter. Unsurprisingly, the *Principles* would have no effect whatsoever on either charter competition or on Delaware law.²⁴⁴ Meanwhile, with the arrival of economic thinking, the legal academy was becoming a source of support.

In sum, by 1980 things were looking up for Delaware.

III. CORPORATE FEDERALISM IN DISARRAY IN THE 1970S—STATE AND FEDERAL COURTS

A chapter is missing from our account of the stresses and strains in corporate federalism during the 1970s. There was another threat to Delaware, a threat from a new source. It came not from Congress or administrative agencies but from the federal judiciary in the form of caselaw under Rule 10b-5,²⁴⁵ promulgated pursuant to Section 10(b)²⁴⁶ of the 1934 Act. The cases challenged Delaware fiduciary law and the Delaware judiciary's control over it, Cary's main targets.

More particularly, private plaintiffs were using a broad reading of Rule 10b-5 to challenge “going private” transactions. Going private transactions were tender offers and mergers that took advantage of the depressed 1970s stock market to cash out minority shareholders of controlled companies. The transactions generated the era's focal point questions respecting fiduciary law—opponents described them as opportunistic schemes designed to eliminate minorities for less than fair value. The Delaware courts proved unreceptive to challenges based on the fiduciary duties of majority to minority shareholders, remitting going private plaintiffs to the appraisal remedy. The plaintiffs, wanting bigger (and easier) recoveries than could be yielded in Delaware appraisal, turned to the federal courts, contending that Rule 10b-5 applied in state law fiduciary territory. Their reading got its first judicial adoption in a federal district court in

243. See Bratton, *supra* note 221, at 335.

244. The author here speaks from personal experience.

245. 17 CFR § 240.10b-5 (2023).

246. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j.

1972.²⁴⁷ Acceptance by the Second Circuit Court of Appeals followed in 1976.²⁴⁸

In 1977, the United States Supreme Court shut down the plaintiffs' game in *Santa Fe v. Green*,²⁴⁹ rejecting the broad reading and pushing Rule 10b-5 back inside a narrow, fraud-based box. It was a landmark moment in the history of corporate federalism. Had the Supreme Court validated the broad reading, the federal-state balance would have returned to the pre-*Erie* posture in which state and federal courts shared substantive authority over the terms of management fiduciary duties. In rejecting the broad approach, the Supreme Court reconfirmed the federalism's division of subject matter authority—disclosure and markets to the federal government and internal affairs to the states. It also put a positive spin on the federalism, enunciating what amounted to norm of respect for state regulation of internal affairs.

A. The Broad Reading of Rule 10b-5

Cary contrasted Delaware judges from their federal counterparts. Where the former were captured and venal,²⁵⁰ the latter were independent and principled²⁵¹ and, moreover, inclined to apply the trust principle expansively: “[I]t seems clear,” he said, “that in the field of management conduct federal courts, shorn of the inhibitions felt by the Delaware court, are moved to extend the concept of fiduciary duty beyond its traditional bounds.”²⁵²

Some of the leading examples of expansive application had been cases decided on under Rule 10b-5, in which, said Cary, there had “been an explosive development of the law based upon a few phrases” in the texts themselves.²⁵³ The Rule's core coverage constrained insiders who traded on or tipped others about nonpublic corporate information,²⁵⁴ an application for which Cary himself had been responsible during his service as Chairman of the SEC.²⁵⁵ Rule 10b-5's envelope had since expanded, for it now applied to corporate misstatements²⁵⁶ and came to bear in cases where there was only a tenuous connection between the underlying fraud

247. *R. J. Bryan v. Brock & Blevins Co., Inc.*, 343 F. Supp. 1062 (N.D. Ga. 1972), *aff'd*, 490 F.2d 563 (5th Cir. 1974).

248. *Green v. Santa Fe Industries, Inc.*, 533 F.2d 1283 (2d Cir. 1976).

249. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977).

250. See Cary, *supra* note 160, at 690–92.

251. *Id.* at 695.

252. *Id.* at 696.

253. *Id.* at 693.

254. *Id.*

255. See Cady, Roberts & Co., 40 S.E.C. 907 (1961).

256. See Cary, *supra* note 160, at 693 (citing *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971)).

and a securities transaction.²⁵⁷ Cary wanted further expansion. The limitation of standing to purchasers and sellers of stock should be relaxed: “federal laws have been designed to protect the purchasers and sellers of stock through the medium of the securities acts. It should also protect the real investors, those who own the stock of corporations. After all, investment counsel are wont to say that every ‘hold’ is a ‘buy.’”²⁵⁸

A further step advocated by many would be “to break the barriers surrounding Rule 10b-5, and to treat it as the watchdog of all corporate activity.”²⁵⁹ Cary hesitated at this point. With a citation to Second Circuit Judge Henry Friendly’s opinion in *S.E.C. v. Texas Gulf Sulphur*,²⁶⁰ he noted, “I must confess my respect, however, for the intellectual integrity of persons who recognize some restraints upon extending the rule to cover the corporate universe.”²⁶¹ In place of an infinitely expanded 10b-5, he said, we should start anew with a regime of federal fiduciary standards.²⁶²

But, of course, no such regime would be forthcoming. Therefore, if there was going to be a federal platform for holding managers accountable for self-dealing or unfair conduct, Rule 10b-5 would have to provide its basis, *pace* Cary. Let us proceed to articulate that basis, starting with the text of the Rule:

[I]t shall be unlawful for any person . . . (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact . . . or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.²⁶³

There is an easy linguistic path to an expansive result. One starts out by including substantively unfair behavior in the class of misconduct covered by “device scheme or artifice to defraud.” One then must face a contrary, narrow, and unfortunately intuitive reading under which “fraud” is a disclosure tort and any “defrauding”—whether by a device, a scheme, or an artifice—has to be pursuant to a material misstatement or omission. Under this fraud-based reading, self-dealing and other unfair behavior do not lie in the covered class. To rebut the narrow reading, the proponent then does a jump shift, making reference to 10b-5(c), arguing that an unfair

257. See Cary, *supra* note 160, at 694 (citing Superintendent of Ins. V. Bankers Life &: Casualty Co., 404 U.S. 6 (1971)).

258. See Cary, *supra* note 160, at 699.

259. *Id.*

260. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 864 (2d Cir. 1968) (concurring opinion).

261. See Cary, *supra* note 160, at 699–700.

262. *Id.* at 700–01.

263. 17 CFR § 240.10b-5 (2023).

act by a manager in connection with the sale or purchase of a security is an “act, practice, or course of business which operates or would operate as a fraud or deceit.” The interpretive key lies in the verb “operate,” which signals that subsection (c) reaches out of the misrepresentation envelope to include “constructive” frauds—actions that do not involve material misstatements or omissions but that nonetheless are very unfair. The classic example comes from the law of creditors rights, which holds as “fraudulent” a distressed debtor’s conveyance of property out from under the creditor’s clutches into friendly third-party hands for a nominal consideration.²⁶⁴ Arguably, the only reason for 10b-5(c) to use the words “operate” and “would operate” is to extend the class of covered conduct beyond the limits of the classic misrepresentation tort.

The proponent emerges with a robust textual case for a broad reading of the Rule. The problem for the proponent lies with the text of the statute. Section 10(b) uses neither the word “fraud” nor the phrase “operates as a fraud.” It instead grants substantive rulemaking authority to the SEC to prohibit the use or employment of “any manipulative or deceptive device or contrivance.” The word “deceptive” denotes misrepresentations and omissions, so the Section is clearly about fraud. The interpretive question raised by the broad reading is whether a particular instance of self-dealing or other unfair conduct by a manager or controlling shareholder can be characterized as “manipulative.” “Manipulative” is a word the interpretation of which can be, well, manipulated. It can be read quite broadly to cover any skullduggery, or, as we will see, quite narrowly to cover only machinations in the stock market. It all depends on the interpreter’s normative proclivities.

B. Going Private Transactions Under Delaware Law

The challenge to the federalism arose when, during the 1970s, the broad reading was applied to minority shareholder complaints against going private transactions. We pause here to describe these deals.

1. Transaction Structures.

Let us begin with a hypothetical.

ABC Corp. goes public in 1968 in the “go go” stock market at \$25 per share. It is a secondary offering: the stock sold—750,000 shares out of 1,000,000 shares outstanding—comes from the holdings of ABC’s insiders rather than from an original issue by ABC. As a result, the offering’s proceeds go into the insiders’ pockets rather than to ABC as additional equity

²⁶⁴ See, e.g., Bankruptcy Code, 11 U.S.C. § 548 (permitting avoidance of “fraudulent” transfers).

capital. The insiders retain 250,000 shares and continue to control the ABC board.

Seven years later, in 1975, the stock market has collapsed and ABC stock is trading for \$2. ABC's insiders cause ABC to make a tender offer for its own shares at \$3 per share, a 50% premium over the market price. The offer fully complies with the requirements of the Williams Act. Note that the insiders, having personally pocketed the proceeds of the original offering, now in effect unwind the offering using the corporation's money. If the transaction succeeds, the insiders once again own all or almost all of ABC even as they personally retain the proceeds of the 1968 offering.

At this point we will pose three alternative transactional means of completing the freezeout.

Scenario 1—issuer tender offer without merger. The tender offer yields 725,000 (96 2/3%) of the 750,000 publicly held shares. Once the tender offer closes, the public float is sufficiently small to permit ABC both to delist its shares from the trading market and to cease to be a reporting company under the 1934 Act. The remaining 25,000 shares are left outstanding but have lost their market liquidity.

Scenario 2—issuer tender offer plus short form merger. The tender offer yields 725,000 (96 2/3%) of the 750,000 publicly held shares. The ABC insiders organize a shell corporation, XYZ, Inc. They exchange their 250,000 ABC shares for all the shares of XYZ. XYZ now owns 90.9% of the shares of ABC. XYZ effects a merger of ABC into itself pursuant to Section 253 of the Delaware code²⁶⁵ (a “short form” merger), paying the holders of the 25,000 shares \$3 per share. No XYZ shareholder vote is required under Section 253, which applies only when XYZ holds at least 90% of the stock of ABC.²⁶⁶ The minority shareholders cashed out in the merger elect to pursue their appraisal rights under Section 262 of the Delaware code.²⁶⁷ In the appraisal proceeding, they will attempt to show that the per share value of ABC is more than \$3.

Scenario 3—issuer tender offer plus long form merger. The tender offer yields 680,000 (90 2/3%) of the 750,000 publicly held shares. The ABC insiders organize a shell corporation, XYZ, Inc. They exchange their 250,000 ABC shares for all the shares of XYZ. XYZ now owns 78% of the shares of ABC. XYZ and ABC enter into a merger agreement, pursuant to Section 251 of the Delaware code.²⁶⁸ Section 253 is unavailable because XYZ holds less than 90% of the shares of ABC. Under Section 251 (a

265. DEL. CODE ANN. Tit. 8, § 253 (2023).

266. The short form merger was a relatively recent innovation. See Act of June 5, 1957, ch. 121, § 253(a), 51 Del. Laws 186 (1957) (current version at DEL. CODE ANN. Tit. 8, § 253(a)).

267. DEL. CODE ANN. Tit. 8, § 262 (2023).

268. *Id.* § 251.

“long form” merger), the merger must be approved at an ABC shareholders meeting. ABC sends its shareholders a proxy statement complying with the rules under Section 14 of the 1934 Act. At the shareholders’ meeting the merger is approved by a vote of 250,000 to 37,500. The holders of the remaining 37,500 shares elect to pursue their appraisal rights under section 262 of the Delaware code. They accordingly have no right to vote on the merger.

The scenarios differ as regards the compliance framework and the minority shareholders’ choice set.

Scenario 1, the issuer tender offer without a second step merger, is covered by the process and disclosure rules of the Williams Act, which, then as now, include no requirement of substantive fairness.²⁶⁹ Review under Delaware fiduciary law would have been at best minimal during the 1970s. By reference to cases decided later, minority shareholders who view the offer as too low can only protect themselves by refusing to tender. Somewhat contradictorily, the Delaware standard would simultaneously interdict “coercion” on the part of the offeror.²⁷⁰ To get into trouble under this standard the ABC insiders must add sticks to the offer’s \$3 carrot, such as a commitment to delist the stock upon the closing of the offer or a threat to cut a dividend.²⁷¹ Absent the sticks, the offer in question would not be deemed coercive.

Unfortunately for the minority shareholders, the transaction is inherently coercive even in the absence of sticks. The choice whether to tender is a Hobson’s choice. Assume a shareholder who deems \$3 to be an unacceptably low consideration. If the shareholder refuses it tender it risks liquidity loss if the offer yields sufficient tenders to justify delisting. Left without a trading market, this minority holdout is left to resell to the company at whatever time the insiders choose to buy and at whatever price they deem appropriate. The rational shareholder accepts the \$3 even though it thinks the price unfair.

Scenarios 2 and 3 remove the choice (whether or not one of Hobson’s). The majority shareholder uses its voting power to effect a merger that forces the minority interest to take cash in exchange for its equity interest. The transaction’s division of value is inherently suspicious because the terms are dictated by one side. The minority gets a fixed sum set by

269. The SEC would propose tougher disclosure rules covering these transactions in 1975. *See* Securities Act Release No. 5567, “Notice of Public Fact-Finding Investigation and Rulemaking Proceeding in the Matter of ‘Going Private’ Transactions by Public Companies or Their Affiliates.” CCH Fed. Sec. L. Rep. ¶ 80,104 (Feb. 6, 1975). The SEC’s initiative would eventually result in Rule 13e-3, 17 C.F.R. § 240.13e-3I.

