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Delaware's Peril

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DELAWARE'S PERIL

MARCEL KAHAN*

ABSTRACT

Delaware has long dominated the market for incorporations by publicly traded firms. It has been able to maintain its dominant position for two reasons. First, other states lack significant incentives, and have failed to make significant efforts, to compete with Delaware. Second, the main constituents for corporate law rules—shareholders and managers—have been largely satisfied with being regulated by Delaware and have not pushed for federal legislation to preempt state corporate law. However, in the recent presidential election cycle, we saw the possible beginning of an erosion of the consensus that a company's internal affairs should be governed by state law. The political platforms of Senators Bernie Sanders and Elizabeth Warren contained proposals that would undermine Delaware's dominant position—including requirements that public companies be federally chartered and that employees (to whom directors would owe fiduciary duties) elect close to half of company's board members. Whatever the specific fate of these proposals, the mere fact that they were made by two leading candidates for the Democratic presidential nomination presents the most significant threat to Delaware over the last fifty years.

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INTRODUCTION

Delaware has long fascinated students of corporate law in America. Why should one of the smallest states in the United States determine the corporate law that governs most of our publicly traded corporations? Is it legitimate that Delaware's elected officials and ten—now twelve—members of its judiciary have so much influence over laws that affect a large segment

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of our national economic activity? Is there a problem that needs to be addressed? And is this situation stable?[1]

The lore among corporate law scholars is that Delaware's prominence is due to Woodrow Wilson's national political ambitions.[2] Until 1913, New Jersey had been the domicile of choice for large entities, with New Jersey having a market share as large as the one that Delaware has today. In his 1912 presidential election campaign, Wilson—then the governor of New Jersey—made the destruction of business monopolies a keystone of his platform. But Theodore Roosevelt, running against Wilson, pointed out that Wilson had done nothing to reform New Jersey's own laws. Wilson reacted by drafting antitrust legislation and personally pushing it through the New Jersey legislature. The Seven Sisters, as the series of acts was dubbed, effectively outlawed trusts and holding companies. Unsurprisingly, business entities moved out of New Jersey and, according to conventional wisdom, settled next door, in Delaware.[3]

Some more recent scholarship casts doubt on this simple story,[4] and the exact historic reasons why Delaware became the state of choice for public corporations are probably not all that important in any case. So let us turn to the more modern period. There are two data points that have grabbed the attention of commentators. First, Delaware is the state of incorporation of roughly half of the publicly traded corporations in the United States.[5] Second, Delaware earns a large amount of money from incorporations. For example, in fiscal year 2019, Delaware was forecasted to earn over $800 million in corporate franchise taxes.[6] The publicly traded companies

1. *See generally* Marcel Kahan, *The State of State Competition for Incorporations*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2015).

2. Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 731 (2002) [hereinafter Kahan & Kamar, *Myth*].

3. *Id.*

4. Sarath Sanga, *On the Origins of the Market for Corporate Law* 3 (July 1, 2020), https://ssrn.com/abstract=3503628 (disputing that Delaware became the leader in the market for incorporations only because New Jersey repealed its liberal corporate laws in 1913).

5. Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1227 (2001) [hereinafter Kahan & Kamar, *Price Discrimination*]. Delaware's share of the much larger number of closely-held corporations is substantially lower. *See* Jens C. Dammann & Mattias Schündeln, *The Incorporation Choices of Privately Held Corporations*, 27 J. L. ECON. & ORG. 79, 84 tbl.1 (2011) (reporting that companies with less than one thousand employees are predominantly incorporated in the state of their principal place of business).

