

Delaware General Corporation Law-A Commentary and Analysis

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BOOK REVIEW

The Delaware General Corporation Law—A Commentary and Analysis. ERNEST L. FOLK, III. Boston: Little, Brown & Company. 1972. Pp. xliii, 708. \$47.50.

Corporation law is often looked upon as an area of the law within the special province of state legislatures and state courts. In fact, however, corporate practice is more national than local, as exemplified by the dominance of federal securities laws and the impact of federal taxation on corporate planning. Furthermore, the basic corporate statute has become significantly nationalized—not by Congress, to be sure, but by the legislature of the state of Delaware.

Delaware is not first among the states in the number of businesses incorporated annually; that distinction belongs to New York.¹ But as the legal home of the larger American corporations, Delaware has no peer.² Significant corporate law developments in state courts often concern Delaware corporations. Moreover, Delaware corporation law has been applied and interpreted frequently in state and federal courts throughout the country, since conflict of laws principles usually direct courts to apply the law of the state of incorporation in matters involving the internal affairs of corporations.³

The legal advisers to these large corporations are by no means all members of the Delaware Bar. These non-Delaware corporate counsel need a working familiarity with Delaware law if they are to possess any expertise in corporate law.⁴ There is consequently a great need for authoritative source material on the Delaware statute. This need is heightened by the fact that the statute was overhauled in 1967 and has since been amended several times.

Professor Folk's book fills the need for that authoritative source. In brief, this is a first-rate product of a first-class scholar. The book is enhanced by Professor Folk's inside position with respect to the statute.

¹ See *Dun & Bradstreet, Inc., Business Economics, Monthly New Incorporations*, Press Release Y-13, No. 12, Feb. 26, 1972. In 1971, there were 44,506 new incorporations in New York as compared with 8,410 new incorporations in Delaware.

² See R. STEVENS & H. HENN, *STATUTES, CASES, AND MATERIALS ON THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* 28 (1965).

³ See *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 302, Reporter's Note at 315 (1971); *id.* §§ 303-07, 309.

⁴ I do not ever recall, for example, hearing of a New York lawyer who was a member only of the New York Bar decline to advise a client about a problem concerning his Delaware corporation on the grounds that Delaware was a foreign jurisdiction to whose Bar he did not belong.

He served as reporter to the Delaware Corporation Law Revision Committee and has written previously about efforts to amend the statute.⁵ Clearly this book is his most careful and thoughtful product dealing with that statute. In a word, the book is invaluable.

State legislatures ordinarily do not provide any published legislative history.⁶ This absence of legislative material is especially regrettable in the case of the Delaware General Corporation Law because of that law's national prominence. Several people who were associated with the drafting of the statute have written articles⁷ and have assisted others in their research, but these efforts fall far short of a comprehensive legislative history. Folk's commentary is not official, and if one were dealing with a well documented federal statute, one might not accord it very high priority. In view of the dearth of official Delaware authority, however, Folk's treatise is likely to perform the same function as official legislative source material, thereby giving the book even greater significance. Under these circumstances, we can be grateful that it is of such high quality.

The book provides commentary to and analysis of the current statutory provisions. It proceeds through the statute in order, setting forth the official text of the law followed by a comment. The commentary features subsections entitled "In General," "Scope and Application," and "Changes in the Statute." For the major provisions of the statute, considerably detailed explanation and a more finely analytical breakdown are provided.

Professor Folk annotates his commentary with extensive discussion of the case law. He looks almost entirely to Delaware cases, explaining that to go outside of Delaware would have resulted in a much longer book.⁸ Although this is undoubtedly true, it is also a limitation, since

⁵ E. FOLK, AMENDMENTS TO THE DELAWARE CORPORATION LAW (1970); E. FOLK, AMENDMENTS TO THE DELAWARE CORPORATION LAW (1969); E. FOLK, THE NEW DELAWARE CORPORATION LAW—1967; Folk, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409 (1968).

⁶ The enactment of the New York Business Corporation Law was preceded by extensive research reports that were developed for the Joint Legislative Committee. However, they are not widely enough available to be of general benefit. Copies of these reports may be found in the State Law Library in Albany and in the Library of the Association of the Bar of the City of New York.

⁷ In addition to Folk's materials in note 5, *supra*, see Arsht & Stapleton, *Delaware General Corporation Law: 1969*, 25 BUS. LAW. 287 (1969); Arsht & Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75 (1967); Carroon, *The Proposed New Delaware Corporation Statute*, 20 J. LEGAL ED. 522 (1968). See also Note, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969).