270. This would not occur until the decision of *Eisenberg v. Chicago Milwaukee Corp*, 537 A.2d 1051 (1987).

271. *See id.* at 1149–50. .

the majority while the majority retains the going concern and its upside value prospects. The implication is that the going concern is worth more than \$3 per share, which is not a *pro rata* division of value.²⁷² Indeed, the transaction makes little sense from the majority's point of view unless that is the case.²⁷³

Scenario 2 is a short form merger, effected in XYZ's boardroom without a shareholder vote. Because there is no shareholder vote, there is no proxy solicitation and the merger triggers no federal compliance requirements. In contrast, Scenario 3, the long form merger, is subject to the federal proxy rules. Then, as now, federal shareholder litigation on disclosure questions was much more likely on Scenario 3, due to the proxy statement,²⁷⁴ than on Scenario 2.²⁷⁵

During the 1970s, Scenarios 2 and 3 amounted to "recent developments" in Delaware law. They depended on the Delaware statute's allowance of cash consideration in mergers, which was in turn a relatively recent innovation dating from the 1967 revision of Delaware's code.²⁷⁶ Transactional lawyers were learning how to wield it to their clients' advantage.

2. Relief for the Minority Shareholders under Delaware Law in Scenarios 2 and 3.

Scenarios 2 and 3 invite application of the majority to minority fiduciary duty—arguably the majority has used its boardroom power to effect an unequal (and therefore unfair) distribution of value to the minority's disadvantage.²⁷⁷

A theory for establishing a breach of the majority-minority fiduciary duty was on the table, put there in a famous 1964 law review article by James Vorenberg of the Harvard Law faculty.²⁷⁸ Under Vorenberg's test,

only where there is a plausible business purpose of the corporation beyond the majority's desire to enlarge their own stockholdings or to

272. See Victor Brudney & Marvin Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 298 (1974).

273. There would be administrative savings and a benefit of enhanced legal certainty.

274. See *generally* Mills v. Electric Auto-lite Co., 396 U.S. 375 (1970) (sustaining a shareholder complaint based on a misleading proxy statement).

275. A plaintiff, drawing on public statements related to the merger, would have to show reliance in foregone pursuit of an appraisal. Cf. *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991) (rejecting on causation grounds a minority shareholder complaint in respect of a proxy statement in a merger where the majority shareholder held 85% of the votes).

276. See 56 Del. Laws 206 (1967) (current version at DEL. CODE ANN. tit. 8, § 251(b)(4)).

277. Early twentieth century cases had established that the minority shareholders have to no "vested right" to continue as equity participants. See Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 627–651 (1981).

278. James Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964).

eliminate a minority stockholder should the minority holder be required to choose between what is available to him as a result of the action proposed by the majority and the cash value of his shares.²⁷⁹

A “plausible business purpose” is a source of value unlocked by the merger, which simultaneously imports a financial explanation and a financial justification. Absent the value-added, the only explanation for the merger is the desire to eject the minority shareholders at a disadvantageous price.

Unfortunately for minority holders in Delaware corporations, as of 1975 Delaware’s courts had not adopted Vorenberg’s business purpose test. *Sterling v. Mayflower Hotel Corp.*,²⁸⁰ a 1952 case, did stand for the proposition that the parent in a parent-subsidary merger bore the burden to show entire fairness. But *Stauffer v. Standard Brands, Inc.*,²⁸¹ decided in 1962, went on to remit shareholders dissatisfied with the outcome of a short form merger to appraisal as their remedy. *David Greene & Co. v. Schenley Industries, Inc.*,²⁸² decided in 1971, held the same thing as regards a long form parent-subsidary merger offering cash and bonds as consideration.

Meanwhile, a Delaware appraisal proceeding was not a plaintiff-friendly place to be. It is axiomatic that value in appraisal is ascertained by reference to the corporation’s pre-merger going concern value.²⁸³ As a result, no reference may be made in appraisal to the price the corporation might have yielded if sold at arm’s length to an independent third-party. This means that the appraisal petitioner gets no direct access to a merger premium as an element of value, which could very well amount to significant opportunity cost in the case of an inside deal.

That was only the beginning of the appraisal petitioner’s difficulties back in 1975. The Delaware courts mandated a methodological approach to the ascertainment of going concern value, or “fair” value. Under this, fair value was a function of three or four building blocks: earnings value, asset value, market value, and, in appropriate cases, dividend value. The value elements, once fixed, were reduced to a final figure on a weighted average basis. The parties disputed both the amount of each value element and the appropriateness of the weights accorded to them. Petitioners tended to push for a higher allocation to asset value, since it was the only element approaching a third-party sale measure; respondents favored the

279. *Id.* at 1204.

280. 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952).

281. 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962).

282. 281 A.2d 30 (Del. Ch. 1971).

283. See *Chicago Corp. v. Munds*, 20 Del.Ch. 142, 150–51, 172. A. 452, 455 (Del. Ch. 1934) (going concern value over market value); *Tri-Continental Corp. v. Battye*, 31 Del. Ch. 71, 74, 74 A.2d 523, 530–31 (Del. Ch. 1950) (endorsing a going concern value approach and making an affirmative statement against reference to asset value).

other elements because they did not. The final weighing was left to the discretion of the Chancery Court, which intuited a result based on all the facts of the case. This approach was termed the “Delaware Block.”²⁸⁴

No principles or guidelines had emerged to guide the Chancery Court at the critical weighting stage,²⁸⁵ at which the judges chose numbers reflecting their level of confidence in the expert presentations made in the case.²⁸⁶ The Block was also increasingly out of date. Its earnings value and dividend value components reflected state of the art practice as of the end of the Second World War.²⁸⁷ The methodological caravan had moved on, energized by insights from modern finance theory. In business practice, valuation analyses now were based on projected cash flow figures. Delaware, in contrast, had locked itself into methodologies based on accounting earnings and dividends. Worse, earnings analysis under the Block systematically understated results.²⁸⁸ Delaware insisted a five-year past average of the target’s earnings and then drew on current price/earnings ratios from comparable companies to capitalize them.²⁸⁹ In a growth era, five

284. See, e.g., *Heller v. Munsingwear, Inc.*, 33 Del.Ch. 593, 98 A.2d 774 (Del. Ch. 1953).

285. See Rutheford B. Campbell, Jr., *The Impact of Modern Finance Theory in Acquisition Cases*, 53 SYRACUSE L. REV. 1, 39 n.138 (2003).

286. See Joseph Evan Calio, *New Appraisals of Old Problems: Reflections on the Delaware Appraisal Proceeding*, 32 AM. BUS. L.J. 1, 37 (1994).

287. For an exposition of valuation techniques common in the post-war period, see 1 ARTHUR STONE DEWING, *THE FINANCIAL POLICY OF CORPORATIONS* 369-401 (5th ed. 1953) (discussing the valuation of industrials in terms of earnings value (based on past earnings figures), liquidation value, trading market value, and sale value). The origins of the instantiation of these techniques in the Delaware Block are obscure, however. See Calio, *supra* note 286, at 31–32.

288. See, e.g., Elmer J. Schaefer, *The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S. CAL. L. REV. 1031, 1032 (1982) (“[T]he weighting method consistently underestimates the value of corporate shares . . .”).

289. Consider in this regard *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 312 A.2d 344 (Del. Ch. 1973), *aff’d*, 334 A.2d 216 (Del. 1975), an appraisal in a parent-subsidiary merger, where the subsidiary’s business had been growing steadily. 312 A.2d at 347. Earnings value was the key Block component in the case. The respondent offered a five year past average of company earnings and drew on the average price-earnings ratios of other companies in the industry to derive a capitalization rate. *Id.* at 347–48. The petitioner argued for use of only the most recent year’s earnings on the ground that it provided the most plausible basis for looking forward, given the record of steady growth. *Id.* at 348. The Court went with the five-year past average as a matter of precedent:

It is established Delaware law that for appraisal purposes earnings are to be determined by averaging the corporation’s earnings over a reasonable period of time. The determination must be based upon historical earnings rather than on the basis of prospective earnings. *Application of Delaware Racing Association*, Del.Supr., 213 A.2d 203 (1965). The five-year period immediately preceding the merger is ordinarily considered to be the most representative and reasonable period of time over which to compute the average. *Application of Delaware Racing Association*, *supra*.

. . . .

The stockholders argue that averaging past earnings is proper only when the earnings history has been erratic. In support of that proposition, Mr. Stanley Nabi, managing partner

year past averages have no utility as value indicators, although they might have made sense during the Depression. Furthermore, current price/earnings figures make sense (albeit limited sense) as capitalization rates only when applied to the most recent earnings of the company being valued. It is a matter of consistency. A perverse effect followed: A control-party could use its control power to put through a minority freezeout merger at a low price without having to worry about dissenter's rights.

To illustrate, consider a classic Delaware appraisal ruling case from the era—*Bell v. Kirby Lumber Company*,²⁹⁰ decided in 1980. This was a short form cash out merger of a five percent minority interest of Kirby, a timber, lumber, and plywood subsidiary of the Santa Fe railroad. Santa Fe had originally acquired 60% of Kirby as a distribution in a Depression-era bankruptcy. Over the decades it had gradually built its stake to 95% of the stock by periodically purchasing shares from minority holders.²⁹¹ During the period 1968–1973, purchase prices paid by Santa Fe in these transactions had ranged from \$65 to \$92.50 per share.²⁹² In the merger, it paid the minority \$150 per share. A Morgan Stanley appraisal report, solicited for the occasion by Santa Fe, had valued Kirby at \$125 per share.

The appraisal proceeding turned on a classic dispute over asset value versus earnings value. Kirby harvested timber on a sustained yield basis, limiting the number of trees cut and replacing them. This generated earnings that the court-appointed appraiser pegged at \$120 per share per year.²⁹³ The petitioner wanted an appraisal based on a much higher asset value figure—the value of the tract if the trees were all cut at once, which it pegged at \$682 per share.²⁹⁴ The appraiser weighted earnings and asset value at 60-40. The petitioners wanted asset value weighted at 90%. The Chancery Court sustained the appraiser's reference to a lower going

of a NYSE brokerage house and an investment and financial analyst, testified that the accepted practice among security analysts is to capitalize present earnings, and to give the trend of earnings important consideration in the selection of the multiplier. The stockholders argue that Universal's earnings history was not erratic but, in fact, had a steady and rapid growth. They contend that the Appraiser therefore should have used the current (1965) earnings as the figure to be capitalized.

This argument is not persuasive even if Mr. Nabi's testimony as to the accepted practice among security analysts for capitalizing earnings is conceded to be correct. Whatever that practice may currently be, the policy of Delaware law is that averaging earnings over the five years immediately preceding the merger should be the rule and not the exception. In short, a choice among alternative techniques for capitalizing earnings has been made and no persuasive conceptual reason has been shown to change that choice now.

Id. at 348–49 (internal citations omitted).

290. 395 A.2d 730 (Del. Ch. 1978), *aff'd*, 413 A.2d 137 (Del. 1980).

291. 395 A.2d at 732.

292. *Green v. Santa Fe Indus., Inc.*, 391 F. Supp. 849, 853 (S.D.N.Y. 1975).

293. 395 A.2d at 733.

294. *Id.*

concern figure based more on the sustained yield business plan, awarding \$254.40.²⁹⁵ The Delaware Supreme Court affirmed—asset value figure was a “liquidation” figure and thus inappropriate.²⁹⁶ In the appraisal parlance of the day, liquidation value was a synonym for third-party sale value.

The plaintiffs did walk away with 169% of the consideration offered by the majority shareholder. It nevertheless was an arguably unsatisfactory value result. After all, Santa Fe was now in a position to garner 454% of the merger price by selling the entire tract to a third party whenever its cash requirements dictated.

C. Santa Fe v. Green: *The 10b-5 Challenge to the Kirby Lumber Merger*

1. In the Lower Courts.

The appraisal was not the only litigation in the wake of the Kirby Lumber merger. A class of Kirby’s minority shareholders brought a Rule 10b-5 action in the Southern District of New York immediately after the merger announcement.²⁹⁷ They had two theories. The first was a misrepresentation theory—Santa Fe had submitted to the shareholders a Morgan Stanley appraisal that pegged Kirby’s value at \$125 knowing that it undervalued the company’s assets.²⁹⁸ The Southern District paid the theory short shrift, finding opinions rather than misstatements of fact in the value report.²⁹⁹ The second theory was a direct transplant into federal antifraud of Vorenberg’s rule of fiduciary fairness: the merger constituted a “device, scheme or artifice to defraud” because it had been effected “without any justifiable business purpose, except to freeze out the minority.”³⁰⁰

Cases in other circuits had validated this 10b-5 fairness theory.³⁰¹ But the Second Circuit amounted to hostile territory. It accepted the notion that breaches of fiduciary duty could be a self-standing basis for a 10b-5 action

295. *Id.* at 740–41.

296. *Id.* at 147–48.

297. *Green*, 391 F. Supp. 849.

298. *Id.*

299. *Id.* at 719.

300. *Id.* at 852.