6. DEL. OFF. OF BUDGET & MGMT., FINANCIAL SUMMARY: BUDGET DOLLAR GOVERNOR'S RECOMMENDED BUDGET (2019), https://budget.delaware.gov/budget/fy2019/documents/operating/financial-summary.pdf. In addition, the budget included $500 million in revenue from abandoned property. *Id.* Much of this revenue is derived from uncahsed checks and thus tied to Delaware's status as domicile for many corporations. Janet Nguyen, *Here's what happens to your unclaimed money—and how you can get it back*, MARKETPLACE (Oct. 15, 2019),

incorporated in Delaware, approximately 2% of all Delaware corporations, account for 80% to 90% of these revenue.[7] The costs to Delaware of providing administrative services by the Division of Corporations and judicial services by the chancery court are less than 3% of its franchise tax revenues.[8] Looked at as a business—and I will comment later on whether this is the correct perspective—Delaware earns profit margins of several thousand percent on its incorporation venture. This looks like a great line of business to get into.

These two facts—that Delaware accounts for the bulk of incorporations by publicly traded firms and that Delaware makes a lot of money from these incorporations—provide the foundation for the state competition debate. The opening shot in this debate was fired by William Cary, a former commissioner of the Securities and Exchange Commission and then a professor at Columbia Law School.[9] Cary argued that Delaware is engaged, in fact that it is the leader, in a "race to the bottom," offering corporate laws that do not sufficiently protect shareholders against overreaching by managers. Cary therefore favored the adoption of a national corporate law that would end this harmful competition among states.[10]

Cary's argument touches on the three components of the state competition debate. To better understand this debate, it is helpful to separate these components clearly. The first component relates to whether states actively compete for corporations. Specifically, do any of the forty-nine states other than Delaware make substantial efforts to attract public corporations to their shores?

An understanding of whether, and how, states compete is crucial in order to examine the second component: the direction of the metaphorical competitive race. What strategy does Delaware, the state that by all accounts is most successful in attracting corporations, follow?

The final component of the debates relates to the desirability of federal intervention. As long as the competitive race does not lead to the very bottom, or to the very top, would a federal corporate law—which by its nature will be subject to its own flaws—be better or worse than the state laws under which companies presently have to operate?

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https://www.marketplace.org/2019/10/15/heres-what-happens-to-your-unclaimed-money-and-how-you-can-get-it-back/.

7. Kahan & Kamar, *Price Discrimination*, *supra* note 5, at 1225.

8. *Id.* at 1211.

9. David Margolick, *William Cary, Former S.E.C. Chairman*, *Dies at 72*, N.Y. TIMES (Feb. 9, 1983), https://timesmachine.nytimes.com/timesmachine/1983/02/09/219199.html?pageNumber=43.

10. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 701–03 (1974).

Cary's article stakes out positions on all these fronts. He argued in effect that multiple, albeit unspecified, states do compete; that the race leads to the bottom; and that federal intervention would be desirable.[11]

I. DO STATES COMPETE?

For many years, corporate law scholars have not questioned Cary's premise that states compete.[12] They have, however, taken a different view of the directional debate, with several prominent scholars arguing that the race leads to the top rather than to the bottom, to laws that maximize firm value, and that federal intervention would hence be undesirable.[13]

I got interested in the state competition debate by coincidence. I was working on an article with Professor Ehud Kamar that lay at the margins of the debate. In researching this article, we investigated the structure of Delaware's franchise tax.[14] Delaware's franchise tax ranges from $175 per year to $200,000 per year and is calculated according to two different formulas.[15] To simplify, under the first formula, companies with a large number of shares pay a higher tax; under the second formula, companies with a large amount of assets pay a higher tax. The actual tax that a company has to pay is the lower of these two figures.[16] As a result, only companies that *both* have a large amount of assets *and* that also want to have, or need to have, a large number of shares, pay taxes in the $10,000 to $200,000 a year range. And most of the companies in that category are publicly traded companies, which tend to be large and which need to have a large number of outstanding shares to facilitate the trading of their shares in public markets.[17]

Our research uncovered that the structure of Delaware's franchise tax was unique. Most other states employed one of two methodologies to determine the amount of annual franchise taxes a corporation must pay. First, twenty-four states and the District of Columbia charged domestic firms either no franchise tax at all or only a trivial annual fee, ranging from $4.50 to $150.[18] Second, twenty states charged firms a tax based on the portion of some measure of the company's value, such as assets or equity, that is

