Delaware Journal Of Corporate Law

Volume 1 1976 Number 2

6 Copyright 1976 by the Delaware Law School of Widener College, Inc.

A BRIEF HISTORY OF DELAWARE'S GENERAL CORPORATION LAW OF 1899

By Joel Seligman*

TO INAUGURATE the Delaware Journal of Corporate Law, Wilmington attorney S. Samuel Arsht published "A History of Delaware Corporation Law." It is a curious document, at once candid and opaque.

Arsht began with an acknowledgment of recent criticisms of the Delaware General Corporation Law and his anxiety that insufficient "emphasis has been given to the positive aspects of the development of the Delaware law." He then crisply described the 189 year history of Delaware corporation law as one intermittent with concern for "the interests of American business and industry" and scandal, in both instances leavened by the fairness of the Delaware judiciary.

In Arsht's view, the history of Delaware corporation law can be divided into two parts: first, a relatively inconsequential period dating from 1786 when Delaware issued its first special charter to 1899 when Delaware enacted its present General Corporation Law; and second, the history from 1899 to the present under the General Corporation Law.

The earlier phase is particularly one of mystery. On February 2, 1786, Delaware issued its first special charter to the Colonial Bank of America.³ This special act was followed by an increasing number of subsequent special incorporation acts through 1875 when the Constitution of 1831 was amended to grant the legislature the power "to enact

^{*} Mr. Seligman is a member of the California bar and of the Corporate Accountability Research Group located in Washington, D.C. With Ralph Nader and Mark Green he has recently published a study of state corporation law entitled Constitutionalizing the Corporation: The Case For the Federal Chartering of Giant Corporations; which will be published in hardcover under the title, Taming the Giant Corporation, in October of 1976.

^{1. 1} Del. J. Corp. L. 1 (1976).

^{2.} Id. at 1.

^{3.} Id. at 2.

a general incorporation act," which the legislature did, that year, and again in 1883 when the law of 1875 was repealed and a new general incorporation law adopted. But "(t)he policy of exclusive incorporation under general law did not exist," explains Arsht, "corporations organized for the purposes set forth in the amendment to the 1831 constitution could be formed under the provisions of the general laws or by special act, as incorporators might prefer." In Arsht's view, however, the choice for incorporators was largely illusory. "The procedure for incorporating under the foregoing general laws was both cumbersome and time consuming."

(T)he Delaware legislature continued to be swamped with bills for special incorporations... in 1897, no fewer than 115 special act incorporations, amendments and renewals... were enacted into law, as compared to approximately 10 incorporations or amendments effected that year under the general law of 1883.⁶

Why this preference for special acts? Arsht does not say but he then compounds the mystery of the popularity of special acts with a tantalizing non sequitur:

(T)he special act procedure had been taken over by permanent lobbyists who would, for a fee, secure the necessary votes in the legislature for their clients. Because [of] the expense and corruption attendant upon the procedure of incorporation by special act, a majority of the members of the Constitutional Convention of 1897 agreed that it was necessary to eliminate the special act process.⁷

The reform minded Constitutional Convention, however, did not end the corruption of the process, for Arsht immediately thereafter informs us:

During the interval between 1898 and 1899, a small group of individuals perceived the possibilities of large revenues if new enterprises could be induced to incorporate in Delaware. This group is generally credited with the drafting of the 1899 General Corporation Law. Their efforts were not altogether altruistic, however, since they planned to organize their own corporation, modelled upon similar ones operating in New Jersey, to engage in

^{4.} Id. at 4.

^{5.} Id. at 4.

^{6.} Id. at 5.

^{7.} Id. at 5-6.

the business of incorporating companies under the new law and representing them in Delaware.8

The new General Corporation Act of 1899 "drew heavily from New Jersey's General Law, then the nation's most popular" and eliminated the opportunity to secure a special incorporation law. "Thus," Arsht concludes his treatment of the first part of his history of Delaware Corporation Law, "by the end of the nineteenth century, the age of the special act method of incorporation had passed, and Delaware began the twentieth century with a general incorporation law which was as modern as any existing at that time." 10

Arsht's treatment of the history under 1899 Act is somewhat more delicate. In opening the second half of his history he cites dicta from four court decisions to demonstrate:

Although the 1899 Act was largely silent with respect to the standards to be adhered to by officers and directors in the performance of their duties, the court of chancery and the Supreme Court promptly asserted the power of the Delaware Judiciary to prevent corporate fraud and the inequitable use of corporate machinery by management....

[These] statements by the Delaware courts, dating from the beginning of the 1899 Act should be borne in mind by those who view the development of the Delaware statute by legislative amendment as a process aimed solely at freeing management from restrictions at the expense of stockholder rights.¹¹

Nonetheless, Arsht, then offers a series of instances in the 1901-1963 period when legislative amendments patently operated "as a process aimed solely at freeing management from restrictions at the expense of stockholder rights." In 1901, for example, the state added a new section permitting the certificate of incorporation to:

contain any provision which the incorporators may choose to insert for the regulation of the business and for the conduct of the affairs of the corporations, and any provisions creating, defining,

^{8.} Id. at 6. Throughout this early period in the history of Delaware's law Arsht relies, in part, upon Larcom, The Delaware Corporation Law (1937) which, in turn, cites James L. Wolcott, The Development of the Delaware Corporation Law, an unpublished thesis submitted to the Harvard Graduate School of Business Administration. In footnote 32, Arsht states, "As best as can be determined, no copy of this treatise still exists." Actually, a copy does exist in the Harvard Law School Library which may be read with the permission of Mr. Wolcott who is now an attorney practicing in Rhode Island.

^{9.} Id. at 7.

^{10.} Id. at 7-8.

^{11.} Id. at 8-9.

limiting and regulating the power of the corporation, the directors and the stockholders, or any classes of the stockholders, provided, such provisions are not contrary to the laws of this state.¹²

The significance of which section Arsht then described:

Since the corporation law, as originally enacted, had granted to the directors the power to manage the business of the corporation, and had permitted the certificate of incorporation to empower the directors to make, alter or repeal the by-laws of the corporation, this new flexibility in the distribution of the corporate power also no doubt aided those promoters who were determined to assure the management the dominant position in the corporation.¹³

In 1917, the statute was amended to grant the board the power to sell all corporate assets after approval by a majority of shareholders. In 1927, the legislature granted power to the board to issue so-called "blank stock" and stock purchase options; in 1943, to indemnify corporate officers and directors; and in 1963, to lend money to them. As Arsht put it, "The legislative development of the statute obviously increased its attractiveness to management."

In 1963, the Delaware General Assembly appropriated \$25,000 to be used by the Secretary of State for a comprehensive review and study of the corporation laws of Delaware. Arsht writes that: "The objectives of the revision committee, in summary, were to update and clarify the language of the existing law, to simplify the mechanics for corporate action, and to make substantive changes where experience indicated that improvements could be made." What type of improvements did experience indicate could be made? Arsht does not say but he does meticulously recount the process by which the Revision Committee — on which he served — conducted its proceedings from 1964 until the enactment of the sweeping 1967 amendments to the General Corporation Law.²¹

Just as meticulously Arsht explains, "Following the enactment of technical amendments to the corporation law in 1968, the Revision Committee's work came to an end and the Delaware Bar Association's

^{12.} Act of March 7, 1901, ch. 167, § 5, 22 Del. Laws 287-89 cited in id. at 9.