301. *See* R. J. Bryan v. Brock & Blevins Co., Inc., 343 F. Supp. 1062, 1070 (N.D. Ga. 1972), *aff’d*, 490 F.2d 563, 569–71 (5th Cir. 1974); Albright v. Bergendahl, 391 F. Supp. 754, 755 (D. Utah 1974). There were also cases not involving mergers that had found Rule 10b-5 to have been violated through fiduciary breaches. *See* Pappas v. Moss, 393 F.2d 865, 869 (3d Cir. 1968) (lowball insider stock sale); Reckant v. Desser, 425 F.2d 872, 882 (5th Cir. 1970) (same); Shell v. Hensley, 430 F.2d 819, 826–27 (5th Cir. 1970) (scheme to sell control).

in 1968 in the famous case of *Schoenbaum v. Firstbrook*.³⁰² But it then did an about face in 1972 in a 10b-5 case arising out of a merger, *Popkin v. Bishop*.³⁰³ *Popkin* was not about a cashout merger—the complaint there went to the exchange ratio in a series of stock-for-stock mergers of majority-owned subsidiaries.³⁰⁴ No misrepresentation or material admission was alleged. That was enough for dismissal: the Second Circuit panel in *Popkin* emphatically rejected the broad reading of 10b-5: “non-disclosure [is] a key issue in Rule 10b-5 cases. Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited.”³⁰⁵ The inconsistent *Schoenbaum* ruling was dismissed as dictum.³⁰⁶ At the same time, the Court made an important comment about the federalism: “Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law.”³⁰⁷ Restating, once the federal courts put a fact pattern inside of 10b-5, pre-existing state rights and remedies not only lacked pre-emptive power, they were irrelevant both doctrinally and as a policy proposition.

In the Kirby Lumber case, *Green v. Santa Fe*, the Southern District of New York followed *Popkin* to reject the broad reading: “if full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5.”³⁰⁸ A panel of the Second Circuit,

302. 405 F.2d 215 (1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). The case involved the sale of original issue common stock to an insider at a lowball price. There was a finding of deception of the minority shareholders, which of course provided an independent basis for a 10b-5 claim. But the court kept going with a constructive fraud theory:

In the present case it is alleged that Aquitaine exercised a controlling influence over the issuance of it of treasury stock of Banff for a wholly inadequate consideration. If it is established that the transaction took place as alleged it constituted a violation of Rule 10b-5, subdivision (3) because Aquitaine engaged in an “act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.”

405 F.2d at 219–220.

303. 464 F.2d 714 (2d Cir. 1972).

304. *Id.* at 716–17.

305. *Id.* at 719–20.

306. In so doing, they were reverting to historical form. In *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), a case about a sale of control, the Court had ruled that 10b-5 was “aimed only at ‘a fraud perpetrated upon the purchaser or seller’ of securities [with] no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers.” *Id.* at 463. Further, said the Court, section 10(b) was intended as a remedy only for that fraud “usually” associated with the purchase or sale of securities, and not for corporate mismanagement. *Id.* at 463–64.

307. 464 F.2d at 718.

308. 391 F. Supp. at 854.

demonstrating a change of heart,³⁰⁹ reversed, two-to-one,³¹⁰ with all three judges writing opinions. The two writers in the majority, Harold Medina for the Court and Walter Mansfield, concurring, played the classic card of broad interpretation. The broad reading, they said, accomplished the statutory purpose of investor protection of investors,³¹¹ citing the Supreme Court at its very broadest in the 1971 decision of *Superintendent of Insurance v. Bankers Life & Casualty Co.*³¹² They conceded that the line of 10b-5 cases had started out focused only on fraud. But, they said, “the ambit of the term ‘fraud’ as used in 10b-5 must be widened if Congress’ objective protection of the public investor was to be achieved.”³¹³ Toward that end, what had earlier been dismissed as dictum in *Schoenbaum* now came back as pathbreaking lawmaking.³¹⁴

The majority also appealed to the transactional context. Much was made of the fact that minority shareholders in short form mergers got no notice of the transaction until it was consummated—a factual distinction held out as sufficient to distinguish *Popkin*.³¹⁵ Even more was made about the evils done on the going private fact pattern, as minority shareholders got pennies on the dollar for shares issued during the “go go” years.³¹⁶ Interestingly, these going private policy arguments bore only tangentially in the case on the table—Kirby Lumber’s variation on the going private theme involved a Depression era corporate reorganization and not a “go go” IPO of the 1960s. But enough was enough:

We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. We do not hold that the charge of excessively low valuation by itself satisfies the requirements of Rule 10b-5 because that is not the case before us.³¹⁷

309. The handwriting already was on the wall. In a recent long form merger case, *Marshel v. AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir. 1976), the Second Circuit had enjoined a long form merger under Rule 10b-5 on a Vorenberg theory.

310. *Green v. Santa Fe Industries, Inc.*, 533 F.2d 1283 (2d Cir. 1976).

311. *Id.* at 1287, 1296.

312. 404 U.S. 6 (1971).

313. 533 F.2d at 1296 (Mansfield, J., concurring).

314. *Id.* at 1290, 1296–97.

315. *Id.* at 1297. The logic escapes this Article’s author.

316. *Id.* at 1295–96.

317. *Id.* at 1291.

2. In the Supreme Court.

The Supreme Court granted certiorari, and that was that. The Second Circuit was reversed, eight-to-one,³¹⁸ with Justice White writing the majority opinion.

The handwriting already was on the wall. The Court had recently started a campaign against expansive application of Rule 10b-5. First came the 1975 decision of *Blue Chip Stamps v. Manor Drug Stores*,³¹⁹ which limited standing to actual purchasers and sellers. The Court upheld to ante the following year in *Ernst & Ernst v. Hochfelder*,³²⁰ which had rejected negligence as the standard of culpability and opted instead for scienter. The interpretation of Section 10(b) articulated in *Hochfelder* would determine the outcome in *Green*.

The *Green* Court made no mention of a policy problem respecting payouts in going private transactions. This was a case about statutory language, and the language in question was not that of the Rule, but of Section 10(b) itself. The device or contrivance had to be “manipulative or deceptive” within the meaning of the statute:

[W]e [have not] been cited to any evidence in the legislative history that would support a departure from the language of the statute. “When a statute speaks so specifically in terms of manipulation and deception, . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute . . .”³²¹

To go off on the concept of “fraud” and arrive at the notion of constructive fraud was to add an improper gloss.³²²

Alright, there had been no deception. But couldn’t the short form merger setup be characterized as “manipulative”? The Court saw the point but had a rebuttal ready. In securities law contexts “manipulative” was a “virtual” term of art.³²³ It had to do with strategic trades on the stock market that impacted the market price, trades “such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.”³²⁴

318. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977). Justices Burger, Stewart, Marshall, Powell and Rehnquist joined all of Justice White’s majority opinion. Justices Blackmun and Stevens joined the part of the opinion addressing the meaning of the statute but declined to join the part of the opinion discussing policy and federalism concerns. Justice Brennan dissented without opinion.

319. 421 U.S. 723 (1975).

320. 425 U.S. 185 (1976).

321. *Green*, 430 U.S. at 473 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976)) (omission in original).

322. *Green*, 430 U.S. at 472.

323. As opposed, one imagines, to an *actual* term of art.

324. *Id.* at 475–77.

That was enough to decide the case. But Justice White had more to say, losing the assent of Justices Blackmun and Stevens as he did so. In Part IV of his opinion, corporate federalism and its subject matter division between markets and internal affairs found its way into Rule 10b-5 jurisprudence. Where the Second Circuit had taken a federal-centric view—we decide what this section means without worrying about the states—the *Green* court was suddenly solicitous of state lawmaking prerogatives:

Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden. As the Court stated in *Cort v. Ash*: “Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”³²⁵

The citation to *Cort v. Ash*, a case that slapped down limiting standards on the interpolation of private rights of action under federal statutes, was not quite apposite. Although *Green* was indeed a private action under Section 10(b), Section 10(b) was also a vehicle for SEC enforcement actions; a narrow interpretation of its scope applied across the board. But there also was a fair point—Delaware had provided a remedy for these plaintiffs in the form of an appraisal proceeding and it apparently was “appropriate” to remit these plaintiffs to pursue their rights there.³²⁶

But what about the dollars and cents rip off that awaited the appraisal plaintiffs in Wilmington? What was “appropriate” about that? It was the majority shareholder rip off, after all, that had motivated the Second Circuit to mash up its own precedents in the process of opening a door to federal relief. Justice White signaled that he knew all about the going private problem with a cite to Cary’s *Reflections on Delaware*:

Professor Cary argues vigorously for comprehensive federal fiduciary standards, but urges a “frontal” attack by a new federal statute rather than an extension of Rule 10b-5. He writes: “It seems anomalous to jig-saw every kind of corporate dispute into the federal courts through the securities acts as they are presently written.”³²⁷

One wonders whether Cary appreciated the citation. One suspects that he did—federal fiduciary standards were still an active prospect on Capitol Hill when the Supreme Court decided *Green* in 1977. *Green*, by

325. *Id.* at 479 (citing *Cort v. Ash*, 422 U.S. 66 84 (1975)) (internal citations omitted).

326. *Green*, 430 U.S. at 478.

327. *Id.* at 479–80, 480 n.17.

cutting off the 10b-5 route to federal fiduciary control, might have enhanced the level of frustration with state law results, adding political traction to a legislative initiative. But, as we now know, it didn't work out that way. Ironically, then, the Supreme Court decision that cited Cary's article was a triumph for the federalism Cary sought to destroy.

D. Observations

The *Santa Fe v. Green* litigation disrupted and then restored corporate federalism in the space of a few short years. Rule 10b-5, read broadly, offered the federal courts a platform on which they were free to create their own common law of internal corporate duties. The decision whether to accept the offer was driven by institutional considerations. The broad reading meant activist policing of corporate transactions both in the absence of clear Congressional authorization and in the teeth of state law results. The narrow reading meant traditional judicial restraint—careful application of the law on the carefully sorted facts along with respect for both political branches. The Second Circuit had been vacillating between activism and restraint in its 10b-5 cases when the *Green* panel allowed fairness concerns raised by going private deals to tip the balance to favor activism. The Supreme Court, already embarked on a project to restrain Rule 10b-5, did the opposite. It applied standard tools of narrow linguistic interpretation, turning a blind eye to policy exigencies.

As an afterthought, the Supreme Court threw in a newly-minted federalism concern. Although the federalism reference was novel, it was a manifestly appropriate addition to the restrained adjudicator's toolbox. Respect for state law now had a place in the interpretive mix, signaling an end to the federal law arrogance displayed in the opinions of the lower courts. But just how much respect remained an open question. The Court was walking a fine line. The citation of Cary made it clear that no substantive approval of Delaware's merger and acquisition jurisprudence should be inferred. In the next case, given a more powerful national level policy imperative, federalism might weigh in differently.

One last question: Suppose *Green* had gone the other way? What impact would a parallel body of federal fiduciary principles have had on charter competition and the balance between federal and state law? One can easily spin a projection of destruction. As we have seen, courts had begun to matter as much as, any maybe more than, corporate codes in the profile of the competitive chartering state. With a parallel federal fiduciary regime, the state courts could well have reverted to the minor role they had played during the early twentieth century, reducing the zone of competitive play and possibly impairing Delaware's competitive position. Meanwhile, the stage would have been set for further federal incursions.

Although the counterfactual projection of the destruction is plausible, it is best to answer the question cautiously—there is no way to tell what would have happened.³²⁸ All we can say for sure is that the federalism pattern would have been materially altered. We do not know how the states would have adjusted to the change and what effects those adjustments would have had on state-level incentives.

IV. TO THE END OF THE CENTURY—THE ERA OF THE DELAWARE JUDICIARY

This Part takes this history of twentieth century corporate law federalism to its end point. The focus remains on Delaware, where the courts adjusted their approach in the wake of the twin threats of the 1970s, federal incorporation and federal fairness review under Rule 10b-5.

Section A describes the Delaware judiciary's response to the threat of federal intervention. Simply, it took fiduciary law more seriously. In 1977, in the immediate wake of *Green*, the Delaware Supreme Court adopted the Vorenberg business purpose test for cash out mergers. Then, six years later, it scrapped the test as unworkable and reinvented corporate fiduciary law in a mode more suited to Delaware's unique position. The new approach drew on the governance agenda to elevate scrutiny of corporate processes over direct fairness review. This squared the circle, making fiduciary review compatible with management's preference for self-regulatory alternatives even as it led to reputational enhancement for Delaware's judges. They emerged as prominent voices in corporate governance discussions, strengthening the state's relations with all corporate constituents. They thereby made Delaware the national leader in corporate law, not just as a charter monger but as a policymaker. With policy leadership came political stability—the federal-state balance remained relatively stable for the rest of the century even as political demands respecting governance continued to register at the national level.

Section B turns to the takeover wars of the 1980s, which confronted Delaware with incompatible demands. Management wanted antitakeover legislation and threatened to exit the state if it wasn't forthcoming. At the same time, the federal government threatened to intervene to protect takeovers. Delaware responded by adhering to its long-time strategy, staring down the federal government even as it made concessions to its customers. This turned out to be the right political choice. The federal preemptive

328. A minority shareholder plaintiff who could make out a disclosure defect respecting a controlled transaction continued to have access to federal court in at least five circuits. *See Goldbery v. Meridor*, 567 F.2d 209 (2d Cir. 1977), cert. denied, 434 U.S. 462 (1977); Pritchard & Thompson, *supra* note 159, at 229–30. One suspects this is possible in respect of many such transactions. Yet, post-*Green*, there is no apparent tilt toward federal forums.

threat stemming from takeover regulation lacked political credibility and would not have disrupted the charter market in any event.