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11. *Id.* at 705.
12. Kahan & Kamar*, Myth*, *supra* note 2*,* at 681.
13. *Compare*, *e.g.*, Cary, *supra* note 10 (arguing that competition leads to race to the bottom) *with* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 256 (1977) (arguing that competition leads to race to the top).
14. Kahan & Kamar, *Price Discrimination*, *supra* note 5.
15. DEL. CODE ANN. tit. 8, § 503(a) (West 2020).
16. *Id.*
17. *See* Kahan & Kamar, *Price Discrimination*, *supra* note 5, at 1223–25 (estimating that 80% of New York Stock Exchange companies pay maximum franchise tax).
18. *Id.* at 1219–20, 1255 app. A.

attributed to business activity conducted in-state.[19] But in these states, foreign corporations—that is corporations incorporated in a different state—that are licensed to do business in the state were taxed equally on the in-state portion of their tax base. As a result, corporations faced no *additional* costs for incorporating in one of these states—and the respective states would gain no *additional* revenue from such incorporations. Besides Delaware, only six other states imposed taxes that varied by whether a corporation was incorporated in-state or out-of-state and that was structured to generate additional income.[20] However, for all these six states, the amount of additional income if, say, one thousand public corporations moved into that state would have been modest.[21]

This finding, on which we stumbled by coincidence, turned out to have significant implications for the first component of the state competition debate: whether states, in fact, compete. Other than Delaware, no state would stand to gain meaningful revenues by increasing its market share among publicly traded corporations. The primary benefit that, according to prior scholars, spurred states to compete was thus absent.[22]

Professor Kamar and I then started to examine more closely the general notion that states compete for incorporations. We asked ourselves: What actions would a state that wanted to succeed in that competition take, and do states other than Delaware take such actions? To answer the first question, we looked at what made Delaware so special. And the answer that jumped to mind is the Delaware Court of Chancery.[23] The chancery court combines two key features: it has narrow jurisdiction, thus making it a de facto specialized corporate court; and, it hears cases without juries, thus making its judges, who resolve questions of law as well as questions of fact, specialists in resolving corporate law disputes with respect to publicly traded corporations.[24] One would expect that other states, if they were trying to succeed in the incorporations "business," would create their own version of a court with limited jurisdiction focused on corporate law that hears cases

19. *Id.* at 1219–20, 1256 app. B.

20. *Id.* at 1220.

21. *Id.*

22. *See, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 15–16 (1993); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1451 (1992); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 548–49 (1990); Cary, *supra* note 10, at 664; John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 650 (1999); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841–42 (1995).

23. Kahan & Kamar, *Myth, supra* note 2, at 708.

24. *Id.*

without juries. But no state did.[25] Professor Kamar and I thus concluded that Delaware faces no serious competition from other states.

Let me attach several caveats to this conclusion. First, corporations can incorporate in any state of the Union, or for that matter abroad, and a sizeable percentage of public corporations do just that. Moreover, every state offers a corporate code and many states update this code on a somewhat regular basis.[26] That is, states make some efforts.

But efforts to what end? A single corporate statute governs publicly traded and closely held corporations. Most closely held corporations are locally incorporated and Delaware's market share of closely held corporations is much lower than its share of publicly traded ones.[27] Having a corporate statute that is not antiquated serves the needs of the local population that is looking for the convenience of incorporating a closely held corporation in-state as well as the interest of the local bar that wants to provide legal advice to these corporations.[28] The fact that a state has a corporate code more likely serves to enable its residents to form a locally-chartered corporation than indicates a serious effort to compete with Delaware for publicly traded corporations.

To be sure, a side effect of having such statutes is that publicly traded corporations are provided with a choice of where to incorporate: in Delaware, as about half of them do, or in their headquarter state, as most of the others do.[29] But the mere fact that corporations—the consumer—have a realistic choice among domiciles does not equate with states—the supplier—competing for corporations. When we want to drink a glass of water, we have a realistic choice between buying a bottle of Poland Spring and drinking tap water. But it would be misleading to say that the local public water supply system competes with Poland Spring and, even though its existence affects Poland Spring's pricing strategy, such choice will not generate a "race" in any particular direction.