^{13.} Id. at 9-10.

^{14.} Id. at 10.

^{15.} Id. at 11.

^{16.} Id. at 11.

^{17.} Id. at 12.

^{18.} Id. at 12.

^{19.} Id. at 12.

^{20.} Id. at 14-15.

^{21.} Id. at 15-17.

Standing Committee on the General Corporation Law resumed its traditional role as the initiator of amendments to the law."22 This committee has endeavored since 1967 to make amendments "to the corporation law on a yearly basis."23 Again, Arsht does not explain the need for these frequent revisions, but he does conclude his article with two pointed remarks directed at the critics of Delaware's law. First, a denial that "every change in another state's corporation law which works a significant shift in the balance of corporate power from the stockholders to management will, of necessity, find favor with the committee, "as exemplified by the fact that Delaware did not follow the lead of 11 states and enact so-called "little Williams Acts" for the purpose of defeating tender offers.24 Second, Arsht "sounds the trumpet for the Delaware Judiciary,"25 which he argues has reaffirmed basic principles of corporate democracy," in recent cases such as Condec Corporation v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967) and Schell v. Chris-Craft, 285 A.2d 437 (1971).

This article presents a different view of Delaware's General Corporation Law of 1899.26 Unlike Mr. Arsht I do not believe that the history of Delaware's present corporation law can be appreciated without a description of its relation to laws other than those of Delaware from which it is derived, the economy to which it corresponds, the motivations of those who participated in the law making and law interpreting process, and the economic and social consequences of the law. A history of Delaware's corporate law, without regard to such facts, is a sterile, abstract exercise; a formal chronicle of official events devoid of an understanding of their practical significance. I have thus assembled the following sketch of the history of Delaware's corporation law to describe certain aspects of the law which Mr. Arsht chose to ignore. Although considerations of time did not allow me to write a full history, I have attempted in the following pages to outline some of the factors which led to the enactment of the present General Corporation Law and to trace its development since 1899 in terms of certain of its empirical consequences. In the conclusion I briefly describe certain questions which this article could not address.

^{22.} Id. at 17.

^{23.} Id. at 17.

^{24.} Id. at 20.

^{25.} Id. at 21.

^{26.} Much of the research for this article was done preparatory to drafting a brief history of state corporation law which appears in R. Nader, M. Green and J. Seligman, Constitutionalizing the Corporation: The Case for the Federal Chartering of Giant Corporations (1976) [hereinafter cited as Constitutionalizing].

I. THE HISTORICAL BACKGROUND OF THE DELAWARE GENERAL CORPORATION LAW OF 1899

From England the Colonies inherited a corporate law very different from that we know today. Most strikingly, the earliest American corporation law made no distinction between a "public" corporation, such as a city or a hospital, and a "private" corporation, such as a bank. In both cases, the corporation was recognized as a political entity or "body politic," principally distinguished from unincorporated associations by its power to enforce by-laws or "private statutes." Since a corporation was considered an arm of the state, it could only be created by the state. In each instance, the Colonial Assembly enacted a compact or "special charter" which specified the terms of corporate existence. Typically, in return for the corporation agreeing to perform a service considered of general value, the legislature granted it the advantage of perpetual existence, the power to purchase and hold property collectively, and the right to sue or be sued collectively.²⁷

Since the earliest business corporations were also granted monopoly privileges, they were not very popular. At most, forty business corporations had been chartered prior to the Constitutional Convention.²⁸ "Puny institutions" Professor Eugene Rostow has called them.²⁹ Local, restricted by their charters to designated lines of business, the earliest business corporations played a minor role in an economy "addicted to agriculture" 30 and unaccustomed to the aggregation of capital outside of the family.31

Almost overnight, the requirements of the United States economy and politics transformed the business corporation into an important instrument of economic development. The overriding concern of all levels of government in the first decades of the republic was to restore commerce. At the state level, this primarily meant the encouragement

^{27.} S. Williston, History of the Law of Business Corporations Before 1800, 3 HARV. L. REV. 105, 149 (1888); J. DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS (1917), II, at 3-33, 291-330. See also W. CARY, CORPORA-TIONS 1-5 (1969).

^{28.} Davis, supra note 27, at 3-33.

^{29.} E. Rostow, To Whom and for What End Is Corporate Management Responsible?, in E.S. Mason (ed.), The Corporation in Modern Society 50 (1959).

30. Alexander Hamilton's celebrated complaint, The Federalist Papers, No. 11.

See also Hamilton's Report on the Subject of Manufacturers (1791).

31. See, e.g., D. Bell, The Breakup of Family Capitalism in his collection of essays, The End of Ideology (1960). On the role of the corporation in the colonial economy, see generally S. Bruchey, The Roots of American Economic Growth (1968); V. CLARK, HISTORY OF MANUFACTURERS IN THE UNITED STATES 1607-1860 (1929); O. and M. HANDLIN, COMMONWEALTH, A STUDY OF THE ROLE OF GOVERN-MENT IN THE AMERICAN ECONOMY, MASSACHUSETTS, 1774-1861 (1969); R. RODERT-SON, HISTORY OF THE AMERICAN ECONOMY (1964); and A. Schlesinger, Jr., Ideas and the Economic Process in S. Harris (ed.), AMERICAN ECONOMIC HISTORY (1961).

of inland transportation projects such as turnpikes, bridges, and canals and the establishment of bank and insurance facilities. Since the states, heavily burdened by Revolutionary War debts, could not directly finance internal improvements,³² they took to supplementing grants of incorporation with valuable privileges to encourage private investment. Not only were shareholders allowed to profit from administering essentially public enterprises, but their risk was reduced by state loans or state purchases of shares, tax exemptions, rights to conduct fund-raising lotteries, and, on rare occasion, direct state bounties.³³

So bolstered, the number of incorporations soared. In the ten years, 1790-1800, the total number of corporations chartered by the first 16 states increased from 37 to 334. Yet the functions of the corporation were little changed. In 1790 nearly half the charters were for the improvement of inland navigation; by 1800, 219 of the earliest corporations, or 65.4 percent, served this general need. In 1790, 11 corporations, or 30 percent, were engaged in banking or insurance; by 1800, 67 corporations, or 20 percent, were so engaged. In 1790, exactly three manufacturing corporations had been chartered; by 1800, the number had increased negligibly to eight.³⁴

It was not until the War of 1812 and the tortuous British embargo that the number of manufacturing corporations began to significantly increase. As Professor E. Merrick Dodd explained,

In this situation some state governments appear to have adopted the view that the chartering of domestic manufacturing associations was a matter of patriotism. Between 1808 and 1815 New York issued more charters (165) to joint stock companies engaged in manufacturing to all public utilities combined.³⁵

Like the earlier colonial corporations, the state corporations of the 1790-1830 period were essentially "chips off the block of sovereignty." Traditional state powers such as those of eminent domain, road planning, or setting toll rates were liberally delegated to turnpike, bridge and canal builders. But as the number of incorporations increased, the corporate character also changed. The doctrine of limited liability exemplified this evolution. Initially, a great advantage of the corporation's quasi-public character had been its power to enforce unlimited assessment of its members in times of debt. Though unlimited shareholder liability certainly protected the fortunes of creditors, it was early recognized that it deterred incorporations. Beginning with New York in

^{32.} HANDLIN, supra note 31, at 61-63, 78-80.