⁸ P. xiii.

much important decisional law concerning the Delaware statute has been decided by other state and federal courts. However, once the reader is warned that the annotations are not complete, the analysis and commentary furnish a very useful working tool, even though other research implements may be needed.

Professor Folk points out that "[t]he book accepts the policy of the statute as it exists."⁹ This does not, however, signify his "agreement with every aspect of Delaware law."¹⁰ There is a tendency in other states to emulate the Delaware statute,¹¹ but legislative draftsmen should ponder carefully the policy judgments of the Delaware statute before they accept its viewpoint.¹² Professor Folk is a sophisticated scholar who knows how corporate statutes are written and the pressures that produce them.¹³ Yet he omits discussion of the policies and interests involved in the formulation of the Delaware statute and refrains from criticizing its provisions. However, I think that his decision to make the book wholly analytical, rather than partly analytical and partly critical, is sound, because it enables him to accomplish thoroughly the significant task of helping us to understand the meaning of the statute. He would doubtless have been hindered in that effort if he had simultaneously undertaken to criticize the statute and to explore the many policy alternatives.

In one of the appendices to the book,¹⁴ Professor Folk provides us with interesting additional insight into why Delaware is likely to remain the legal home for large corporations. Management prefers to have controversies concerning its stewardship settled in Delaware courts following Delaware precedents. The Delaware statute invites and facilitates that result. Section 169 declares the situs of stock in a Delaware corporation to be Delaware, wherever the stock certificates may be physically located.¹⁵ This permits the seizure of property of nonresident directors of a Delaware corporation through sequestration so as to compel their appearance in the Delaware Court of Chancery. This statutory scheme makes it easy to obtain service on all of the de-

⁹ *Id.*

¹⁰ *Id.*

¹¹ One of the sponsors of the new Michigan corporation law wrote that the primary purpose of the law was to "out-Delaware Delaware." Downs, *Michigan To Have a New Corporation Code?*, 18 WAYNE L. REV. 913, 914 (1972).

¹² The underlying approach of the Delaware statute is explained and criticized in Note, *supra* note 7.

¹³ See Folk, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409 (1968).

¹⁴ P. 565, *An Essay on Sequestration and Foreign Attachment* (App. 1).

¹⁵ DEL. CODE ANN. tit. 8, § 169 (Supp. 1968).

fendants in Delaware, whereas it might not be possible to join all of them in any other state court. As Professor Folk points out, some attorneys dislike this practice so much that they recommend against Delaware incorporation, but "many thoughtful persons view sequestration as an affirmative good. It tends to center litigation in the Delaware Court of Chancery, which has considerable expertise in corporate law matters."¹⁶ Thus, the Delaware statute has the anomalous effect of drawing plaintiffs into a forum whose body of law is generally favorable to the corporate defendant.

Certain substantive discussions in the book merit comment. More than eighty pages are devoted to the merger provisions, making it the most fully developed area in the book.¹⁷ A particularly helpful description of the procedures in different types of acquisitions, especially the three-party merger where a subsidiary is used, is presented.¹⁸ The discussion of the problems of fairness in a merger involving a subsidiary¹⁹ is perhaps the best that I have seen. Nor will one find better treatment of the Delaware approach to appraisal rights, in particular, the provisions of section 262(k) that eliminate appraisal rights under certain circumstances.²⁰ The entire area of parent-subsidiary relationships is also well treated in the discussion of sections 261 and 262 as well as in the discussion of section 144,²¹ which provides new statutory rules for self-dealing.

As Professor Folk's lengthy commentary makes clear, many of the problems regarding acquisitions and other interested transactions cannot be handled within the four corners of the statute. For example, the business judgment rule is not even mentioned in the statute. As it is used in other jurisdictions, the business judgment rule prescribes a limited role for judicial intervention in transactions in which directors are capable of protecting fully the interests of the corporation and the shareholders.²² A conflict of interest between director and corporation removes the presumption of the director's ability to protect "fully" the interests of others.

One would expect that if there were any significant advantage to management in forming a corporation under Delaware law, it would

¹⁶ P. 571.

¹⁷ Sections 251-62.

¹⁸ Section 251, at pp. 326-31.

¹⁹ *Id.* at pp. 333-41.

²⁰ Section 262, at pp. 391-97.

²¹ Pp. 75-95.