Second, shortly after we published our article, and perhaps not coincidentally, Nevada substantially raised its franchise tax so that it now too

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25. *Id.* at 708–15.

26. *Id.* at 701–05.

27. *See* Dammann & Schündeln, *supra* note 5.

28. Kahan & Kamar, *Myth*, *supra* note 2, at 699. Since closely help corporations are rarely involved in corporate disputes, they would not benefit correspondingly from Delaware's expert judiciary. Delaware, in turn, charges most closely help corporations only a minimal franchise tax and derives no significant revenue from them. *See* Kahan & Kamar, *Price Discrimination*, *supra* note 5, at 1225–27

29. Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1591–92 (2002).

can benefit from attracting incorporations.[30] And indeed, Nevada is the only state other than Delaware to attract a meaningful share of incorporations that do not incorporate in their home state. Nevada, however, seems to be pursuing a niche strategy that focuses on small publicly traded firms that look for extremely lax corporate law,[31] and thus poses no fundamental competitive threat to Delaware's dominance.

Some studies also cite Maryland as a state attracting a fair number of publicly traded companies headquartered elsewhere.[32] This is technically correct. But these companies are not regular corporations. Rather, they are real estate investment trusts ("REITs") and other regulated investment companies.[33] Maryland's attraction for investment funds is based on the fact that Maryland law contains a number of statutory provisions targeted at investment companies, such as a waiver of the requirement to hold annual meetings of shareholders.[34]

It is not only that Maryland is not a serious competitor for incorporations by regular corporations. Maryland achieved its status of leading domicile for REITs and investment companies by coincidence. Mutual funds originally incorporated in Maryland because Maryland corporate law, unlike the corporate laws of other states, did not restrict the ability of corporations to redeem their common stock. This was historically part of Maryland law, rather than an affirmative attempt by the state to attract mutual funds.[35] As mutual funds flocked into Maryland, they became a constituency for the state legislature and a source of political influence—and Maryland adopted additional laws beneficial to investment companies.[36]

The monetary benefits that Maryland and its residents derive from investment companies are, however, small. Maryland derives no significant franchise tax revenues from such companies and Maryland lawyers derive only modest benefits from providing corporate advice to them.[37]

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30. Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 948 (2012) (noting that Nevada increased its maximum annual tax from $85 to a $11,100).

31. *Id.*

32. *See* Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 395 tbl.5 (2003) (reporting that a relatively large number of publicly traded firms are incorporated in Maryland but headquartered elsewhere); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1816 (2002) (noting that Maryland controls a sizeable portion of the out-of-state incorporation market).

33. Kahan & Kamar, *Myth*, supra note 2, at 693 n.43.

34. *Id.* at 721.

35. *Id.* at 721 n.149.

36. *Id.*

37. *Id.*

That no other state seriously competes with Delaware raises a further question: Why? Why do Delaware's profit margins not entice potential competitors?

The answer to this question is that competition among states is fundamentally different from competition among firms because states are fundamentally different from firms. One way in which they are different is obvious. You and I, looking at Delaware's profits, cannot just decide to go into that business by forming a new state. But beyond that, states, unlike firms, should not be thought of as profit maximizers. Thus, many state officials have no particular interest in the incorporation business and the profits it generates; and even in states where some political actors may be inclined to "compete" for incorporations, they face special political constraints.[38]

Pennsylvania, for example, at some point seriously considered establishing a chancery court with appointed judges who would hear cases without juries in order to compete with Delaware. But labor unions and public interest lawyers opposed a bill to establish such a court, fearing it would set a precedent for eliminating jury trials in other cases, and the bill failed.[39] New York is one of the least attractive states to incorporate because, under its law, the ten largest shareholders are personally liable for wages and salaries payable to the company's employees. Repeated efforts by the local bar to repeal that provision failed due to opposition by organized labor.[40] Maryland, in turn, succeeded in becoming a home for REITs and investment companies because a small organized group in the state pushed for certain changes in Maryland law—and because no other organized political group cared about these changes and pushed back.