^{33.} Id. at 98-99, 106-14. See also DAVIS, supra note 27, at 326-28.

^{34.} Davis, supra note 27, at 26, 291.

^{35.} E. Dodd, Corporations in the Encyclopedia Britannica, VI, at 524 (1971).

^{36.} Thomas Hobbes' phrase, LEVIATHAN.

1811, several state legislatures reduced the maximum personal liability of shareholders to the stated share value within the next two decades.⁸⁷ Those capable of wrangling a special charter from the state legislature could then solicit capital with the assurance that a business failure would not endanger their other personal assets.

The ensuing proliferation of bank and manufacturing corporations ultimately undermined the quasi-public character of the business corporation. In its landmark *Dartmouth College*³⁸ decision of 1819, the United States Supreme Court recognized the diffusion of the "private" corporation whose property was employed primarily for the benefit of its shareholders from the "public" corporation which existed only for public purposes. More importantly, the Court held that all corporate charters were protected by the United States Constitution clause prohibiting a state "from impairing the obligation of contracts." Under that ruling, after granting a corporate charter, a legislature could no longer repeal or revise it.

The Jacksonian Reaction

By the time of Andrew Jackson's presidency, the role of the private business corporation had become a matter of intense political dispute. Anti-corporate sentiment crystallized around President Jackson's "War on the Bank." In 1836, the charter of the Second Bank of the United States was to expire. Although a private, profit-seeking corporation, the Bank performed many of the monetary and credit functions of the present Federal Reserve Board. At its apogee, the Bank's issuance of bank notes and "branch drafts" determined the amount of currency available for exchange or investment throughout the country.

In 1832, Jackson vetoed the Act to extend the term of the Bank's charter principally because of the Bank's tendency to concentrate "power in the hands of a few men irresponsible to the people." His veto message emphasized themes applicable to all specially chartered business corporations:

Distinctions in society will always exist under every just government. Equality of talents, of education, or of wealth can not be produced by human institutions . . . but when the laws undertake to add to these natural and just advantages artificial distinctions . . . to make the rich richer and the potent more powerful, the humble members of society — the farmers, the mechanics, and laborers — who have neither the time nor the means of securing like favors

^{37.} New York initially limited shareholder assessments to double the stated value of shares. E. Dodd, American Business Corporations Until 1860 With Special Reference to Massachusetts (1954).

^{38. 4} Wheat. 518 (1819).

to themselves, have a right to complain of the injuries of their government.³⁹

Within months, the "War on the Bank" had been broadened into an attack on all corporate privileges. William Gouge, a leading egalitarian economist, summarized the Jacksonian position:

Against corporations of every kind, the objection may be brought that whatever power is given to them is so much taken from either the government or the people. As the object of charters is to give to members of companies power which they would not possess in their individual capacity, the very existence of monied corporations is incompatible with equality of rights... [S]uch are the inherent defects of corporations that they can never succeed, except when the laws or circumstances give them a monopoly or advantages partaking of the nature of a monopoly.⁴⁰

The essence of the Jacksonian assault was not against the corporate form per se but against the monopoly privileges that so often accompanied the special charter. Thus rather than abolish the corporation, most Jacksonians sought to make its advantages freely available. Such "liberalism" harmonized well with the economic realities of the day. The industrialization of the United States began during the 1830-1860 decades. Textile manufacturing — our first domestic industry --- was almost completely mechanized by 1860. Iron smelting matured; coal and steam power became widely used. Entrepreneurs applied machine tools to the fabrication of arms, clocks, sewing machines, rubber, glass and tin products on a factory scale.41 The railroad — "America's first big business" — grew from a local curiosity into an important local transportation.⁴² The 1850's, calculated historian Stuart Bruchey, "saw a phenomenal increase in incorporation, with nearly half of all corporations chartered between 1800 and 1860 appearing in that decade."43

The effect of three decades of Jacksonian politics was to transform the nature of the business corporation. The constitutions of several states were amended to enjoin their legislatures from creating corpora-

^{39.} Jackson's Veto Message quoted in A. Schlesinger, The Age of Jackson 90 (1945). See also Handlin, supra note 81, at 218.

^{40.} Gouge (1833), quoted in J. Hurst, The Legitimacy of the Business Corporation 30 (1970).

^{41.} ROBERTSON, supra note 31, at 197-202; BRUCHEY, supra note 31, at 194-207, 83-87, 139-40.

^{42.} See Dodd, supra note 37, at 258, 376, 338-39; Bruchev, supra note 5, at 152-53. The description of the railroads as "America's First Big Business" is the title of a book by business historian Alfred Chandler.

^{43.} Bruchey, supra note 31, at 139.

tions by special act "when the object of the incorporation is attainable by general laws." Under the new general incorporation acts, the privileges of the special acts were unavailable. The corporate form — once available only to those few capable of lobbying a legislature — became automatically available to everyone who satisfied minimum capital and registration requirements.

At the same time, the general incorporation acts imposed limitations on corporate size and activity so that "general" incorporation would remain possible in fact as well as in theory. First, there were limitations upon authorized capital. Well into the nineteenth century, few states permitted corporations to aggregate more than \$500,000 or \$1,000,000. Similarly, severe limitations were imposed on the amount of indebtedness, bonded or otherwise, and the power of one corporation to hold in stock in another was neither conferred nor implied. Second, limitations upon the scope of a business corporation's powers were also universal. Until 1837 every state in the Union limited incorporation to a single purpose or a limited number of purposes, such as a particular transportation, mining, or manufacturing project. Permission to incorporate for "any lawful purpose" was not common until 1875. Third, corporate charters were limited to a term of years — generally 20, 30, or 50 years in duration. And corporations were limited geographically. Several states prohibited corporations from doing business or owning property outside the state of their creation.45

The general corporation acts explicitly established the power of shareholders to direct the policy of their corporation as well. The shareholders meeting — much like a New England town meeting — became the critical decision-making forum. At the meeting, any proposal to change the corporation's assets, share structure, capitalization, or bylaws had to be unanimously approved. To assure strict conformity with their will, the shareholders annually chose directors by majority vote. The directors, in turn, appointed a manager or other agents to execute their business plans. For many years, shareholder control was further augmented by the common law principle that directors could be removed at will.

^{44.} Dodd, supra note 37, at 287-88, 183; Liggett v. Lee, 288 U.S. 517, 541 n.4 (Brandeis, J., in dissent) (1933); R. LARCOM, THE DELAWARE CORPORATION 2-3 (1937).

^{45.} Liggett v. Lee, supra note 44; A. BICKEL (ed.), THE UNPUBLISHED OPINIONS OF MR. JUSTICE BRANDEIS 142-44 (1957); Dodd, supra note 37, at 317-18, 325; and A. BERLE and G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119-40 (rev. ed. 1968).

^{46.} Berle and Means, supra note 45, at 122-24, and E. Dodd, Statutory Developments in Business Corporations Law, 1886-1936, 50 Harv. L. Rev. 27, 33 (1936).