Section C takes a look at Delaware at the end of the century, at the dawn of the era of shareholder capitalism. Time had been on Delaware's side. The federal government had lost all interest in takeovers. Institutional shareholders, who were now governance players, remained dissatisfied with takeover defenses. But their complaints registered only in a narrow network. Ironically, their waxing voting power strengthened Delaware's position in the charter market, for it meant the end of unilateral management control over reincorporation decisions, which in turn made less likely the emergence of a competing state marketing a more management-favorable product.

A. Fiduciary Law in the Delaware Courts

Rent extraction, when visible, can come at the cost of diminished reputation.³²⁹ Cary imposed that cost on the Delaware courts when he accused them of monolithic support of management, citing a cluster of cases as evidence.³³⁰ The Delaware courts proved sensitive to Cary's allegation,³³¹ becoming more noticeably responsive to the shareholder interest remaining years of the twentieth century.³³² Most of the cases Cary cited are no longer good law.³³³

329. See TORSTEN PERSSON & GUIDO TABELLINI, *THE ECONOMIC EFFECTS OF CONSTITUTIONS* 18 (2003).

330. See Cary, *supra* note 160, at 673–98.

331. *Id.* at 684, 696–98.

332. For empirical confirmation, see Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 *VAND. L. REV.* 85, 104–108 (1990). Branson's study of Supreme Court cases decided between 1974 and 1987 finds a larger number of pro-shareholder results than pro-manager results.

333. *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964), a mainstay of management takeover defensive practice, fell to *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954–55 (Del. 1985) (reversing *Cheff* and applying an expanded review of tender offer defensive tactics under proportionality test) and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1985) (inventing a duty of management defending tender offer to auction company in limited circumstances), during the takeover wars of the 1980s. *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963), also fell, untenable in light of a generation of contrary management practice under the monitoring model of corporate governance. See *In re Caremark Int'l Derivative Litigation*, 698 A.2d 959 (Del.Ch. 1996). A similar fate could be suggested for *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970). See E. Norman Veasey & William E. Manning, *Codified Standard—Safe Harbor or Uncharted Reef? An Analysis of the Model Act Standard of Care Compared to Delaware Law*, 35 *BUS. LAW.* 919, 929–30 (1980) (discussing *Graham*). *American Hardware Corp. v. Savage Arms Corp.*, 136 A.2d 690 (Del. 1957) (refusing to enjoin a defensive shareholders meeting called on short notice or to act respecting a proxy statement the court acknowledged to be incomplete), might well come out differently today, given *Unocal* and other cases more closely scrutinizing management procedural manipulations, see *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), and misrepresentations. See *Zirn v. VLI Corp.*, 621 A.2d 773 (Del. 1993) (confirming director duty of full

1. The Courts' New Approach.

The first break with the past occurred when *Singer v. Magnavox Co.*³³⁴ imposed Vorenberg's business purpose test on parent firms in cash out mergers. *Singer* is famous for having come down in September 1977, just six months after the Supreme Court's opinion in *Green*.³³⁵ 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, Nader, and others prompted the Delaware Supreme Court to reverse its direction so as to better accommodate the interests of investors and thereby diminish the possibility of federal intervention.³³⁶ As we have seen, threats were still cropping up—two federal chartering initiatives would show up in Congress in 1980.³³⁷

A more immediate problem came from the SEC, which, only two months after *Singer* was decided, proposed a rule that required substantive fairness in the going private transactions.³³⁸ But *Singer* already had taken the wind out of the initiative's sails. The final rule promulgated two years later reverted to the traditional federalism pattern, dropping the fairness test and limiting its reach to disclosure.³³⁹

The other leg of the cash out merger problem—appraisal rights under the Delaware Block—came up for revision six years later, in *Weinberger v. UOP, Inc.*³⁴⁰ Although *Weinberger* was not an appraisal proceeding, the Delaware Supreme Court took the occasion at the damages phase of the

disclosure of shareholders in connection with merger). Two other cases Cary cited, *Federal United v. Havender*, 11 A.2d 318 (Del. 1940) (permitting firms to use charter amendments effected through common shareholder voting power to strip preferred stockholders of contract rights), and *Hariton v. Arco Electronics*, 188 A.2d 123 (Del. 1963) (extending the doctrine of independent legal significance to mergers and acquisitions) are still good law. But operate in a less relentlessly management-favorable context. A good faith duty to preferred stockholders has been acknowledged, see, e.g., *HB Korenvaes Investments, L.P. v. Marriott Corp.*, No. 12922., 1993 WL 205040 (Del. Ch. June 9, 1993), and mergers are subject a more broad-ranging fiduciary scrutiny. Only *Sinclair v. Levien*, 280 A.2d 717 (Del. 1971) (leaving burden of proof on complaining minority shareholders), stood unqualified at the end of the century, but few would have complained about it. In recent years, *Sinclair* has been applied more loosely. See *In re Tilray, Inc. Reorganization Litig.*, No. 2020-0137-KSJM, 2021 WL 2199123, at *14 (Del. Ch. June 1, 2021) (“To the extent that *Sinclair* requires that a plaintiff plead the existence of a detriment to minority stockholders to give rise to entire fairness review, the power dynamics in negotiations between a controller and its controlled corporation render a detriment reasonably conceivable.”).

334. 380 A.2d 969 (Del. 1977).

335. 430 U.S. 462 (1977).

336. The author relies on his own memory of events.

337. See *supra* notes 192-203 and accompanying text.

338. See Securities Exchange Act Release No. 14185 (Nov. 17, 1977).

339. See Securities Act Release Nos. 6100, 6109 (August 1979); Ralph C. Ferrara & Marc I. Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263, 272-73 n.49 (1980).

340. 457 A.2d 701, 704, 715 (Del. 1983) (overruling *Singer* in favor of less restrictive process scrutiny of cash out mergers).

case to withdraw the Block mandate.³⁴¹ It did not, however, delete the Block from the menu of acceptable valuation methodologies. It instead expanded the menu. The Block, said the Court, “shall no longer exclusively control [A] more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community”³⁴² It was time to bring appraisal valuation into “accord with the realities of present day affairs” and open the door to consideration of the company’s future prospects.³⁴³

Thus did the Delaware courts’ reputational interest combine with their residual worries about federal intervention to prompt an appreciation of the practical importance of solicitude to shareholder interests.³⁴⁴ The post-Cary behavior pattern persisted as the courts articulated unexpected new shareholder-protective applications of basic fiduciary rules. The most famous examples concerned takeovers—*Unocal Corp. v. Mesa Petroleum Co.*,³⁴⁵ and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,³⁴⁶ which established a regime of fiduciary scrutiny of takeover defensive tactics. Friendly mergers also came under scrutiny—*Smith v. Van Gorkom*³⁴⁷ and *Cede & Co. v. Technicolor, Inc.*³⁴⁸ surprised everyone with surprisingly aggressive applications of the duty of care to boards approving mergers. *Paramount Communications, Inc. v. QVC Network, Inc.*,³⁴⁹ later brought the takeover and the merger cases together with a broadly phrased directive to managers to enhance shareholder value when selling their

341. *Id.* at 712. The case concerned a cashout merger of a 49% minority by a 51% parent corporation. It was not an appraisal proceeding, but an action for breach of fiduciary duty in which appraisal precedents on valuation were invoked at the damages phase. The Chancery Court, following the Block, had rejected the plaintiff’s DCF analysis. *Id.* at 712–13. The Supreme Court reversed.

342. *Id.*

343. *Id.* at 713. This would of course be subject to limitations imposed by the statute itself, in particular the bar to value elements “arising from” the merger. *Id.* at 713–14. The statutory language was also cited to justify the change. Section 262 had been amended in 1976 to insert the word “fair” in front of the word “value,” and amended again in 1981 to mandate that the Court “take into account all relevant factors.” *Id.* at 713–14. By implication, the Block regime had been neither fair nor sufficiently capacious.

344. Note also that judicial reputations depend on comparisons with the performance of judges on other courts, state and federal. It follows that a critical atmosphere can arouse reputational concerns even with a less immediate federal threat.

345. 493 A.2d 946, 954–55 (Del. 1985) (reversing *Cheff* and applying an expanded review of tender offer defensive tactics under proportionality test).

346. 506 A.2d 173, 182 (Del. 1985) (inventing a duty of management defending tender offer to auction company in limited circumstances).

347. 488 A.2d 858, 873–81 (Del. 1985) (suddenly expanding the duty of care to cover board approval of arm’s length merger).

348. 634 A.2d 345, 366–71 (Del. 1993) (applying a heightened duty of care scrutiny of boardroom merger decision and suggesting expanded remedial concept inclusive of post-merger gain).

349. 637 A.2d 34 (Del. 1994) (holding that management has an obligation to achieve best value reasonably available for shareholders).

companies.³⁵⁰ Even corporate compliance law finally showed up on the Delaware courts' fiduciary screen.³⁵¹

But the pattern was volatile. Delaware was still straddling between the opposing interests of managers and investors. New rules were enunciated in famous cases only to have their application restricted in less famous cases. The *Singer* rule did not last long, being in turn rejected in 1983 in the main part of the *Weinberger* opinion. The Supreme Court substituted a looser, process-based approach to cash-out mergers³⁵² centered on a constructed negotiation between the shareholder majority and the independent directors of the cashed-out subsidiary. *Weinberger* later was itself cut back when short form mergers were excepted from the category subject to fiduciary scrutiny.³⁵³ The promises inferred by many in the *Unocal* and *Revlon* opinions also went unfulfilled. Under *Moran v. Household International*³⁵⁴ and its progeny, the poison pill emerged as a potent and largely unregulated defense.³⁵⁵

A critical observer could have dismissed the judicial turnaround as little more than a conjuring trick. The courts garnered publicity in a handful of highly publicized cases, ruling against management and announcing vague standards that held out the prospect of shareholder value enhancement. Later, in less well-publicized cases, they used the camouflage of complex facts to refrain from applying the standards in management-constraining ways. The full set of results tallied by the lawyers signaled considerably more room for management maneuver than did the public profile signaled by the leading cases.

But, whatever the merits of the cases' holdings and whatever the cases' shortcomings from a shareholder perspective, Delaware's judges transformed the state into a respectable lawmaker. This partly resulted from the quality of the bench—its analyses were thoughtful even when it ruled for management in cases of palpable shareholder injury. William T. Allen, Chancellor from 1985 to 1997, emerged as one of the country's leading jurists. With Allen in the lead, members of the Delaware bench played a national role, maintaining a dialog on governance issues with the

350. Less surprising but equally important is the recent invalidation of a delayed-redemption poison pill in *Quickturn Design Systems, Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998).

351. See *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), which overruled *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963), and articulated a shareholder cause of action in respect of management failure to monitor legal compliance.

352. 457 A.2d 701, 704, 715 (1983) (overruling *Singer* in favor of less restrictive process scrutiny of cash out mergers).

353. See *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001).

354. 500 A.2d 1346, 1356–57 (Del. 1985) (sustaining poison pill defense).

355. *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1150–54 (Del. 1989), made this clear with its allowance of extraordinary latitude to managers defending a tender offer that disrupts preexisting plans for a friendly merger.

bar, financial intermediaries, and academics.³⁵⁶ Outsiders when Cary wrote, they became important players in the elite governance policy network. They there made a convincing case for their state's legitimacy,³⁵⁷ explaining the state's interest in balancing conflicting interest group demands and acting in a meditative capacity. They took care to point out that they not only mediated management-shareholder conflicts, but as also protected market risk-taking even as they imposed ethical constraints.³⁵⁸ It was hard to imagine a bench that could have done a better job, particularly given the constraining effect of charter competition.³⁵⁹

2. Innovation.

Two facets of the case law demonstrate the Delaware bench's astuteness and creativity particularly well.

a. Process review. The first is the Delaware courts' deployment of the special committee of independent directors, a process device first mentioned in a footnote in *Weinberger*.³⁶⁰ The predecessor case, *Singer*, had effected Delaware's fiduciary about face with substantive review of the fairness of the corporate action taken—the classic approach under the trust principle. *Weinberger* dropped this, instead scrutinizing transactions impacting the rights of minority shareholders through the process-based governance agenda. The court held out a carrot to the majority shareholder—there would be relaxed scrutiny provided that a committee of independent directors was constituted to negotiate on behalf of the minority. It was a brilliant compromise: Judicial scrutiny of the transaction still would be necessary, but scrutiny in the first instance extended only to the conduct of the constructed negotiation. This entry-level process review potentially obviated the need for direct, substantive review of the transaction and direct judicial confrontation with facts concerning the value of the firm. The

356. See Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1613–14 (2005).

357. See Eric Rasmussen, *Judicial Legitimacy as a Repeated Game*, 10 J. L. ECON. & ORGS. 63, 72–74, 78–80 (1994) (offering a repeat game model of judicial motivation showing that judges follow precedent if there is a self-enforcing system based the need to uphold systemic legitimacy). See also Thomas J. Miceli & Mertin M. Cosgel, *Reputation and Judicial Decisionmaking*, 23 J. ECON. BEHAV. & ORG. 31, 44–49 (1994) (modeling the preferences of judges on a utility function that includes both a private and a reputational component).

358. See Andrew G.T. Moore, II, *State Competition: Panel Response*, 8 CARDOZO L. REV. 779, 779–800 (1987) (at the time a Justice of the Delaware Supreme Court). They also have acknowledged the federal threat. See William T. Quillen, *The Federal-State Corporate Law Relationship—A Response to Professor Seligman's Call for Federal Preemption of State Corporate Fiduciary Law*, 59 BROOK. L. REV. 107, 129 (1993).