II. WHERE DOES THE "RACE" LEAD?

If no other state actively competes for incorporations, what does this imply for the direction of the "race"? When I discuss this question, I will frequently refer to Delaware or Delaware's strategy as if Delaware were a single person that deliberately devised and then executed a sort of business strategy. This is obviously meant as a simplification. I do not mean to suggest that anyone in Delaware, and in particular that any member of the Delaware judiciary, fashions Delaware law in any conscious way to serve Delaware's strategic interest. Rather, I would suggest that what comes natural to many members of the Delaware bar—which proposes most

38. *Id.* at 728–30.
39. *Id.* at 733–34.
40. *Id.* at 732–34.

changes to the General Corporation Law[41]—and of the Delaware bench also happens to coincide with what promotes Delaware's strategic interests and therefore accounts for Delaware's dominating position in corporate law.

What does the fact that other states do not seriously compete with Delaware imply for Delaware law? Even absent competition, Delaware wants companies to pay Delaware's steep annual franchise taxes. Delaware must therefore make its law appealing to those who have power over incorporation decisions—the shareholders and the board of directors. Delaware law thus strives to offer a high-quality product on all issues where the interests of shareholders and managers do not conflict—and lack of serious competition makes it easier to offer a product that is superior to those of other states. Delaware, for example, updates its law regularly, often by including provisions that entail no significant conflicts;[42] it runs a highly efficient Division of Corporations; and its chancery court is the most distinguished state trial court in the nation.[43]

With respect to issues where the interests of shareholders and managers do conflict, the issue of interest to race-to-the-bottom scholars, lack of serious competition suggests that Delaware law should be designed to appeal to the pragmatic middle ground. Delaware seeks a middle-of-the-road position that is acceptable to both groups even if it is not optimal for either one.[44] This way, due to Delaware's superiority on issues where the interests of shareholders and managers do not conflict, Delaware would remain attractive to both groups relative to the laws of other states. And indeed, companies incorporated in Delaware face no meaningful pressure, by either shareholders or directors, to relocate to another state.

III. FEDERAL THREATS TO DELAWARE'S DOMINANCE

As long as no state suddenly starts to compete seriously with Delaware—and both the failure by any state to do so in the last fifty years and the political barriers most states would face if they tried suggest this is an unlikely possibility—Delaware's position would seem to be stable. But so far, we have overlooked the most significant threat to Delaware. That threat is not that some other state beats Delaware in competing for incorporations but rather that the federal government ends state competition

41. Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 898 (1990).

42. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1601 (2002) [hereinafter Kahan & Rock, *Symbiotic Federalism*] (listing examples of uncontroversial statutory amendments).

43. *See* Kahan & Kamar, supra note 5, *Price Discrimination*, at 1212–13.

44. Alva, *supra* note 41, at 114–155 (discussing the Delaware antitakeover statute).

in its entirety.[45] Whether we are right or wrong that no state but Delaware seriously competes, and whether the race is to top, to the bottom, or to some other point, competition among states can only take place as long as Congress permits it.

To replace Delaware, Congress would of course not have to offer a more appealing product; it would not need to establish a court like the chancery court; and it would not be motivated by franchise taxes. Congress could just impose its corporate law rules on all corporations with sufficient business ties to the United States. Indeed, this is part of the attraction for race-towards-the-bottom scholars like William Cary or Lucian Bebchuk who have called for federal intervention to preempt state law on a wholesale or piecemeal basis.[46] For those scholars, the competitive dynamics, or Delaware's desire to make itself appealing, are negative because Delaware tries to appeal too much to managerial interests which they see as having undue influence over selecting the state of incorporation. And the fact that the federal government would not need to appeal to managerial interests to attract incorporations is therefore a positive.

However, the observation that a federal corporate law would not be designed to attract incorporations is just a starting point. It does not answer the question what a federal law would be designed to do.