^{47.} Berle and Means, supra note 45, at 125-29.

^{48.} Id. at 129.

Underlying the Jacksonian statutes was a basic fear of corporate power. "First, there was the fear of monopoly," Justice Brandeis would subsequently explain,

Then, the fear of a domination more general. Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjection of labor to capital. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital.⁴⁹

Most frequently, the Jacksonians derogated the corporation's callousness to employees and its alleged financial unscrupulousness. "As directors of a company," complained William Gouge, "men will sanction actions of which they would scorn to be guilty in their private capacity." Agreeing, a committee of the Massachusetts legislature stated, "These artificial creatures . . . unlike individual employers, are not chastened and restrained in their dealings with laborers, by human sympathy and direct personal responsibility to conscience and to the bar of public opinion." ⁵¹

This distrust of the corporation was reflected in the judicial decisions of the Jacksonian period. The information in the nature of quo warranto, the writ of mandamus, the defense of ultra vires contract—all were employed to strictly confine corporate behavior within the ambit of the corporate charter.⁵² Most famously, Chief Justice Taney contravened the effect of the Dartmouth College case by holding in Charles River Bridge v. Warren Bridge⁵³ that monopolistic privileges were never to be implied, even if the grant, without such privilege, was of little value. "The object and end of all government is to promote the happiness and prosperity of the community," Taney generalized;

it can never be assumed that the government intended to diminish its power for accomplishing the end for which it was created... The continued existence of a government would be of no great value, if by implications and presumptions, it was disarmed of the powers necessary to accomplish the ends of its creation; and the functions it was designed to perform, transferred to the hands of privileged corporations.

^{49.} BICKEL, supra note 45, at 140-41.

^{50.} A. Schlesinger, The Age of Jackson, at 335.

^{51.} Id. at 335.

^{52.} Donn, supra note 37, at 104-05, 121, 184-85; CARY, supra note 27, at 50-69.

^{53. 11} Peters 420 (U.S. 1837).

Thus where the *Dartmouth College* case tended to free the corporation from government regulation, *Charles River Bridge* reduced corporate autonomy.

The Trusts

The hallmark of the Jacksonian economy was its atomization. Business firms tended to be small, and bought their raw materials and sold their finished goods locally. "Vertical integration" was a concept barely known. Farmers and miners who produced raw materials were largely discrete from the concerns which processed goods. When a firm manufactured for a market more than a few miles from the factory, it bought and sold through independent agents who handled the business of several other firms.⁵⁴

During the decades after the Civil War, the character of the United States economy was radically transformed. On May 10, 1869, the first transcontinental rail line was completed at Promontory Point, Utah. This linkage symbolized the great age of railway construction. In the next decade, a staggering 20 percent of United States capital formation was devoted to extending rail line systems. Trunk lines burgeoned in the Middle Atlantic states and the North Central states and then across the Great Plains and finally into the South.

By greatly broadening the markets of an agrarian economy, the railroads quickened the growth of such established commercial centers as New York, Philadelphia, and St. Louis and helped populate such new centers as Chicago, Minneapolis, Kansas City, Dallas, and Atlanta. In the four decades prior to 1880, the proportion of urban population rose from 11 to 28 percent; by 1900, it had risen to 40 percent. This great urban expansion increased the demand for consumer goods such as clothing, food, and whiskey. At the same time, railroad construction created the first large market for producers' goods such as steel.⁵⁵

The genesis of a national transportation network and an expanding urban market made possible a new type of business corporation. For the first time, a single manufacturer could dominate not just a local market, not just a regional one, but an entire national market. To the corporation, the advantages of such a national monopoly were obvious. Risk would be reduced. No longer would rivals compete for markets, or raw materials, or the best locations, or employees. Without competition, capital would be easier to secure. Money need not be squandered on advertising or independent salesmen or price wars. More

^{54.} See especially A. Chandler, The Beginning of "Big Business" in American Industry, 33 Bus. Hist. Rev. 1, 4 (1959).
55. Id. at 4-5, and 28-29; and ROBERTSON, supra note 31, at 280-82.

importantly, without competition, the likelihood of profit would be increased.⁵⁶ It was a wisdom as ancient as Aristotle that the merchant who controls a market may charge a monopoly price.⁵⁷

The great Eastern railroad corporations were the first to secure important national monopolies. Exploiting their strategic position by discriminatory freight rates and refusals to deal, eight railroad corporations were able to wrest ownership of 95 percent of the anthracite coal industry by 1893.⁵⁸

Geopolitics was not, however, a business method reserved to railroads. Soon after the Civil War, producers of cordage, gunpowder, whiskey, upholstery felt, and other products organized "output pools" to regulate competition by apportioning production and setting prices. Occasionally pooling associations were successful. More often, however, these "gentlemen's agreements" were violated by secret sales or high profits which attracted new competitors who were less "gentlemanly" and refused to join the pools.⁵⁰

In 1871, John D. Rockefeller set out to consolidate the oil refining industry under a more effective legal form. Rockefeller already had become the leading refiner in Cleveland by combining several local refineries and then persuading two of three competitive railroad lines to secretly rebate 37½ percent of the freight tariff on crude oil shipments from the Pennsylvania oil region and on refined oil shipments from his Cleveland refinery to the Eastern states. His Standard Oil Company was able to secure this extraordinary advantage from the railroads because of its large capacity (four percent of the oil refined in the nation) and because Cleveland refineries could ship East or West by water if railroad rates were not to their liking.⁶⁰

In late 1871, Rockefeller met with the leading refiners of Philadelphia and Pittsburgh to form a corporation capable of monopolizing the country's oil refining industry. By contract, dated January 18, 1872, their concerns merged into the "South Improvement Company." Although the Company possessed less than ten percent of the refining capacity of the nation, the strategic locations of its refineries enabled Rockefeller to persuade each of the three regional railroads to cooperate

^{56.} See G. Leinwand, A History of the United States Federal Bureau of Corporations (1903-1914) 1962 (doctoral dissertation, New York University) at 13, 15-16.

^{57.} ARISTOTLE, THE POLITICS.
58. See H. D. LLOYD, WEALTH AGAINST COMMONWEALTH (1936), for a critical description of the early railroad monopolies.

^{59.} W. STEVENS, INDUSTRIAL COMBINATION AND TRUSTS 1 (1913); and H. Faulkner, Consolidation of Business in E. Rozwenc (ed.), Roosevelt, Wilson, and The Trusts (1950).

^{60.} Lloyd, supra note 58, at 9-10; and I. Tarbell, The History of the Standard Oil Company, 2 Vols., 33, 38-52 (1925).

"as far as it legally might to maintain the business of the South Improvement Company against injury by competition, and to lower or raise the gross rates of transportation for such times and to such extent as might be necessary to overcome the competition." This reference to legality was gratuitous. Contrary to judicial decisions requiring common carriers to charge equal rates to all customers, Rockefeller secured substantial rebates for the Company, e.g., a 40¢ per barrel rebate on the regular 80¢ rate for oil shipped from Titusville, Pennsylvania to Cleveland, Ohio. Emboldened by his success, Rockefeller argued that the rival rail lines would destroy themselves competing for oil freight unless a single refining corporation allocated a settled proportion of freight traffic among them. All three rail lines were thus induced to rebate to the South Improvement Company \$1.06 per barrel on the regular rate of \$2.56 for oil shipped from Pennsylvania to New York by any competitor of the South Improvement Company.