359. For a contrasting approbation of the Delaware courts, see Kahan & Rock, *supra* note 356 (comparing Delaware case law to nineteenth century jurisprudence and explaining that structural weakness causes Delaware cases to take on a neutral, technocratic gloss).

360. 457 A.2d 701, 709 n.7.

salient question whether the majority was robbing the minority would be addressed indirectly and circumstantially.

After *Weinberger*, the independent committee device was drawn on across the board in Delaware fiduciary cases.³⁶¹ An additional, incidental benefit appeared over time. Issues about the composition of special committees and their conduct of proceedings brought the Delaware courts to the forefront of debates about corporate best practices.³⁶² Delaware caselaw became a focal point in self-regulatory corporate governance discussions. This was exactly the right place for Delaware fiduciary law to be.

b. Prospective application. The second salient aspect of Delaware adjudication was identified by Professor Edward Rock: the courts had a habit of making normative pronouncements with doctrinal implications on a prospective basis. Delaware judges used their cases' complex facts to make pronouncements about unacceptable management behavior. The culpable manager was not, however, hit with an injunction against the deal on the table; a money judgment was still less likely.³⁶³ Instead, the court announced its dissatisfaction with the manager's conduct even as it denied an injunction against the transaction or dismissed the complaint. It was the actor in the *next* deal who replicated the disapproved conduct who faced a litigation risk.³⁶⁴ Rock argued that this worked well: Delaware judges communicated normative standards to the business community through a network of lawyers and investment bankers, imposing a reputational rather than a financial behavioral deterrent.³⁶⁵

The Delaware courts had learned to take this kid gloves approach the hard way. An innovative and aggressive application of the duty of care in *Smith v. Van Gorkum*,³⁶⁶ decided in 1985, had resulted in a substantial money judgment against independent directors deciding on a merger. The result was nervousness in boardrooms, a substantial increase in insurance premiums, and much criticism. It amounted to a serious misfire. The legislature, prompted by the corporate committee of the state bar, intervened to mitigate the damage, amending Delaware's code to permit firms to opt

361. See, e.g., *Kahn v. Lynch Comm'n Sys.*, 638 A.2d 1110 (Del. 1994).

362. See, e.g., *In re Oracle Derivative Litigation*, 824 A.2d 917 (Del. Ch. 2003) (expounding on the meaning of directorial independence).

363. See Edward B. Rock, *Saints and Sinners: How Does Delaware Corporation Law Work?*, 44 UCLA L. REV. 1009, 1015-1039 (1997). Although a money payment (probably in the form of a settlement) may follow where the injunction against the deal is denied but the complaint is not dismissed. *Id.* at 1039.

364. *Id.* at 1023-39.

365. *Id.* at 1012-1016.

366. 488 A.2d 858 (Del. 1985).

out of the duty of care by charter amendment.³⁶⁷ The courts would not make the same mistake again.

With this prospective, dialogic approach, the Delaware courts broke out of the conventional pattern of legislation and adjudication. In the conventional set up, only the legislature acts prospectively; common law is applied by judges on a present basis, even if the ruling is unprecedented. The litigant who breaches an extant duty on a new fact pattern loses the case and pays a judgment or has its course of conduct enjoined. The Delaware courts derived a *sub rosa* exemption from these rules of the game for corporations and their managers. From an abstract perspective, it is hard to see what makes corporate managers such delicate beings as to require this. The charter market provides an explanation—since the exemption has been purchased, any expectation of solicitude is not at all unreasonable. The system satisfied management, which was happy to pay attorneys to churn litigation that rarely entailed more substantial costs in terms of money judgments or lost deals. Clearly the lawyers also were satisfied. For advocates of the shareholder interest, however, the system would remain problematic for some time. But it still was clearly superior to the system pre-Cary.

3. Summary.

The Delaware courts responded to the instability, criticism, and challenges of the 1970s with a new approach that merged the self-regulatory governance agenda into fiduciary review—they in effect synthesized Berle's trust principle with Douglas's governance agenda. Commentators looking at the cases' holdings saw an unstable body of law.³⁶⁸ But a stable approach becomes apparent when we take a broad view in the context of the federalism. The Delaware courts learned that, for charter market purposes, the salient part of the case can be the remedy rather than the holding. At the same time, a well-articulated statement of the law meant a rise to prominence as a governance center with diminished vulnerability to federal attack. Once Delaware held a prestigious place in elite governance networks, federal agenda setters no longer saw it as a problem.

367. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001) (permitting opting out of personal liability for directors for duty of care violations).

368. It has been suggested that Delaware cases' indeterminacy stems from strategic concerns and amounts to an abuse of the state's dominant position in the charter market. See Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1919, 1927–28, 1931, 1935 (1998). I am unpersuaded. See William W. Bratton, *Delaware Law as Applied Public Choice Theory*, 34 GA. L. REV. 447, 469–72 (2000).

B. Hostile Takeovers

Let us look back at the evolution of corporate legal theory. Recall that the trust principle dominated academic thinking from the Depression through the post-war period only to face a challenge from an opposing economic perspective beginning in the 1970s.³⁶⁹ The trust principle suited progressives seeking to disempower managers with new regulations and to protect actors in vulnerable economic positions. As such it lost its leading role in public policy discussions after 1980, along with the general collapse of confidence in regulatory solutions to economic problems. Although it still echoed in a significant body of academic commentary,³⁷⁰ it neither informed corporate law reform agendas nor figured importantly in contemporary discussions of charter competition. The economic paradigm amounted to an ideological mirror image. It suited deregulatory policy agendas and devolutionary federalists. The deregulatory 1980s provided a background conducive to its unquestioned ascendancy. But it instead ran into an unanticipated public choice problem when the states' mature, enabling corporate law system underwent the twentieth century's third and final round of statutory innovation.

1. Antitakeover Legislation in the Supreme Court.

Antitakeover provisions started to appear in state securities or "Blue Sky" laws during the 1960s and 1970s. These statutes, later denominated as "first generation,"³⁷¹ imposed disclosure requirements on hostile offerors and subjected their tender offers to substantive review by state securities administrators. In 1982, the Supreme Court, in *Edgar v. MITE*,³⁷² invoked both the Williams Act and the Commerce Clause to invalidate them. The states returned to the drawing board, producing new, more limited statutes that operated in internal affairs territory. The new statutes passed constitutional inspection in 1987, when the Supreme Court decided *CTS Corp. v. Dynamics Corp. of America*.³⁷³ The replacement statutes tended either (a) to condition the voting rights of shares purchased by takeover bidders on the approval of the shareholders as a whole, (b) to impose freeze periods on mergers or asset combinations between bidders and targets, or (c) to require that an equal price be paid in the second stage

369. See *supra* notes 235–241 and accompanying text.

370. See, e.g., Lynn A. Stout & Margaret M. Blair, *A Team Production Theory of Corporation Law*, 85 VA. L. REV. 247 (1999).

371. See CLAIRE A. HILL, BRIAN J.M. QUINN & STEVEN DAVIDOFF SOLOMON, *MERGERS AND ACQUISITIONS: LAW, THEORY, AND PRACTICE* 478–79 (2d ed. 2019).

372. 457 U.S. 624, 640–46 (1982). For discussion, see Pritchard & Thompson, *supra* note 159, at 238–45.

373. 481 U.S. 69 (1987).

of a two tier acquisition.³⁷⁴ Twenty states enacted such statutes in the years between the two rulings, with fourteen more acting in the six months after *CTS*.³⁷⁵

MITE and *CTS* bear comparison with *Green*, at the time still a recent case. All were about state corporate law and its possible pre-emption, with *Green* focused on judge-made fiduciary law and *MITE* and *CTS* focused on provisions in state codes. All were about mergers and acquisitions. But, as between *Green* and *MITE-CTS*, there is a critical change in the policy focus. *Green* concerned the statute's zone of operation and asked the Court to set parameters. Corporate law federalism concerns figured in at a secondary level, deployed in the Court's opinion to back up an interpretive ruling in chief. Policy concerns respecting the mergers and acquisitions market were barely mentioned.³⁷⁶ *MITE* and *CTS*, in contrast, were first and foremost about the mergers and acquisitions market and posed the question whether its uninhibited operation ranked as a first order federal policy concern. The more particular question was whether hostile takeovers were a good thing. The Court struggled unsuccessfully to articulate a clear answer.

a. Edgar v. MITE. The first-generation statute at issue in *MITE* applied to tender offers for shares of corporations either (a) chartered in Illinois, (b) headquartered in Illinois, (c) with significant physical assets in Illinois, or (d) at least ten percent of the shareholders of which resided in Illinois.³⁷⁷ A potential offeror was required to make a filing with the state securities administrator prior to launching the offer. A twenty-day freeze then began, during which the state securities administrator determined whether to call a hearing on the offer's substantive fairness.³⁷⁸ The case's tender offer target was chartered in Delaware with a principal place of business in Connecticut. The statute, in effect, put the economic welfare of target shareholders in 49 states at the mercy of the Illinois blue sky administrator. The offer had been made in 1979 and the offeror and the target had settled in the same year.³⁷⁹

There were two grounds for invalidation—preemption under the Williams Act³⁸⁰ and impairment of interstate commerce in violation of the

374. For a summary, see ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 53–57, 74–75 (1993).

375. See Roberta Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 461–62 (1988).

376. See *supra* note 325 and accompanying text.

377. 457 U.S. at 627.

378. *Id.*

379. *Id.* at 629.

380. Pub. L. No. 90-439; codified in 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2022).

constitution.³⁸¹ The Court invalidated on both grounds, in an opinion by Justice White. Three justices accepted the Williams Act theory while six justices accepted the Commerce Clause theory. Four of the justices thought the case moot or otherwise not presenting a justiciable controversy.³⁸² The numbers do not add up without further explanation: One of the four on the mootness side, Justice Powell, waived the objection to join the Court's commerce clause opinion.³⁸³

Williams Act preemption turned on the question whether the state statute frustrated the federal legislation's purpose.³⁸⁴ Justice White answered yes, marshalling bits of legislative history that stressed the federal statute's objective of evenhanded treatment for management and investor interests.³⁸⁵ Invalidation followed easily given this premise, since the statute's pre-commencement notification and hearing requirements tipped the advantage notably to management.³⁸⁶ But the premise was shaky, looking forward. The statute's meaning remained up for grabs: with only a three-justice plurality backing the reading, it could be inferred that the Court's non-assenting majority saw the statute differently, as a weak but still pro-management piece of interest group legislation. Given that perspective, there need be no pre-emptive conflicts between the operation of the state and federal statutes: If the state statute slowed things down, so be it.³⁸⁷

The opinion articulated two separate grounds for invalidation under the Commerce Clause. Under the first, the statute directly restrained commerce, violating the dormant Commerce Clause. Blue Sky laws had long ago passed Commerce Clause inspection on the assumption that the transactions covered were intrastate. The Illinois statute now crossed this boundary, operating extraterritorially and covering transactions outside of Illinois as well as within.³⁸⁸ This ground, like the Williams Act ground, garnered the assent of only a minority of the Court. A second, narrower Commerce Clause ground provided the only theory accepted by a majority of the Court. Under this, the statute imposed an excessive burden on interstate commerce in relation to the local interests it protected.³⁸⁹

How should *MITE* be evaluated in this history of corporate federalism? One could jump to conclusions and designate it a landmark: Here,

381. U.S.CONST., Art. I, § 8, cl. 3.

382. They were Brennan, Mashall, Powell and Rehnquist. 457 U.S. at 646, 655–65.

383. *Id.* at 646. The Court began its deliberations with a majority for mootness. See Pritchard & Thompson, *supra* note 159, at 239.

384. 457 U.S. at 632.

385. *Id.* at 633–34.

386. *Id.* at 634–39.

387. See, e.g., Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978).

388. 457 U.S. at 641–43.

389. *Id.* at 643–45.

for the first time, the Supreme Court constrained a state's corporate law regime, using the constitution to invalidate the latest expansion of the envelope of management discretion. On further consideration, however, *MITE* is better dismissed as an outlier. The reason is simple: the state statute in question applied to internal affairs only indirectly. Blue Sky laws regulate transactions in securities markets, territory on the federal side of the subject matter line. They are tolerated only on an intrastate basis. The Illinois statute overstepped the line, disrupting the federalism. *MITE*, in invalidating it, reaffirmed the federalism. The primary federalism question respecting hostile takeovers remained open: Whether state antitakeover statutes would pass inspection once reframed as regulation of internal affairs.

b. CTS v. General Dynamics. They would. Five years later, *CTS Corp. v. Dynamics Corp. of America*³⁹⁰ brought a second generation anti-takeover statute to the Court in the form of Indiana's "control share" statute.³⁹¹ Under this the purchaser of 20%, 33 1/3%, or 50% of the shares of an Indiana corporation lost the votes attached to the shares purchased unless a majority of the corporation's disinterested shareholders voted to confer them, whether at the first annual meeting after the acquisition or at a special meeting conferred 50 days after the acquisition at the acquiror's option.³⁹² The idea was that control could be transferred only with the consent of the shareholders as a whole.³⁹³ The further idea was to reposition the antitakeover barrier within the sphere of corporate internal affairs, where a favorably disposed reviewing court could analogize it to long-accepted deterrents to control transfer like classified boards and supermajority vote requirements.³⁹⁴

The challenge to the statute came up through the Seventh Circuit, which, in a bristling opinion by Judge Richard Posner, invalidated the statute on both Williams Act and Commerce Clause grounds.³⁹⁵ Posner, who manifestly approved of hostile takeovers, brought his formidable talents to bear in protecting them. On the Williams Act ground, he made it clear that he found the *MITE*'s preemption analysis risible:

Ordinarily when Congress passes a statute punishing some supposedly unfair or unjust practice such as monopolization or misrepresentation, the states are free to add on their own penalties. . . . If, therefore, the Williams Act is, as a critical literature forcefully argues . . . , an anti-takeover

390. 481 U.S. 69 (1987).