The commentators who call for federal law assume that federal law would be designed to protect shareholder interests, as they define them—or, more fairly, they call for specific federal legal rules designed to protect these interests. However, taking a step back, once the federal government gets more heavily involved, we do not really know what shape federal law would take. Looking at the corporate law of states that do not seem to care about attracting incorporations—states like California and New York—gives, at least to me, little reason to be optimistic that these states would come up with a law that benefits shareholders.[47] It is not clear whether federal law, which likewise would not be designed to attract incorporations, will be much better.

But let's put to the side the issue of whether federal intervention would be desirable from a public policy perspective. From Delaware's perspective, the possibility of federal intervention is a clear threat, and a potentially severe one, much more severe than the threat emanating from other states. But, happily, the best way to respond to this threat is to do what Delaware would want to do in any case: have its law appeal to the pragmatic middle ground.

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45. Kahan & Rock, *Symbiotic Federalism*, *supra* note 42, at 1576.

46. *See* Cary, *supra* note 10; Bebchuk, *supra* note 22.

47. *See, e.g.*, Frederick Attea, *State Has Hard Time Following a Lead*, 16 BUS. FIRST OF BUFFALO, Apr. 17, 2000, at 30 (describing New York statute making ten largest shareholders of a company personally liable for wages and salaries payable to the company's employees as "the single most important reason why New York shareholders decide to incorporate in Delaware").

The problems of a potential federal corporate law that I have raised before—that it would not have to offer a more appealing product than Delaware; that it would not to be designed to appeal to corporate constituents in order to generate incorporations and franchise tax revenues; and that its content would therefore not be predictable or, for that matter, stable—are, from Delaware's perspective, advantages. They imply that Congress has no strong intrinsic desire to adopt a federal corporate law for fiscal reasons and that any political group calling for a federal corporate law would have to be concerned that federal law, over the long term, will not advance its interest.

To reduce the risk of federal intervention, Delaware thus has to make sure that the main constituents potentially interested in a federal corporate law—shareholder interests and managerial interests—are sufficiently satisfied with being regulated by Delaware that they do not clamor for federal intervention.[48]

Offering a high-quality product on issues where the interests of shareholders and managers do not conflict and adopting a middle-of-the-road approach where they do largely achieves this goal. Even if managers or shareholders are dissatisfied with a particular substantive rule of Delaware law, they may nevertheless disfavor federal intervention. For example, they may believe that Delaware, in order to attract incorporations, will be more responsive to new developments or they may view the current state-law based system as less likely to generate radical legislation than a monopolist federal regulator.

At least so far, Delaware's approach has been a success. Even when Congress has enacted legislation that otherwise tramples on states' rights, it has taken special care not to intrude upon Delaware. For example, the Securities Litigation Uniform Standards Act,[49] which federalized securities class actions for misrepresentation and deceit, contains the so-called "Delaware carve-out."[50] The carve-out specifically exempts actions for misrepresentations based on the corporate law of a company's state of incorporation.[51] Similarly, the Class Action Fairness Act, which was designed to assure that most class actions with a national class of plaintiffs are adjudicated in federal court, specifically excludes corporate law class actions arising under the law of the company's state of incorporation.[52]

48. Kahan & Rock, *Symbiotic Federalism*, *supra* note 45 at 1587.

49. 15 U.S.C. § 77p.

50. *See, e.g.*, Spehar v. Fuchs, No. 02-9352CM, 2003 WL 23353308, at *9 n.4 (S.D.N.Y. June 18, 2003) (noting that the Securities Act contains three exceptions known as the "Delaware carve-outs").

51. 15 U.S.C. § 77p(d)(1).

52. Class Action Fairness Act, 28 U.S.C. § 1453(d)(2).

Perhaps not coincidentally, Delaware Senator Thomas Carper was one of eight original sponsors (and one of a handful of Democratic supporters) of the Senate version of the Act.[53] As it seems, Delaware's corporate law seems to enjoy great respect on Capitol Hill.