Rockefeller used this railroad contract like a club. On the date it was signed, there were twenty-six rival refineries in Cleveland. Rockefeller threatened "to crush" any competitor which did not sell its refinery to his Standard Oil Company. Within three months, Ida Tarbell reports:

(T)he entire independent oil interest of Cleveland collapsed.... Of the twenty-six refineries, at least twenty-one sold out. From a capacity of probably not over 1,500 barrels of crude a day the Standard Oil Company rose... to one of 10,000 barrels. By this manoeuvre it became master of over one-fifth of the refining capacity in the United States.⁶¹

The most extraordinary aspect of Rockefeller's tactic was that the railroad contract had not yet gone into effect. It never did. The day the rate discriminations became publicly known, every oil producer in Pennsylvania refused to sell to the South Improvement Company. Shortly thereafter, the Pennsylvania legislature rescinded the charter of the South Improvement Company.

Although criticized by a committee of the United States Congress, ⁶² Rockefeller emerged unscathed. In 1874, he traded Standard Oil stock to purchase leading refineries in Philadelphia and Pittsburgh. Shortly thereafter he bought a major refinery in New York City. Fortified by new surreptitious railroad rebates, Rockefeller applied the same business tactics nationally that he had first employed in

^{61.} TARBELL, supra note 60, I, at 67-68. See generally 55-62; LLOYD, supra note 58, at 43-44; Standard Oil Co. v. United States, 221 U.S. 1 (1911).

^{62.} TARBELL, supra note 60, I, at 100.

Cleveland. Within five years, he controlled 95 percent of all refined oil shipments in the United States.⁶³

But he did so through a corporate form that permanently altered the course of American history. Effectively blocked by the law of every state from organizing any one corporation large enough to possess the assets of 95 percent of the nation's oil refineries, Rockefeller's legendary counsel, S. C. T. Dodd, devised the corporate trust. Under a trust, several legally separate corporations deposited a controlling interest of their stock with a common board of trustees in return for a contractual right to dividends. In effect, the trust was a transparent evasion of state chartering restrictions on corporate size. The trustees of the Standard Oil Trust had exactly the same powers as the managers of the earlier Standard Oil Company.⁶⁴ But the Trust had one great advantage over an illegally organized corporation; it was totally secret. Only years later were the legislatures of Pennsylvania, New York, and Ohio able to establish that "Standard was simply a revival of the South Improvement Company."⁶⁵

The dimensions of the Standard Oil Trust's success were not lost on the business community. In 1884, a Cotton Oil Trust was organized in the State of Arkansas. In 1887, three great trusts, the "Whiskey Trust," the "Sugar Trust," and the "Lead Trust" were created. By 1890, twenty-four trusts with a total capitalization of \$376,000,000 had been formed.⁶⁶

Nor were the dimensions of unrestrained railroad practices and the accelerating trust movement lost on the country. Between 1871 and 1874 railroad regulatory statutes were enacted by Illinois, Iowa, Wisconsin, and Minnesota. After the constitutionality of state railroad commission regulation was affirmed by the United States Supreme Court in 1877,⁶⁷ thirty other states and the Federal Government enacted laws affecting railroad operation by 1890.⁶⁸

Also by 1890, twenty-seven states and territories had enacted laws intended to destroy or prevent trusts or monopolies. Fifteen states had taken the further precaution of incorporating antitrust provisions in their constitutions.⁶⁹ As S. C. T. Dodd complained: "They are all

^{63.} Id. at 145-46; Faulkner, supra note 59, at 10-11.

^{64.} Faulkner, supra note 59.

^{65.} TARBELL, supra note 60, I, at 224-29.

^{66.} Stevens, supra note 59, at 13; Faulkner, supra note 59, at 7; H. Wilgus, Need of A National Incorporation Law, 2 Mich. L. Rev. 358, 368 (1903).

^{67.} Munn v. Illinois, 94 U.S. 113 (1877). 68. ROBERTSON, supra note 31, at 289-91.

^{69.} Faulkner, supra note 59, at 15; and Report of the United States Industrial Commission (1900–1902), II, Table following page 264.

penal laws..."⁷⁰ In 1890, Congress enacted the Sherman Act. Henceforth, it was the law of the United States that, "Every contract, combination, in the form of trust or otherwise, or conspiracy, in restraint of trade is hereby declared to be illegal..."⁷¹

The trusts were on the ropes. In 1887, the Supreme Court of Louisiana held the Cotton Oil Trust to be an "illegal association" and ordered it liquidated.⁷² In 1890, the high court of New York ruled it was a violation of law for corporations to enter into the "Sugar Trust" and ordered that "partnership" be disbanded.⁷³ In 1892, in the most important case of all, the Supreme Court of Ohio ruled that the Standard Oil Trust was "organized for a purpose contrary to the policy of our laws" and therefore "void."⁷⁴

Without exception, each of these actions was based not upon the new antitrust statutes but rather upon the common law of corporations. Trusts were unlawful because the charters of the constituent corporations gave them no power to enter one. As the Ohio Supreme Court held, "The act so done is ultra vires (beyond the powers) of the corporation and against the public policy . . ."⁷⁵ Concurring, the Court of Appeals of New York stated:

It is quite clear that the effect of the defendant's action was to divest itself of the essential and vital elements of its franchise by placing them in trust; to accept from the State the gift of corporate life only to disregard the conditions upon which it was given; to receive its powers and privileges merely to put them in pawn; and to give away to an irresponsible board its entire independence and self-control."⁷⁶

Standard survived because of a revolution wrought in the law of corporations;⁷⁷ a calculated decision on the part of the impecunious state of New Jersey to franchise a lax corporation law that "would allow business to do business just as business pleases" as a device for raising the tax revenues.

^{70.} S.C.T. Dodd, The Present Legal Status of Trusts, 7 HARV. L. REV. 157 (1893).

^{71. 26} Stat. 209 (1890).

^{72.} On legal issues concerning the trusts, see S.C.T. Dodd's partisan — though informative — article, The Present Legal Status of Trusts, 7 HARV. L. Rev. 157 (1893).

^{73.} People v. North River Sugar Refining Co., 121 N.Y. 582, 24 N.E. 834 (1890).

^{74.} State ex rel. Attorney v. Standard Oil Co., 49 Ohio St. 137, 30 N.E. 279 (1892).

^{75.} Id.

^{76.} People v. North River Sugar Refining Co., supra, 24 N.E. at 839-40.

^{77.} See Tarbell, supra note 60, II, at 129-40, 256-69, for a description of Standard's seven year battle in Ohio to ignore the State Supreme Court ruling ordering its dissolution and the 1897 contempt action which compelled the trust to flee to New Jersey.