391. IND. CODE ANN. § 23-1-17-1 et seq.

392. 481 U.S. at 74-75.

393. *Id.* at 74.

394. *Id.* at 90.

395. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986).

statute, expressing a view, however benighted, that hostile takeovers are bad, one would be hard pressed to argue that the Act forbids the states to pass fiercer anti-takeover statutes.³⁹⁶

He preempted anyway: the fifty-day delay favored the target and *MITE* was representative of the weight of precedent however misguided its interpretation of the Williams Act.³⁹⁷ His Commerce Clause analysis was an extension of that in *MITE*: since most of the disadvantaged shareholders were located outside of Indiana, the burden outweighed the benefit.³⁹⁸ The shift from the Blue Sky law to corporate law changed nothing—the internal affairs doctrine was just a principle of conflict of laws with no power to insulate a burden from the dictates of the Commerce Clause.³⁹⁹

The Supreme Court reversed, six-to-three, in an opinion by Justice Powell, who was as manifestly anti-takeover as Judge Posner was pro.⁴⁰⁰ Where Posner had taken a macro view, worrying about free markets and assets going to the highest valuing user, Powell went micro, worrying about individual, unsophisticated stockholders and the tender offer's inherently coercive aspects. Posner had dismissed internal affairs as a policy consideration. With Powell, corporate law federalism came back with a vengeance.⁴⁰¹

Powell played a multi-sided game on the Williams Act issue. The *MITE* analysis, as a three-Justice plurality, was not binding.⁴⁰² And even if it was, the Indiana statute did not disrupt the Williams Act's balance—indeed, it restored the balance by protecting helpless shareholders from coercion.⁴⁰³ The 50-day delay incident to the shareholder vote was not a show-stopper—nothing prevented the offeror from making the closing of the offer contingent on a favorable vote.⁴⁰⁴ *MITE* had stated no *per se* prohibition of statutory delays and the delay here was short compared to the delay there in any event. Finally, the Act's preemptive reach should be minimized. Now that the question was preemption of state regulation of internal affairs, narrow construction was in order: “if Congress had

396. *Id.* at 262.

397. *Id.* at 261

398. *Id.* at 263–64.

399. *Id.* at 264.

400. Powell had drafted Virginia's first antitakeover statute. See Pritchard & Thompson, *supra* note 159, at 235–36. Pritchard and Thompson's survey of his papers in respect of *CTS* show repeated expressions of hostility and suspicion respecting hostiles. *Id.* at 241–45. They note that Powell had lost touch with the control market—he was still responding to 1960s tender offers—the ones that built conglomerates—during the “bust-up” 1980s. *Id.* at 244.

401. See *id.* at 241–44, for a discussion of the central role in Powell's thinking played by the internal affairs doctrine.

402. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 81–82 (1987).

403. *Id.* at 82–83.

404. *Id.* at 84.

intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly.”⁴⁰⁵

As to the dormant Commerce Clause, the statute did not discriminate—in-state and out-of-state offerors were given the same treatment. Nor was there any possibility of interstate conflict, for each state set rules only for its own corporations: “No principle of corporation law and practice is more firmly established than a State’s authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.”⁴⁰⁶ Of course, there remained the fact that the statute discouraged tender offers, thereby inhibiting the free market in shares and impeding commerce. Powell brushed off the objection—those free markets in shares presupposed corporate entities organized under state law and took the entities as they found them.⁴⁰⁷ Powell took the internal affairs doctrine and made it a Commerce Clause sword:

It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.⁴⁰⁸

Summing up, *MITE* and *CTS* were neatly distinguishable, with the federalism supplying the point of distinction. The Illinois statute constrained markets, which lay in federal territory. The Indiana statute regulated internal affairs, which was state territory. Everything else followed, almost. That was Posner’s point: although nominally rooted in internal affairs, the Indiana statute still had a market impact. It followed that if one elevated substance over form the distinction between the two statutes diminished to one of degree rather than one in kind. Such substance over form analyses had been part and parcel of the federalism for a long time—Congressional incursions into state law territory like the FCPA and, indeed, the Williams Act itself presupposed them. Powell, however, refused to be drawn into the economic substance. He instead reaffirmed the formal integrity of the subject matter division that had evolved in history.

With that, Powell brought *CTS* to the same end point as *Green*: it was not the Court’s job to traverse the subject matter distinction bound up in the federalism. That ball was in the court of the political branches.

405. *Id.* at 86.

406. *Id.* at 89.

407. *Id.* at 90.

408. *Id.* at 91.

2. Antitakeover Legislation in Delaware.

Actors in Washington wanted to put the ball in play. Management was pressuring Delaware to join the states with antitakeover statutes.⁴⁰⁹ Actors in the Reagan administration exerted counter-pressure on Delaware, threatening to preempt its takeover regulation if it did.⁴¹⁰

Delaware finally enacted a weak statute in 1988.⁴¹¹ Commentators put contrasting glosses on the event. One view emphasized that Delaware's weak response reflected shareholder demands unique to the national chartering state. Other states' antitakeover legislation stemmed from the influence of potential targets amongst the local firms. Delaware, in contrast, was home to bidders as well as targets.⁴¹² A countervailing capital market interest also registered there.⁴¹³ The other view emphasized the federal threat, which focused particularly on Delaware.⁴¹⁴ Under this, the federal pressure on Delaware was an exemplar of constructive back and forth within the federation, with the threatened intervention curbing Delaware's structural preference for the management interest.

The two accounts were complementary. Nothing prevented the inclusion of both in a unitary picture of events. A third influence also can be noted, also complementary—Delaware's position in the charter market. Delaware had been making concessions to management in the teeth of opposition at the national level for almost a century. Its antitakeover statute may have been weak and Delaware may have dragged its feet in enacting it, but it did finally act. It thereby signaled its fidelity to the management interest and its determination to maintain its law's managerial tilt. The federal threat imported credibility to the signal.

The threat dissipated quickly, to the extent there really was a threat in the first place. By implication, the proponents of takeover protection lacked the political wherewithal to follow through. Moreover, even if there had been sufficient Congressional support for takeover protection, it is not

409. See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 625 (2003) (noting that Martin Lipton was recommending reincorporation out of Delaware).

410. *Id.* at 626–27 (noting that the White House Counsel of Economic Advisors opposed the Delaware statute, that an SEC Commissioner threatened to preempt, and that SEC Chair David Ruder said the same in a speech and also warned the statute's drafter that enactment would be imprudent).

411. See DEL. CODE ANN. tit. 8, § 203, (2001).

412. See Romano, *supra* note 375, at 467.

413. *Id.* at 468.

414. See Roe, *supra* note 409, at 629–30; see also Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1455 (1992); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1512 (1989); Cary, *supra* note 160, at 688. Anecdotal evidence shows that Delaware lawmakers keep federal intervention in mind when they take politically sensitive steps. See Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 906–08 (1990).

at all clear that federal intervention would have disturbed the charter market. The legislation introduced in the House in 1987⁴¹⁵ would have given the SEC authority to promulgate rules prohibiting defensive tactics and to create “standards for the fair conduct of contests for corporate control,” subject to a shareholder “opt in” privilege.⁴¹⁶ Such a provision would have terminated Delaware’s takeover case law under *Unocal* and *Revlon*, but otherwise would have left in place the enabling state law regime. Such a result might even have benefited Delaware by removing the competitive threat posed by tighter antitakeover provisions enacted in other states.

3. Observations—Hostile Takeovers, State Corporate Lawmaking, and the Failure of the Economic Paradigm.

The antitakeover round followed the earlier pattern of state law innovation in two familiar ways. First, the states catered to management’s interest in freedom of action, and secondly, they were enacted against the backdrop of a booming stock market.⁴¹⁷

But the antitakeover statutes also broke the historical pattern. Innovations in the bull markets of the 1920s and 1960s had facilitated dealmaking; now the states chilled transactions. Formerly, state law innovation almost always moved in an enabling direction. Here, even as the governance device of shareholder ratification figured prominently, so did mandates. Formerly, the first mover had been Delaware, the charter market leader. Here states that did not pursue charters made the first move.

The politics differed. Where Delaware innovated with an eye to business preferences nationwide, the states enacting antitakeover statutes moved at the behest of nervous but influential managers who, acting independently of local business, labor, and community leaders, used their influence to procure legislation⁴¹⁸ that externalized the costs of takeover defense on out of state shareholders. Delaware’s process differed, reflecting the more diverse constituency swept in by its law’s national reach. As happened elsewhere, managers seeking protection (and their lawyers) lobbied in favor, some even threatening to pull out of the state. But in Delaware

415. H.R. 2172, 100th Cong. 1st Sess. (proposed April 27, 1987).

416. *Id.* § 14. The statute also imposed a one share/one vote rule, *id.* § 3, prohibited greenmail, *id.* § 5; accorded shareholders access to the proxy statement to nominate directors, *id.* § 6; prohibited street sweeps, *id.* § 11, prohibited golden parachutes, *id.* § 12; and amended the Williams Act in numerous ways. *Id.* §§ 4, 7, 8, 9, 10, 13.

417. The DJIA hit a recession low of 2832 in August 1982. By August 1987, it was at 7147. It ended the decade at 6704 in December 1989. *Dow Jones—DJIA—100 Year Historical Chart*, MACROTRENDS, <https://www.macrotrends.net/1319/dow-jones-100-year-historical-chart> [hereinafter *DJIA Chart*].

418. See Romano, *supra* note 375, 462.

they were countered by institutional investors, shareholder organizations, and SEC commissioners,⁴¹⁹ resulting in a weaker statute.

Once the new barriers to takeovers were in place, the historical pattern shifted in a second respect: shareholders for the first time went into irreconcilable opposition. Previously, shareholders had remained quiescent when the states extended more slack to managers. There were several reasons. First, shareholders suffered collective action problems. Secondly, under the “Wall Street Rule,” shareholders were content to resort to exit by market sale when excessive slack led to poor results. Thirdly, since 1934, the SEC had stood in to protect the shareholder interest at the national level. Sleazy market practices facilitated by enabling innovations in the 1920s had been addressed by federal disclosure and market regulation mandates. In the 1980s, however, federal regulators did not come to the shareholders’ rescue. Meanwhile, institutional shareholding had ameliorated the collective action problem. Now organized, the shareholders found their voice, a dissenting voice.⁴²⁰

Just as the economic paradigm had enervated the trust principle, so now did the economic paradigm suffer enervation. The race-to-the-top validation of state law bypassed the problem of the shareholders’ lack of influence over state lawmaking with a reference to the control market deterrent. The assertion, in effect, was that the managers’ option of exit adequately disciplined the states, while the possibility of shareholder exit by tender to a hostile offeror adequately disciplined the managers. The collaboration of managers and state politicians to hamper the market deterrent presented a manifest case of charter market failure. The states were containing the very mechanism on which the economic paradigm relied to incentivize corporate agents. Charter competition, far from acting as a check on rent seeking activity, had promoted it. State law results were anything but efficient.⁴²¹

The law as product analogy works as a policy justification only to the extent that the supplying jurisdiction purveys an unbundled regulatory product to a consumer with a unitary set of preferences without externalizing costs on anyone else.⁴²² The charter market met the former

419. *Id.* at 464.

420. See Robert Daines & Michael Klausner, *Do IPO Charters Maximize Value?* 17 J.L. & ECON. & ORG. 83, 87–88 (2001).

421. For a formal model showing that charter competition leads to optimal rules on matters in which managers and shareholders have a commonality of interest but suboptimal rules on matters directing impacting the private benefits of managers (such as compensation and antitakeover rules), see Oren Bar-Gil, Michal Barzuza & Lucian Bebchuk, *The Market for Corporate Law*, 162 J. INST. & THEORETICAL ECON. 134 (2006).

422. See William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201, 267–68 (1997).

qualification—Delaware’s customers took only its corporate law free of all other regulations. The latter qualification had always been problematic, for it depended on the heroic assumption shareholder and manager interests always were perfectly aligned, rendering irrelevant the mandated agenda control managers enjoyed under the state system. Where, as with takeovers, interests did not stand aligned, the state system displayed a structural defect. Because the market forced a competing state to focus on the variables that influence incorporation decisions,⁴²³ there followed a concern for management preferences rather than for shareholder value itself. Accordingly, nothing at the state level prevented suboptimal accommodation of management preferences.⁴²⁴

C. Late Twentieth Century Federal Incursions into Internal Affairs

We have seen two post-war extensions of the federal securities laws onto territory formerly occupied by the states. One, the Williams Act, was interest group legislation enacted at the behest of management, then benefiting from the good will engendered by the “go go” stock market. The other, the FPCA, was an anti-management initiative enacted in the wake of scandal and stock market collapse.