²² See N. LATTIN, *CORPORATIONS* 273 (1971); Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 270-73 (1967).

be manifested in the area of management's dealings with the corporation. Professor Folk's discussion of the business judgment rule in his commentary on the self-dealing transaction²³ shows that this expectation is at least partially fulfilled. Many questions remain regarding the application of the rule in Delaware. For example, is it anything more than a presumption of good faith action by management? Does it do more than determine the burden of going forward with proof? What degree and kind of proof are required? Nonetheless, it appears that Delaware law affords liberal protection to corporate managers.

In his discussion of *Getty Oil Co. v. Skelly Oil Co.*²⁴ and *Sinclair Oil Corp. v. Levien*,²⁵ Professor Folk shows that the Delaware Supreme Court has applied at least the language of the business judgment rule to transactions between a corporation and its subsidiary.²⁶ The rule as applied in these cases appears to enable a court to avoid judging the fairness of the transaction and to ask only whether or not it has a rational basis.²⁷ As applied in the more conventional setting of a disinterested transaction, Professor Folk concludes that although no particular formalities in reaching the decision challenged are required for the application of the rule,²⁸ some application of judgment by the directors is obviously necessary.

The statutory language of the Delaware corporation law is particularly unenlightening in the area of corporate finance. The Model Business Corporation Act, largely through definition, has attempted to clarify a corporation's power to declare dividends and other distributions and to purchase its own stock.²⁹ Professor Folk notes that the Delaware legislature rejected the approach of the Model Act and "retained the vestigial noncomponent surplus approach."³⁰ As a result, neither the legislature nor Professor Folk tells us whether dividends may be paid out of revaluation surplus, as appears to be permitted both

²³ Section 144, at pp. 77-81.

²⁴ 267 A.2d 883 (Del. 1970).

²⁵ 280 A.2d 717 (Del. 1971).

²⁶ Section 144, at pp. 77-81.

²⁷ *Id.* at p. 78.

²⁸ *Id.* at p. 81.

²⁹ ABA-ALI MODEL BUS. CORP. ACT § 45(a) (1971) authorizes payment of cash dividends "out of the unreserved and unrestricted earned surplus." Section 46 permits distributions except when the corporation is insolvent (and subject to specified conditions) "out of capital surplus." The key terms—"earned surplus," "capital surplus" and "insolvent"—are defined in § 2; "unrestricted" is explained in § 6; and "unreserved" is explained in § 70. See Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 HARV. L. REV. 1357 (1957).

³⁰ Section 154, at p. 125. This section and § 170 are the principle provisions dealing with dividends.

in New York³¹ and under the Model Act.³² Generally speaking, the relationship of accounting concepts and practices to corporation law is not spelled out very well in the statute, and it probably remains a mystifying subject for many who need to understand corporate statutes.

Recently, much attention and controversy have surrounded the right of stockholders to submit proposals which they intend to present at annual corporate meetings for inclusion in the proxy materials furnished by the company. Under the rules of the Securities and Exchange Commission, the shareholders may require such an inclusion subject to management's right to exclude the resolution if, among other things, it is "not a proper subject for action by security holders."³³ The appropriateness of the subject matter is to be determined under state law.³⁴ Thus, for many large corporations, the question of whether a proposal submitted by a shareholder may be excluded from the corporation's proxy statement turns upon an interpretation of Delaware corporation law.

The most controversial proposals in recent years have been those submitted by so-called corporate activists, such as the Project on Corporate Responsibility,³⁵ which has waged several proxy contests with General Motors, a Delaware corporation. The proposals have sought to enlarge General Motors' board of directors, to compel disclosure of information regarding racial discrimination, pollution, and safety, to create shareholder committees that would report on areas of public concern, and to change the method of nominating and electing directors of the corporation.

SEC rules require a corporation that objects to the inclusion of a proposal to attach an opinion of counsel stating that the proposal may be excluded under state law.³⁶ Corporate counsel have found little authority to support their opinion that certain proposals are not proper under state law.³⁷ Professor Folk does not furnish them with significantly more authority, although he does state that "§ 141(a) probably vests in the board of directors all powers not reserved by law, by the

³¹ N.Y. BUS. CORP. LAW §§ 102(a)(6), 510 (McKinney 1963).

³² ABA-ALI MODEL BUS. CORP. ACT § 2, Comment at 36 (1971).

³³ Securities Exchange Act Rule 14a-8(c)(1), 17 C.F.R. § 240.14a-8(c)(1) (1972).