New Jersey

In 1891 New Jersey had gone into the charter-mongering business. A statute was rushed through the legislature authorizing New Jersey corporations to buy and sell the stock or property of other corporations and to issue their own stock as payment. This "Holding Company" Act effectively legalized the trust organization by authorizing a single corporation to control the stock or assets of its competitors in the same fashion as a trust. Law. Lest anyone misunderstand, in 1892 New Jersey repealed its Antitrust Law. In 1893, New Jersey garnered \$434,000 in corporation fees. Three years later the first "reform" Governor of New Jersey in thirty years appointed Wall Street attorney James B. Dill to chair a Revision Committee and by 1896 New Jersey had completely revolutionized corporate law.

Broadly, the General Revision Act of 1896 had three basic themes, which, to this day, comprise the heart of all "modern" state corporation statutes.

First, unlimited corporate size and market concentration were permitted. The "Holding Company" provision was broadened to read:

Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of the shares . . . or any bonds, securities, or evidences of indebtedness created by any other corporation or corporations of this or any other state, and while owner of such stock may exercise all the rights, powers, and privileges of ownership, including the right to vote thereon. 82

But, in the 1896 Act, these breathtaking privileges were a mere prelude. The fifty year limitation on corporate life was removed. Corporations might be formed for any lawful purpose. They could carry on their business in any state or in any foreign country. New Jersey corporations could merge or consolidate at will and thereafter the consolidated corporation could sell, mortgage, lease, or franchise any property so obtained. A corporation could change the nature of its business, change its name, increase or decrease its capital, extend its corporate existence, change its common stock into one or more classes of preferred stock,

^{78.} On history of corporate law in New Jersey, see J. Dill, National Incorporation Laws For Trusts, 11 Yale L.J. 273 (1902) and L. Steffens, New Jersey: A Traitor State, 25 McClure's 41 (1905). See also H. Stoke, Economic Influences Upon the Corporation Laws of New Jersey, 30 J. Pol. Econ. 551 (1930); and E. Keasbey, New Jersey and the Great Corporations, 13 Harv. L. Rev. 193, 264 (1899).

^{79.} Steffens, supra note 78, at 47; Stoke, supra note 78, at 207-08; and LARCOM, supra note 44, at 60-62.

^{80.} Stoke, supra note 78, at 209.

^{81.} Steffens, supra note 78, at 45-48; and Stoke, supra note 78, at 572.

^{82.} Statute quoted in Steffens, supra note 78, at 47.

and make any other alterations desired by a vote of the directors, provided the amendment could legally have been a part of the original charter.⁸³

Second, by revising capitalization requirements, New Jersey eased the financing of consolidations and mergers. Since 1891, New Jersey corporations had been allowed to purchase the stock of other corporations by payment in their own stock. In 1896, they were given carte blanche to exaggerate or "water" the value of the acquired company, for "the judgment of directors as to the value of property purchased shall be conclusive."84 This meant putative monopolists could buy up competing corporations without paying a penny in cash while offering the owners of the acquired corporation stock worth far more than the assets of the acquired firm. Everyone profited but the public investor. He or she was then induced to pay cash for shares in a giant "sound" corporation some of whose assets were imaginary. Since New Jersey did not require stock promoters to disclose the basis of purported assets, shareholders "became pawns," in Harvard Professor William Ezra Ripley's words, "in the great game of chance by reason of that mystery."85

Third, the 1896 Revisions undermined shareholder control. Stockholders could be classified, preferred and common, and unequal voting powers given to them. Consequently, the organizers of a corporation could sell large quantities of non-voting stock to the public while retaining voting stock for themselves. But a New Jersey corporation did not have to go that far. It could distribute voting stock to everyone while simultaneously granting directors the right to amend by-laws without the consent of shareholders. Or, it could rely solely on the "proxy" device. Under the revised law, all shareholder meetings were required to be held in New Jersey. Since it was usually inconvenient for most shareholders to attend meetings there, shareholders were given the Hobson's choice of not voting or signing proxies designating management representatives to vote for them.

After the 1896 Revision Act, the largest corporations, quite literally, flocked to New Jersey.*

^{83.} Stoke, supra note 78, at 572-73; and Keasbey, supra note 78, at 208.

^{84.} Steffens, supra note 78, at 48; Report of the United States Industrial Commission (1900-1902); I, at 248-49, 251, 1080-81; and W. Ripley, Main Street and Wall Street 101 (1927).

^{85.} RIPLEY, supra note 84, at 205.

^{86.} See S. McReynolds, The Home of Trusts, 4 World's Work 2526 (1902).

^{87.} REPORT OF THE UNITED STATES INDUSTRIAL COMMISSION, I, at 243.

Incorporation in New Jersey, 1896-191288

Number of

| | Number of charters | corporations with capital of \$20,000,000 | | Annual franchise |
|--------|-----------------------|---|--------------------|---------------------|
| Year | granted | or more | Filing fees | tax |
| 1896 | 834 | 1 | \$ <i>7</i> 5,000* | \$ 857,655.25 |
| 1897 | 1,059 | 3 | 100,000* | 856,806.67 |
| 1898 | 1,103 | 7 | 150,000* | 951,608.51 |
| 1899 | 2,181 | 50 | 700,000* | 1,063,991.53 |
| 1900 | 1,987 | 11 | 400,000* | 1,766,013.48 |
| 1901 | 2,347 | 12 | 687,479 | 2,315,592.78 |
| 1902 | 2,250 | 11 | 465,089 | 2,878,073.11 |
| 1903 | 2,005 | 5 | 269,147 | 3,380,439.87 |
| 1904 | 1,620 | 5 | 147,659 | 3,416,824.22 |
| 1905 | 1,912 | 8 | 257,476 | 3,306,020.23 |
| 1906 | 2,093 | 2 | 223,181 | 3,169,254.47 |
| 1907 | 1,828 | 1 | 135,496 | 2,947,979.72 |
| 1908 | 1,649 | 4 | 148,387 | 2,900,589.76 |
| 1909 | 2,119 | 5 | 188,059 | 2,793,561.17 |
| 1910 | 1,920 | 0 | 142,449 | 2,725,156.69 |
| 1911 | 1,855 | 3 | 155,296 | 2,691,891.37 |
| 1912 | 1,882 | 4 | 172,738 | 2,646,738.29 |
| * (200 | rozzimatal | | | |

* (approximate)

In the sixteen year period, 1880-1896, exactly 15 corporations with authorized capital of \$20,000,000 or more had been chartered under New Jersey's General Corporation Laws. In the next seven years, 1897-1904, 104 were. So As early as 1900, economist G. H. Montague estimated that 95 percent of the nation's "major" corporations were chartered in New Jersey. For example, Standard Oil reincorporated in New Jersey in 1899. In 1901, the United States Steel Corporation, then the nation's largest company, was incorporated in New Jersey with a total capitalization of \$1,370,000,000. In 1904, John Moody identified five other "Greater Industrial Trusts": the Amalgamated Copper Corporation, the American Smelting and Refining Company, the American Sugar Refining Company, the Consolidated Tobacco Company, and the International Mercantile Marine Company.

^{88.} Sources: McReynolds, supra note 86; Stoke, supra note 78, at 574; Steffens, supra note 78, at 49; and G.A. Evans, Business Incorporations in the United States 1800–1943, 49 (1948).

^{89.} Evans, supra note 88, at 49.

^{90.} Montague quoted in Stoke, supra note 78, at 574.