Late twentieth century extensions of the federal securities laws continued this bipolar pattern. The first two, the National Securities Markets Improvement Act of 1996 (NSMIA) and the Securities Litigation Uniform Standards Act of 1998 (SLUSA) came from management legislative wish lists, with NSMIA eviscerating the state Blue Sky laws and SLUSA extending to the states recent federal reforms aimed at containing plaintiffs’ lawyers. Neither statute directly impacted internal affairs. Like *MITE*, they concerned state activity on federal turf, aggressively protecting the integrity of federal securities regulation from parallel activity in the states. The third statute, the Sarbanes Oxley Act of 2002 (SOX),⁴²⁵ did concern internal affairs and fell emphatically on the anti-management side of the line. Its enactment parallels that of the FCPA. As with the earlier statute, (a) an external economic shock had energized Congress, (b) corporate compliance failures had triggered broad-based political demands, (c) corrective action in response to the demands could not reasonably be expected at the state level, and (d) the federal legislative response reached more deeply into internal affairs than had its predecessors.

423. See Bebhuk, *supra* note 414, at 1452, 1454.

424. *Id.* at 1462–63, 1468, 1488.

425. Pub. Law. 107-204, 116 Stat. 745 (codified in sections of 11, 15, 18, 28, and 29 U.S.C.).

1. Securities and Litigation Reform.

The NSMIA displaced much of the parallel (and antecedent) state system of securities regulation. More particularly, the NSMIA (1) preempted state level merit review and disclosure requirements for firms registered at the federal level, federally registered investment companies, and most private placements;⁴²⁶ (2) preempted much state level regulation of broker-dealers;⁴²⁷ and (3) provided for exclusive federal regulation of advisors to federally registered investment companies and other advisors with large portfolios. Thus constituted, the statute harmonized and streamlined securities regulation. It did not traverse internal affairs, narrowly defined, even as it mowed down volumes of state law. Nor did it disturb the charter market: the Blue Sky laws applied to offers and sales of securities within each state, regardless of the issuer's domicile.

The Act originated on the Republican side of the aisle, as a deregulatory initiative.⁴²⁸ The Democrats and the SEC both complained that it went too far in reducing protections for shareholders. The sponsors promptly dropped the most far-reaching proposals.⁴²⁹ Thereafter, the bill garnered bi-partisan support, passing the House by a 407 to 8 vote⁴³⁰ and the Senate by a voice vote.⁴³¹ President Clinton signed the legislation on October 11 1996.⁴³²

SLUSA was drafted to cover a perceived loophole in the Private Securities Litigation Reform Act of 1995, which had erected barriers to private securities law litigants in federal courts. Forum shopping was alleged—plaintiffs were bringing securities fraud class actions in state court, avoiding the new federal process strictures.⁴³³ The bill limited both state level class actions and fraud actions based on state law.⁴³⁴

In 1997, the bill was reported out on a bipartisan basis in both the House and the Senate. SEC Chair Arthur Levitt and Senator Paul Sarbanes both voiced opposition at hearings, and the matter stalled for a few

426. 15 U.S.C. § 77r.

427. *Id.* § 78o(h)(1).

428. See Stevenson, *supra* note 133.

429. *Id.* These included provisions that would have impaired the states' ability to regulate small cap companies and otherwise enforce their laws. See *id.*

430. See *House Vote #249, H.R. 3005 (104th): National Securities Markets Improvement Act of 1996*, GOVTRACK.US, <https://www.govtrack.us/congress/votes/104-1996/h249> [<https://perma.cc/289T-Z5C3>].

431. See *Securities Regulation Bill Is Cleared by Senate*, N.Y. TIMES, June 29, 1996, at 34.

432. See *H.R. 3005 (104th): National Securities Markets Improvement Act of 1996*, GOVTRACK.US, <https://www.govtrack.us/congress/bills/104/hr3005> [<https://perma.cc/UK2X-49NG>].

433. See Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 2, 4 (1998).

434. Delaware was not a target: Under prevailing conflict of laws rules, the fraud actions are not decided under the law of the state of incorporation. See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2402–12 (1998).

months.⁴³⁵ In 1998, the legislation moved forward with renewed vigor, due in no small part to the steadily-rising stock market and the increasing political muscle of Silicon Valley.⁴³⁶ High-tech companies and other corporations interested in the success of the new legislation created a lobbying group for the occasion,⁴³⁷ which was joined by the National Venture Capital Association, the American Institute of Certified Public Accountants, and the American Electronics Association.⁴³⁸ Several organizations, including some consumer groups and organizations representing state and local governments, lobbied against the bill. But they lacked their opponents' political muscle.⁴³⁹ But then, in the later 1990s, the stock market was going through the roof.⁴⁴⁰

Silicon Valley got what it wanted. Levitt and President Clinton dropped their opposition in exchange for legislative history making it clear that no prohibition of federal suits for recklessness was intended.⁴⁴¹ Although there were significant numbers of dissenters in both houses, the bill went through with strong majorities.

Before passage, a Delaware-oriented carve out was added in the Senate, assuring that state litigation in respect of breaches of fiduciary duty would be unaffected.⁴⁴² With this we come to a complete policy reversal within the federalism. Twenty-two years earlier, when the Second Circuit decided *Green*,⁴⁴³ state-level fiduciary enforcement was the federalism's sore point and forces gathered with a view to putting it out of business and recreating it in favored federal courts under 10b-5. Now federal litigation itself was the problem, as plaintiff's lawyers used Rule 10b-5 to hold up companies experiencing business reverses, all without much in the way of

435. In mid-1997, there were many who questioned the need for a uniform standards act for securities litigation. In hearings, S.E.C. Chairman Levitt declared that it was still too early to assess whether a Uniform Act was needed; several senators, led by Senator Sarbanes, agreed with this assessment. See Eugene P. Caiola, *Comment: Retroactive Legislative History: Scierer Under the Uniform Security Litigation Standards Act of 1998*, 64 ALA. L. REV. 334, 337 (2000). The SLUSA thereafter stalled due to a lack of support. *Id.*

436. See Leslie Eaton, *The Silicon Valley Gang: An Influential Industry with Lots of Money Is Getting Its Way on Capitol Hill*, N.Y. TIMES, June 11, 1998, at D1.

437. Matthew Greco, *Wait 'Til 1998 for Uniform Standards Bill: Congress Adjourns Early without Bringing Measure to the Floor*, INV. REL. BUS., Nov. 17, 1997.

438. See Painter, *supra* note 433, at 49.

439. *Id.* at 50.

440. In January 1998 the DJIA stood at 15022. By the end of the year it was up to 17197. *DJIA Chart*, *supra* note 417.

441. See Painter, *supra* note 433, at 7, 53.

442. *Id.* at 56–57; see also Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475 (2002); Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215 (1999).

443. See *supra* notes 318—and accompanying text.

policy justification.⁴⁴⁴ With SLUSA, the cleanup effort extended down to the state level not because there was anything wrong with state courts but because that was where the plaintiff's lawyers had led it. In the states' forums for fiduciary enforcement, in contrast, the plaintiff's bar was under control.

2. Enron and Sarbanes Oxley.

The scenario acted out in the mid-1970s in the run up to the FCPA was repeated in 2002 in the wake of reporting failures at Enron, WorldCom, and other firms. Three ingredients once again combined—a major and ongoing decline in the equity markets,⁴⁴⁵ headline-grabbing stories of corporate corruption, and popular anger towards corporate management. Once again, legislation intended to “rein-in” corporations passed with bipartisan support. Once again, internal affairs were traversed without apparent concern for the federalism norm. The result was the Sarbanes-Oxley Act of 2002 (SOX).⁴⁴⁶

SOX had a quick gestation. The Enron scandal and accompanying media frenzy began with news of paper shredding in January 2002. The House enacted its bill in April, by a vote of 334 to 80.⁴⁴⁷ WorldCom fell while the Senate held hearings on the House bill, triggering an accelerated timetable and passage by voice vote on July 15. The Conference Report, passage by both Houses, and presidential approval all followed before the end of the month.⁴⁴⁸ The Republicans disliked many provisions, but with a mid-term election coming up and a falling stock market (coming on the heels of a precipitous plummet two years earlier),⁴⁴⁹ they fell in line. Even the leading business lobbies were split, with the Business Roundtable saying yes and the Chamber of Commerce saying no.⁴⁵⁰ So rapidly was the

444. See generally William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011) (critically examining each of the prevailing justifications of the fraud on the market private action—compensation, deterrence, and governance).

445. At the end of January 2002, the DJIA stood at 17,201. A year later it stood at 13,610. See *DJIA Chart*, *supra* note 417.

446. Pub. L. No. 107-204, 15 U.S.C. §§ 7201 et seq. (2002).

447. See *House Vote #110, H.R. 3763 (107th): Sarbanes-Oxley Act of 2002*, GOVTRACK.US, <https://www.govtrack.us/congress/votes/107-2002/h110> [<https://perma.cc/ZF3B-AQZR>].

448. See Roberta Romano, *The Sarbanes Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1522, 1549–64 (2005).

449. Between the end of December 1999 and the end of September 2001 the DJIA fell from 20,971 to 15,235. See *DJIA Chart*, *supra* note 417.

450. See Romano, *supra* note 448, at 1564.

package cobbled together that few of its contents received much in the way of considered attention.⁴⁵¹

Some of the SOX mandates picked up where the FCPA left off. For example, SOX required that the CEO and CFO certify public reports, making them responsible for the maintenance of the firm's internal controls system,⁴⁵² along with accompanying criminal penalties.⁴⁵³ While these modifications went to internal affairs, they addressed topics federalized long before. Moreover, the integrity of the federal disclosure system stood out as the ultimate goal. The federal government, having instituted the mandatory system, reacted to successive compliance failures by reaching further and further back to cover the internal processes that generated the mandated reports. The federal political response resembled that seen with other regulatory regimes implicating criminal penalties: High profile non-compliance triggered a ratcheting up of duties and penalties, symbolically reassuring the public.⁴⁵⁴ No one in Congress wanted to be seen as soft on crime, of whatever variety.

SOX also traversed internal affairs in regulating auditor client relationships, forbidding a list of nonaudit services.⁴⁵⁵ But here also the territory already had been federalized—the statute's list of nonaudit services tracked a list already promulgated by SEC rule.⁴⁵⁶ The new audit oversight board instituted by the statute tracked regulatory templates already established for regulation of securities market professionals.

451. *Id.* at 1562, 1585. Mark Roe, *Backlash*, 98 COLUM. L. REV. 217 (1998), is the leading discussion of the politics that follow upon economic adversity. On the scandals of the day, see Joseph A. Grundfest, *Enron: Lessons and Implications: Punctuated Equilibria in the Evolution of United States Securities Regulation*, 8 STAN. J.L. BUS. & FIN. 1, 1 (2002) (analogizing the development of the securities laws to the “punctuated equilibrium” theory of evolution in which “species are relatively stable over long periods of time, but ‘events of rapid speciation occasionally punctuate this tranquility’”); Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U. L.Q. 95, 105 (2004) (describing corporate crime legislation as normally coming after a public outcry for greater regulation following revelations of corporate wrongdoing, usually during a weak economy); Kai-Alexander Heeren & Oliver Rieckers, *Legislative Responses in Times of Financial Crisis—New Deal Securities Legislation, Sarbanes-Oxley Act and Their Impact on Future German and EU Regulation*, 11 EUR. REV. PRIVATE L. 595, 623 (2003) (arguing that Sarbanes-Oxley's purpose was to calm investors by demonstrating Congressional activism).

452. Sarbanes Oxley Act, § 302.

453. *Id.* § 906(a) (enumerating penalties for knowing violation of similar certification requirement); see Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002).

454. See Bruce T. Fitzpatrick, *Congressional Re-Election Through Symbolic Politics: The Enhanced Banking Crime Penalties*, 32 AM. CRIM. L. REV. 1, 3, 28 (discussing the response to the banking scandals of the late 1980s).

455. Sarbanes-Oxley Act, § 201.

456. See Revision of the Commission's Auditor Independence Requirements, 65 Fed. Reg. 76,008-01 (2000) (codified at 17 C.F.R. §§ 210.2-01, 240.14e-101).

Federally speaking, SOX marked out new territory in requiring audit committees composed entirely of independent directors, defining the independent director, in laying down audit committee duties and powers, and in requiring disclosure respecting the expert status of committee members.⁴⁵⁷ But none of this was new. The committee-based governance agenda dated back to Douglas. The same went for the other headline internal affairs item in SOX—the ban on corporate loans to officers and directors.⁴⁵⁸ When Douglas mentioned this in 1934,⁴⁵⁹ he was only restating a suggestion made many times in the early decades of the twentieth century.⁴⁶⁰ The novelty lay in the mandatory federal bottles in which the old wine now was contained. SOX, then, manifested political scientist John Kingdon’s model of a law reform idea that sits at the bottom of agenda for decades, waiting for a window of political opportunity to open and a normative entrepreneur to put it at the right spot on the agenda during the opening.⁴⁶¹

Little in the way of real-world institutional adjustment was required. Most large firms were organized with audit committees and compliance systems already, reflecting the influence of decades of self-regulatory conversations about best governance practices. National level audit committee mandates date from the Watergate era, albeit through the medium of exchange listing requirements. Indeed, amendments to NYSE listing requirements mooted in 2002 and approved in 2004 tracked the SOX audit committee provisions and extended them to the compensation and nominating committees before going on to the final redoubt of the boardroom to mandate a majority independent board.⁴⁶² The stock exchange, then, remained the primary source of new mandates from the governance agenda.