³⁴ *Id.*; see SEC v. Transamerica Corp., 163 F.2d 511 (3d Cir. 1947), cert. denied, 332 U.S. 847 (1948).

³⁵ This reviewer must now reveal his bias and disclose that he has served as counsel to the Project on Corporate Responsibility in its efforts to present stockholder proposals.

³⁶ Securities Exchange Act Rule 14a-8(d), 17 C.F.R. § 240.14a-8(d) (1972).

³⁷ The materials filed by General Motors were made public records by the Commission on September 22, 1972. See Public Availability of Materials Filed Pursuant to § 240.14a-8(d) and Related Materials, 37 Fed. Reg. 20,557 (1972).

certificate of incorporation or by the by-laws, to the stockholders, or delegated by the board to the corporation's officers."³⁸ However, this does not tell us that stockholders may not, as a matter of right, compel the directors to listen to stockholder opinion presented in the form of a resolution, even though corporate action must await director resolution. This possibility would relate both to shareholder "recommendations" to the board of directors and broad shareholder mandates of corporate policy that, as a practical matter, only provide guidelines for director action. A leading New York decision, *Auer v. Dressel*,³⁹ is often cited for the proposition that stockholders may require a meeting to be called in order to take a vote on certain matters that are within the sole jurisdiction of the board of directors.⁴⁰ If no statute circumscribes the power to require the board to make available an opportunity to speak, it probably exists as a common law right. Nothing in Delaware appears to the contrary.

Of course, as a matter of state law, stockholders cannot force an avenue for their collective opinion on *all* questions.⁴¹ Mundane operational matters are not the concern of stockholders. The proper resolution of the issue of the allocation of corporate powers, or the extent to which stockholders may force consideration by the board of the views of the stockholders, may turn on a matter of policy as to how one views the corporation. The decision of the United States Court of Appeals for the District of Columbia in *Medical Committee for Human Rights v. SEC*⁴² involving a stockholder proposal submitted to the Dow Chemical Corporation, may well afford a rationale applicable under state law. In its dicta, the court strongly suggested that stockholders have a right to consider those aspects of corporate business activity that significantly affect public policy.⁴³

³⁸ Section 121, at p. 34.

³⁹ 306 N.Y. 427, 118 N.E.2d 590 (1954).

⁴⁰ The SEC has followed this approach in determining the appropriateness of inclusion of shareholder proposals. See Crown, Cork & Seal Co., Minutes of Commission Meeting, Feb. 28, 1964, excerpted in W. CARY, CASES AND MATERIALS ON CORPORATIONS 327 (4th ed. 1969); Columbia Pictures Corp., Minutes of Commission Meeting, Nov. 23, 1964, cited in Note, *Shareholder Proposals: The Experience of Rule 14a-8*, 59 GEO. L.J. 1343, 1370 n.150 (1971).

⁴¹ The stockholders' right to speak is properly limited to those areas in which stockholders are capable of providing intelligent judgment. See *Carter v. Portland General Elec. Co.*, 227 Ore. 401, 407, 362 P.2d 766, 769 (1961).

⁴² 432 F.2d 659 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972).

⁴³ 432 F.2d at 678-81. The recent decision of State *ex rel.* Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1970), not cited by Professor Folk, demonstrates another context in which this issue may arise. The case was decided by the Minnesota Supreme Court, but it involved a Delaware corporation. The issue in *Pillsbury* concerned

One final note on the great value of Professor Folk's book is in order. If the time ever comes when Congress considers the enactment of a federal corporation law, the task must begin by an attempt to understand the workings of our most important state statute. No better guide than that provided by Professor Folk could be found.

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whether a stockholder could inspect the stockholder list, a right which he could exercise under Delaware General Corporation Law section 220 if he had a "proper purpose." The stockholder wanted the company to stop producing anti-personnel weapons. The court decided that the stockholder did not have a proper interest since his real concern was not with the well-being of the corporation but with influencing public policy. The decision appears to hold as a matter of law that a proper stockholder interest in the corporation relates only to profitability and not to the quality of corporate conduct. This seems entirely too narrow. It does not accord with the business community's notion of the place of business in the world today (*see generally* COMMITTEE FOR ECONOMIC DEVELOPMENT, *SOCIAL RESPONSIBILITIES OF BUSINESS* (1971)) or with the role that many shareholders see for themselves. *See, e.g.*, J. SIMON, C. POWERS & J. GUNNE-MANN, *THE ETHICAL INVESTOR: UNIVERSITIES AND CORPORATE RESPONSIBILITY* (1972).

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