^{91.} J. Moody, The Truth About the Trusts 453 (1904).

^{92.} Id. at 453.

All five were incorporated in New Jersey. Of Moody's 318 "Greater Industrial Trusts," "Lesser Industrial Trusts," and "Trusts in Process of Reorganization," 170 were incorporated in New Jersey, most in the seven years, 1897-1904.⁹³

During these same years, New Jersey's statute facilitated the greatest merger movement in American history. Shaw Livermore calculated that 328 combinations, effected between 1888-1905, controlled roughly two-fifths of the manufacturing capital of the country as of 1904. Abraham Kaplan of the Brookings Institution similarly concluded that of 92 "major" trusts of the year 1904, 78 controlled 50 percent or more of the sales in their respective fields; 26 of the 78 controlled 80 percent or more. 95

New Jersey's corporate laws were bitterly resented. Yet while muckraking journalists accused "Jersey" of "trafficking in treason" and other states vehemently protested this subversion of their corporate laws, New Jersey's only concern, according to Lincoln Steffens, was "Does it pay?" ⁹⁸

It did. By 1902, New Jersey was earning so much from corporation filing fees and franchise taxes that it was able to abolish all property taxes and still pay off its entire state debt. By 1905, it had a \$2,940,918 surplus in its treasury and a governor who could brag:

Of the entire income of the government, not a penny was contributed directly by the people. . . . The state is caring for the blind, the feebleminded, and the insane, supporting our prisoners and reformatories, educating the younger generations, developing a magnificent road system, maintaining the state governments and courts of justice, all of which would be a burden upon the taxpayer except for our present fiscal policy. 97

Retaliation against the "traitor state" was impossible, for the United States Supreme Court had ruled in 1886 that a corporation was a "citizen" within the meaning of the privileges and immunities clause of the Constitution. This meant that a corporation chartered by New Jersey had the same right to do business in a second state as a corporation chartered by that state. New Jersey buttressed this constitutional shield with two "retaliatory statutes": the first refused to enforce the criminal or contractual laws of any other state against a

^{93.} Id. at 453-68, 486.

^{94.} S. Livermore, The Success of Industrial Mergers, QUART. J. Econ. (November, 1935).

^{95.} A.D.H. KAPLAN, BIG ENTERPRISE IN A COMPETITIVE SYSTEM (1954).

^{96.} Steffens, supra note 78.

^{97.} Id. at 50; and Stoke, supra note 78, at 574-75.

^{98.} Santa Clara County v. Southern Pac. R.R., 118 U.S. 394 (1886).

New Jersey corporation;⁹⁹ the second provided that when the laws of any other state taxed or penalized a New Jersey corporation doing business in that other state, then New Jersey would impose the same taxes or penalties on the corporations of that other state doing business in New Jersey.¹⁰⁰

Soon West Virginia, then Maine, Maryland, and Kentucky—anxious for some of New Jersey's lucrative franchise tax income—entered the charter-mongering business. 101 As corporations and their annual fees gravitated toward the states with the laxest laws, the balance of the states began weakening their laws to hold onto their tax base. A law review note complained, "For a state to be conscientious would be synonymous with cutting its own throat." Social Darwinism was stood on its head. "[The] corporate laws of the states tend to drag down one another to the level of the lowest. Competition between the states produces a survival of the unfit, a truly anomalous situation." Great industrial states such as Massachusetts and New York gutted their laws to reduce the attractions of New Jersey. 104

By 1912, New Jersey had reshaped the corporate law of virtually every state in its own image:

- * Forty-two states, by then, permitted the organization of corporations for "any lawful purpose."
- * Forty-three states had abolished capital stock limitations.
- * Twenty-four states issued perpetual charters and in most of the rest, charter renewal had become pro forma.
- * Eighteen states permitted the merger and consolidation of corporations. Such combinations were specifically prohibited in only two states.
- * Nineteen states sanctioned the holding of stock in other corporations; holding companies were specifically prohibited in only two states and qualified in seven states.

^{99.} Stoke, supra note 78, at 576; Dill, supra note 78, at 284-85.

^{100.} REPORT OF THE UNITED STATES INDUSTRIAL COMMISSION, I, at 227; and Dill, supra note 78, at 287.

^{101.} Report of the United States Industrial Commission, I, at 241, 247-48, 1078-79; Stoke, supra note 78, at 575-76; and Keasbey, supra note 78, at 201-02. Actually West Virginia had sent its Secretary of State to New York City to sell corporate charters even before New Jersey went into the business. But he was not received very enthusiastically, both because West Virginia had retained a \$5,000,000 capital stock limitation and because "tramp" corporations — those organized in one state to do business in another — were still considered somewhat undignified.

^{102.} Note, State Laws: Survival of the Unfit, 62 U. PA. L. REV. 509, 510 (1914).

^{103.} *Id*. at 514

^{104.} Dill, supra note 78, at 282; and Dodd, supra note 46, at 34-39. See also Report of the Committee on Uniform Incorporation Law quoted in Note, supra note 102, at 511-12.

- * Forty states had abolished the requirement that capital stock must be paid for in money.
- * Nine states declared the judgment of the board of directors as to the value of property for which stock was issued conclusive except in case of fraud.
- * Thirty-three states had no provisions requiring any of the directors to be residents of the chartering state.¹⁰⁵

Ironically, of all the states with so-called "liberal" incorporation laws, only New Jersey ever reformed. In 1913, shortly after New Jersey's own Governor Woodrow Wilson had been elected President, Wilson proposed seven detailed provisions (known as "The Seven Sisters Acts") to outlaw the trust and the holding company. In his final message as Governor, Wilson explained:

The corporation laws of the state notoriously stand in need of alteration. They are manifestly inconsistent with the policy of the Federal Government and with the interests of the people in the all-important matter of monopoly, to which the attention of the nation is now so earnestly directed. The laws of New Jersey, as they stand, so far from checking monopoly actually encourage it... These are matters which affect the honor and good faith of the state. We should act upon them at once and with clear purpose. 100

Within days, a bemused nation witnessed the strange spectacle of a state known as "The Mother of Trusts" outlawing any corporation or combination of corporations from acquiring a monopoly; conspiring to limit production or increase prices; preventing competition; fixing prices; buying stock in competing corporations with a view towards controlling them; discriminating in price save on the basis of quantity, quality, transportation, or other "valid" charges; or issuing stock for property unless the property was the full equivalent of the money value of the stock.¹⁰⁷

This penitence was shortlived. By 1917, New Jersey had repealed most of the "Seven Sisters Acts," but reform did have one enduring effect. New Jersey's hegemony of the incorporation of giant companies was forever shattered. Any state that could elect Woodrow Wilson governor could never be fully trusted by big business again. Henceforth, the largest corporations would have to look elsewhere to find a more congenial home.

^{105.} J. Baker, The Evil of Special Privilege, 22 YALE L. REV. 220, 222-23 (1912)

^{106.} Wilson quoted in 96 THE NATION 91 (January 23, 1913).

^{107.} Id. at 91; and Stoke, supra note 78, at 577-79.

II. THE DELAWARE GENERAL CORPORATION LAW OF 1899

Such was the historical setting for the enactment of Delaware's General Corporation Law in 1899, and for its ascendancy, after 1913, to the role of state of incorporation for more large business corporations than any other state.