Congress’s off-handed but emphatic revision of the internal affairs line drawn after 1934 did upset settled expectations.⁴⁶³ But did it imply anything further for corporate federalism? Let us look at the political pattern. FCPA and SOX have sufficient similarities to suggest a template for federal traversals of internal affairs. First, both statutes responded to compliance failures by pushing federal regulation past the end product, the reports themselves, to the generative processes. Both concerned compliance with law (or in the case of “questionable payments,” quasi law), and responded to political demands appearing in the wake of high-profile

457. Sarbanes Oxley Act, §§ 301, 407.

458. *Id.* § 402(a).

459. *See supra* text accompanying notes 66–77.

460. *See Mitchell*, *supra* note 9.

461. *See generally* JOHN KINGDON, *AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES* (1984).

462. *See* NYSE Listed Company Manual ¶ 303A.

463. *See, e.g.*, Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, *REGULATION*, Spring 2003, at 26–31.

noncompliance. In both cases, the political demands could not have been satisfied at the state level, partly due to dispersion across fifty states and partly due to the states' competitively-driven attachment to an enabling approach. Meanwhile, in both cases, the political demands stemmed from the general public, rather than from organized interest groups. (The interest groups benefited, lawyers and accountants primarily, amounted to incidental beneficiaries rather than prime movers.) Both statutes drew on a nonideological source, the governance agenda, and surmounted partisan politics in their enactment. Finally, and most importantly, neither statute disturbed the state system. Isolated mandates drawn from the governance agenda do not amount to external shocks that force changes in the law at the state level. They apply across the board, putting no competitive pressure on Delaware. Because they supplement the states' enabling regime, no state level adjustment is necessary. It is management that must adjust. The twenty-first century Congress intervenes against management, not Delaware.

Finally, SOX demonstrated the political implications of the rise of the shareholder class.⁴⁶⁴ As the shareholder class rises, sharp stock market reverses and concomitant corporate misdeeds are more likely to have national political implications. Significantly, federalism concerns did show up prominently in the history of the FCPA—the Ford administration wanted to respect the post-1934 internal affairs boundary. But with SOX twenty-five years later, federalism concerns did nothing to deter either the Congress or the Republican administration. The political demands, or at least Washington's perception of them, had materially increased in magnitude.

D. Delaware and the Advent of Shareholder Capitalism

The shareholder interest only nominally lost the takeover wars of the 1980s. Although legal innovations during the 1980s made tender offers more expensive and less likely to occur, the normative agenda of the hostile offerors and their proponents won in the long run. Offerors during the 1980s demanded shareholder value maximization in the teeth of resistance from managers and state legislatures. During the 1990s, managers did an about face and assimilated the norm.⁴⁶⁵ Incentivized by stock options, managers began building their careers by maximizing value. Disinvestment and conglomerate unbundling, which came by force in the 1980s,

464. For a description, see Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 452–53 (2001).

465. See Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1278–87 (1999).

became an ordinary business agenda item.⁴⁶⁶ At the same time, institutional shareholders, outraged by the antitakeover triumph of the 1980s, ameliorated the shareholder collective action problem by organizing and making their voice heard.

The changes worked to Delaware's advantage. Ongoing debates about the separation of ownership and control lessened in intensity. For most of the twentieth century there had prevailed a managerialist model of corporate governance that endorsed the delegation of substantial discretion to managers.⁴⁶⁷ But, at the century's close, the absolutist view represented a minority perspective.⁴⁶⁸ The deflation of managerialism implied a concomitant diminution of anti-managerialism. Corporate governance debates lost their ideological coloration and corporate federalism became depoliticized. Functional questions about value creation and agency cost reduction now dominated, a context in which Delaware came up looking relatively attractive.

Shareholder capitalism brought the conduct of business and stock market results forward in the national consciousness,⁴⁶⁹ making negative shocks more politically salient in Washington than ever, as demonstrated with SOX. SOX, like its shock-related predecessors, addressed political demands that Delaware's charter market strategy made it powerless to anticipate or confront.⁴⁷⁰ And, despite its entry into internal affairs, SOX in no way impaired the charter market or Delaware's rent flows. A counterfactual suggestion arises: Delaware's new respectability assured that the Enron crisis worked itself out as a federal enforcement event; no one suggested that self-regulation in the states bore responsibility.

V. CONCLUSION: AT THE DAWN OF THE TWENTY-FIRST CENTURY

At the close of the twentieth century, the three core elements of corporate law federalism—the charter market, the division of subject matter between internal affairs and the securities markets, and the federal

466. The unbundling of Sears, Roebuck & Co. was a prominent example. It spun off its broker dealer firm, Dean Witter, in 1993 and its insurance subsidiary, Allstate, in 1995. See Shauna O'Brien, *Sears' History: A Visual Narrative of Mergers & Spinoffs*, DIVIDEND.COM, <https://www.dividend.com/how-to-invest/the-complete-visual-history-of-sears/> [<https://perma.cc/4JIM-99Y6>].

467. See Hansmann & Kraakman, *supra* note 464, at 444.

468. Steve Bainbridge was the leading proponent. See, e.g., Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 866 (2002).

469. See ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE* 71–95 (2000).

470. For a contrary view, see Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 654–62 (2004). Professor Jones saw the Delaware courts making a belated, but still preemptive response to SOX in recent cases.

noninterference norm—were poised to continue into the new century with their historical alignment intact.

Continuance would not imply stasis, however. Recall that an observer in 1962 might reasonably, if precipitously, have predicted an end to Delaware's dominance.⁴⁷¹ So might an observer at the end of the century reasonably have questioned the description of "active" charter competition—it seemed that only Delaware remained in the game as an active player, perhaps wary of potential competition from states like Maryland, New Jersey, and Nevada, but not challenged actively. But challenges did come. In 2001, Nevada shifted to active posture, amending its code to eliminate director and officer liability for breach of the duty of loyalty.⁴⁷² It was a bid directed to the bottom of the market and it met with some success. Nevada's share of out of state incorporations rose 20% in the immediate aftermath of the change.⁴⁷³ But this sounds like more than it was—the twenty percent bump took Nevada from 5.5% to 6.6% of all out of state incorporations.⁴⁷⁴ It meant a jump in the state's franchise tax draw but not a westward stampede of reincorporations out of Delaware. Nevada was carving itself a niche, the occupants of which were not pretty to look at: Nevada corporations have been shown to be 40% more likely to undergo accounting restatements;⁴⁷⁵ the proportion of Nevada companies in the penny stock category is twice the size of Delaware's.⁴⁷⁶ The beat goes on: Elon Musk formed an artificial intelligence company in Nevada in April 2023.⁴⁷⁷

Delaware now had a competitor to its right, the very existence of which only served to enhance its reputation. Another competitor soon cropped up to its left: In 2007, North Dakota enacted⁴⁷⁸ a shareholder-friendly code with features notably absent from Delaware's—it included proxy access and majority voting, a prohibition of staggered boards, and

471. See *supra* text accompanying note 136.

472. A Nevada shareholder plaintiff would be required to show intentional misconduct, fraud, or a knowing violation of law. See Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 949–51 (2012).

473. *Id.* at 948–49.

474. *Id.* at 949.

475. See Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593 (2014).

476. 60.4% to 30.5%. See Robert Anderson, *Are Nevada Public Companies for Real?*, WITNESSETH, <https://witnesseth.typepad.com/blog/2012/07/are-nevada-public-companies-real.html>.

477. See Berber Jin & Deepa Seetharaman, *Elon Musk Creates New Artificial Intelligence Company X.AI*, WALL ST. J. (Apr. 14, 2023), <https://www.wsj.com/articles/elon-musks-new-artificial-intelligence-business-x-ai-incorporates-in-nevada-962c7c2f>.

478. See, e.g., Larry Ribstein, *The North Dakota Experiment*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Apr. 23, 2007), <https://corpgov.law.harvard.edu/2007/04/23/the-north-dakota-experiment/> [<https://perma.cc/5RRG-UTH3>].

constraints on antitakeover initiatives.⁴⁷⁹ Carl Ichan, who promoted the legislation, engineered the reincorporation to North Dakota of a company he controlled. Otherwise, nothing happened. Despite nudges from activists, other corporations failed to follow.⁴⁸⁰

It seems that the more the charter market changes, the more it stays the same. The Nevada experience belied the old point that competition drags corporate codes to the bottom: Nevada lowered the bar, but other states did not join it there. Nor, in the twenty-first century bottom-directed leadership automatically translate into market share. Nevada carved out its niche without dislodging Delaware's market position.⁴⁸¹ Shareholder empowerment, that new factor in the governance equation, may have played a role in this. Even if the managers of a given Delaware corporation might have been tempted by Nevada, there was no reason to expect the shareholders to go along at the ratification stage. Contrariwise, the rise of institutional shareholders did not imply a redirection of charter competition toward a shareholder-oriented top. A most prominent institutional investor, Carl Icahn, gave the proposition a shot only to miss. The tentative take-away is this: shareholder empowerment has strengthened Delaware's position as market leader.

Delaware caselaw would reflect this in a manner inconceivable only a few years earlier. So confident had the Delaware courts become that they constitutionalized internal affairs, drawing on the due process, full faith and credit, and commerce clauses as grounds to block application of the law of other states to Delaware corporations.⁴⁸² *MITE* and *CTS* were prominently cited.⁴⁸³

479. See Barzuza, *supra* note 472, at 971 n.96; see also Carl C. Ichan, *North Dakota's Pro-Shareholder Law: A Major Advancement*, 84 N. DAKOTA L. REV. 1039 (2008).

480. *Id.* at 971.

481. Franchise fees accounted for 12.1% of Delaware's state and local general revenue in 2021. See *Project Delaware*, URB. INST., <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-fiscal-briefs/delaware> [<https://perma.cc/DX4S-QD6X>].

482. See, e.g., *Salzberg v. Sciabacucchi*, 227 A.3d 102, 136 (Del. 2020); *Citigroup Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1134 (Del. 2016); *VantagePoint Venture Partnership 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005). The doctrine dates back to *McDermott Inc. v. Lewis*, 531 A.2d 206, 216–17 (Del. 1987) (“[A]pplication of the internal affairs doctrine is not merely a principle of conflicts law. It is also one of serious constitutional proportions—under due process, the commerce clause and the full faith and credit clause—so that the law of one state governs the relationships of a corporation to its stockholders, directors and officers in matters of internal corporate governance. The alternatives present almost intolerable consequences to the corporate enterprise and its managers. With the existence of multistate and multinational organizations, directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions. Stockholders also have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs.”).

483. *Lewis*, 531 A.2d at 214, 217.

Delaware and the state enabling regime would remain vulnerable to preemptive federal mandates, of course. But, with the waning of the take-over issue, the federal threat receded, figuring only at a structural level into the calculations of Delaware lawmakers, who remained averse to any exercise of federal preemptive power.⁴⁸⁴ The 1980 federal fiduciary standards bill⁴⁸⁵ had ended the century's long series federal chartering initiatives with more of a whimper than a shot across Delaware's bow. Looking back across the century, federal chartering was a reform initiative that steadily fell lower and lower on legislative agendas. It lay at the top of the agenda of Theodore Roosevelt's administration.⁴⁸⁶ It dropped to the second tier of the agenda of the second administration of Franklin Delano Roosevelt.⁴⁸⁷ By the 1970s, it remained alive only in the offices of a handful of congressmen.⁴⁸⁸ After 1980 it dropped into the inactive drawer.⁴⁸⁹

The next political emergency, the financial crisis of 2008, would be triggered by excess leverage in the real estate market rather than by defalcations by corporate managers. Even so, the resulting federal legislative intervention, the Dodd-Frank Wall Street Reform and Consumer Protection Act,⁴⁹⁰ hewed to the federalism pattern in its corporate governance sections, drawing down a fistful of items from the then current governance agenda.⁴⁹¹ Thus did shareholder concerns remain salient even in the wake of an economic collapse triggered by errant pursuit of shareholder value. But shareholder value would fall from favor in the fullness of time. When federal chartering finally returned to the floor of the Congress in 2018, in the form of Senator Elizabeth Warren's proposed the Accountable Capitalism Act, the immediate target would be the shareholders, rather than the states. Warren's legislation would have required a federal charter for all companies with gross receipts exceeding \$1 billion, a charter according board seats to employees and requiring the board to pursue the public benefit and to perpend to stakeholder interests.⁴⁹² As per the federalism, the bill went nowhere.

484. See William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of the Residents of One Small State*, 152 U. PA. L. REV. 953, 953–60 (2003).

485. See *supra* text accompanying notes 198–203.

486. See Brabner-Smith, *supra* note 35, at 162–63.

487. See *supra* text accompanying notes 86–90.

488. See *supra* text accompanying notes 192–204.

489. Accountable Capitalism Act, S.3348 (115th Congress 2017–2018).

490. Pub. L. 111–203, 124 Stat. 1376 (July 21, 2010).

491. *Id.* § 951 (requiring say on pay votes); *id.* § 952 (requiring independent compensation committees); *id.* § 953 (requiring additional disclosures respecting executive pay), § 954 (requirement compensation clawbacks in certain situations); *id.* § 971 (according the SEC authority to mandate shareholder access to the proxy statement to nominate board candidates); *id.* § 972 (requiring disclosures respecting jointly held offices of CEO and board chairman).

492. Accountable Capitalism Act, *supra* note 489, §§ 2,5,6.