Or perhaps I should say "enjoyed" rather than "enjoys." Our discussion so far, along with most of the academic literature on state competition, has treated corporate law as if the only groups that mattered are shareholders and managers. The "race to the bottom" case, for example, amounted to an argument that Delaware caters to the interests of managers and that federal law is needed to protect shareholders. The "race to the top" case is that market forces, together with shareholders' power over incorporation decisions, make federal intervention unnecessary.

But what about other groups—so-called stakeholders? Stakeholders are not entirely new to the debate. In the late 1980s, many states adopted constituency statutes that permitted the board to consider the interests of groups other than shareholders, such as employees and customers, in particular in deciding how to respond to a hostile takeover.[54] But in my view these constituency statutes were not really about protecting employees or customers. Rather, they were about enabling managers to obstruct a bid that managers opposed but shareholders favored. The notion that constituency statutes would induce a board—technically elected by shareholders but in practice often deferential to top management—to take an action opposed by managers *and* shareholders because it benefitted other constituents, such as employees, or not to take an action favored by managers and shareholders because it would hurt employees, seems farfetched. Constituency statutes, which paid lip service but ultimately conferred no real power to any other constituency, thus fit neatly into the shareholder-manager duality.

But in the 2020 presidential election cycle, we saw the emergence of proposals by Senator Bernie Sanders and Senator Elizabeth Warren that would confer real power on other constituents. Under Senator Sanders's proposal, employees at publicly traded companies would be entitled to elect 45% of the board members.[55] In addition, publicly traded companies would be required to give at least 2% of their stock to their workers each year until the company is at least 20% owned, on behalf of employees, by a Democratic Employee Ownership Fund. All publicly traded companies would also have to obtain a federal charter from a newly established Bureau of Corporate

53. Kahan & Rock, *Symbiotic Federalism*, *supra* note 42, at 1588.

54. *See generally* American Bar Association Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990).

55. FRIENDS OF BERNIE SANDERS, *Corporate Accountability and Democracy*, https://berniesanders.com/issues/corporate-accountability-and-democracy/ (last visited Aug. 1, 2020).

Governance at the Department of Commerce. Under this new federal charter, the board would have to consider the interests of all of the stakeholders in a company—including workers, customers, shareholders, and the communities in which the corporation operates. Moreover, institutional investors, such as Vanguard and BlackRock, would not be permitted to vote stock held by mutual funds they advise unless mutual fund shareholders provide specific voting instruction. At least as far as employees are concerned, this constituency provision has teeth as employees elect 45% of the board directly and the Democratic Employee Ownership Fund would in most companies, especially given the eviscerated voting powers of institutional investors, be the single largest shareholder. Senator Warren's Accountable Capitalism Act[56] would go a bit less far but would also require a federal charter for large public corporations, give employees the right to elect 40% of the board, and have a constituency provision.

The Sanders and Warren proposals combine two elements that would destabilize, or perhaps revolutionize, the current political economy of corporate law: the notion of a federal charter and the focus on employee interests—via a constituency provision coupled with an allocation of board seats to employees. The first, the federal charter, directly challenges Delaware's dominance. While the second, the focus on employees, could undermine the power of the shareholder-manager coalition that has favored the preservation of the status quo.

IV. CONCLUSION

The proposals put forth by Sanders and Warren are far from being enacted. The Democratic presidential nominee Joe Biden, a former Senator from Delaware and more moderate Democrat, has not endorsed either proposal. Out of loyalty to his home state or out of political conviction, he may not favor such a radical change. And even if Sanders or Warren had won the nomination and then the presidential election, they may not have pushed these proposals.

But the significance of the proposals is not that they currently stand a high chance to become law. Rather, the fact that two leading candidates for the Democratic nomination advanced them reflects the erosion of the consensus that provides the foundation on which Delaware's dominance of corporate law is built. Let's face it. As far as corporate law is concerned, Delaware is the establishment. And these days, more than for a long time, the establishment is under attack.

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56. *Accountable Capitalism Act*, https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf (last visited Aug. 1, 2020).