In 1899, Delaware had become one of the first imitators of New Jersey's "liberal" statute. A Wilmington attorney, Josiah A. Marvel, with the aid of a New York attorney and the financial editor of a New York newspaper, drafted and secured unanimous approval for the predecessor of Delaware's present General Corporation Law. Marvel then formed the Corporation Service Company and began mailing out pamphlets to advertise the advantages of the new law as if it were a miraculous new patent medicine:

The State of Delaware has just adopted the most favorable of existing general corporation laws . . . The law is based upon that of the State of New Jersey and embraces all of the beneficial provisions and safeguards found in the laws of that State. It has, however, in many respects advanced far beyond New Jersey and made Delaware a far more attractive home for a business corporation . . . It does not encourage reckless incorporations nor permit the existence of wildcat companies. But it furnishes at least expense, ample right to stockholders, and reduces restrictions upon corporate action to a minimum . . . [A Delaware Corporation] may engage in any lawful business except banking . . . Its existence may be perpetual or limited . . . It may conduct business anywhere in the world . . . Stock may be issued for property purchased or services rendered, and, in the absence of fraud, the judgment of the directions as the value of such property or services is conclusive . . . The amount of capital stock it may issue is unlimited ... It may commence business before any sum whatever is paid in . . . It may have different classes of stock with different privileges or restrictions . . . [Its] charter may be easily amended . . . [Its] capital stock may be easily increased or decreased . . . [It] may be readily merged or consolidated with other corporations ... It may own and vote upon the stock of other corporations ... The original fee to be paid for incorporation is small, — about three-fourths of that in New Jersey, for instance. The annual tax is very small. In New Jersey, for instance, a corporation with a capital of \$4,000,000 pays \$3,000 annual tax. In Delaware, it pays but \$1,500 . . . Stockholders and directors may hold their meetings wherever they please and need never meet in the State of Delaware (New Jersey stockholders must meet in that state.) ... The stock and transfer books (which in New Jersey corporations must be kept in the State) may be kept in or out of Delaware, in the discretion of the company . . . The examination of the books by intermeddlers is made much more difficult under the Delaware laws than under the laws of any other state . . . The liability of the stockholder is absolutely limited when the stock has once been issued for cash, property or services . . . ¹⁰⁸

What Marvel had done was to take New Jersey's Revised Corporation Act and systematically "improve" it. 100 In his haste, he had included provisions to permit stock watering which were patently unconstitutional under the Delaware Constitution of 1897. But that apparently did not matter. The Assembly was so pleased with the prospect of reducing property taxes that it readily amended the Constitution to conform to the corporation law. 110

Then when, in 1913, Wilson's reforms "ruined" New Jersey, Wall Street's attentions were fully directed to Dover. Beginning in 1915, the Delaware General Assembly periodically revised its corporation law to adopt "suggestions" forwarded by the New York bar.

Principal among the early revisions was the adoption of "no par" stock. Following New York's lead, Delaware, in 1917, legitimated stock watering by authorizing shares without a stated value which could be issued for any price fixed by the board of directors. Since "no par" reduced the possibility of a shareholder or creditor suit for fraud when controlling shareholders sold themselves stock at a price lower than that they charged the public, "no par" was particularly desirable to corporate managers. ¹¹¹ By 1931, 82 percent of the Delaware corporations listed on the New York Stock Exchange had issued "no par" stock. ¹¹²

Just as important, Delaware retained the most attractive features of New Jersey's law. In 1899 and 1901, Delaware had legislated broad holding company provisions. These permitted the economic concentration legalized in New Jersey at the turn of the century to be preserved and enhanced. Indeed, Delaware allowed the holding company to emerge in a more attenuated form. By tolerating "stock pyramiding", Delaware permitted financiers not only to hold control of a subsidiary corporation through a parent but to reduce their personal investment

^{108.} Quoted in Note, Little Delaware Makes A Bid for the Organization of Trusts, 39 Am. L. Rev. 418 (1899). See generally E. Latty, Why Are Business Corporation Laws Largely "Enabling," 50 Cornell L.Q. 599, 602-03 (1965); and Larcom, supra note 44, at 9-10, 60-62.

^{109.} See Report of the United States Industrial Commission, I, at 241, 248, 1079, 1119-23.

^{110.} LARCOM, supra note 44, at 84-88.

^{111.} BERLE and MEANS, supra note 45, at 145-46. LARCOM, supra note 44, at 100-13; and RIPLEY, supra note 84, at 46-50.

^{112.} LARCOM, supra note 44, at 112.

^{113.} Id. at 60-62.

in the controlling stock to a trivial amount by selling off most of the parent's equity in non-voting stock or bonds.¹¹⁴ This procedure could be repeated at several successive levels so that investors such as the Van Sweringen brothers were able to control billion dollar combinations with a personal investment of less than 1 percent of the total equity value.¹¹⁵

The key to stock pyramiding and other devices by which Delaware became, in Professor Dodd's words, "the happy hunting ground for the corporate promoter" was a second provision Delaware copied from the revised New Jersey law. To quote Delaware's 1899 Act:

The certificate of incorporation may also contain any provision which the incorporators may choose to insert for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting, and regulating the powers of the corporation, the directors and stockholders; provided, such provisions are not contrary to the laws of this State.¹¹⁷

These sanguine little words, literally, turned corporate law inside out. The first 100 years of the corporation's history in the United States had stood for one rule above all else: The business corporation could only exercise powers or seek capital in the ways explicitly provided in its charter with the State or necessarily implied. The New Jersey — Delaware "self-determination" provision exactly reversed this rule. Now the corporation could be a law-maker, itself. The corporation could conduct business in any way it chose as long as the State did not explicitly prohibit it.

During the 1920's, the promoters and managers of Delaware corporations used this power of self-determination to assault the last vestiges of shareholder control. Investors were disenfranchised through the proliferation of non-voting preferred and common shares and almost as completely disbarred through the inception of "restricted", "limited", or "contingent" voting shares.¹¹⁸

The power of self-determination also permitted a kindred attack on the public shareholder's property rights. First fell the shareholder's

^{114.} Berle and Means, supra note 45, at 184-85; J. Bonbright and G. Means, The Holding Company (1932); and Larcom, supra, note 44, at 70.

^{115.} Berle and Means, supra note 45, at 69-70.

^{116.} Dodd, supra note 46, at 27.

^{117.} See supra note 12.

^{118.} A. Berle, Investors and the Revised Delaware Corporation Act, 29 COLUM. L. Rev. 563 (1929); A. Berle, Corporations and the Public Investor, 20 Am. Econ. Rev. 54 (1930); Berle and Means, supra note 45; Hurst, supra note 40, at 148-49; Ripley, supra note 84, esp. at 84-85, 52-53, 123-24; and W.H.S. Stevens, Stockholders Voting Rights and the Centralization of Voting Control, Quar. J. Econ., May, 1926, at 353.

"pre-emptive right". Since 1807 State judicial decisions had universally recognized that each shareholder possessed an option to buy shares in subsequent issues of stock in his corporation in the proportion which his holdings bore to the total number of shares before the new securities were offered to the general public. This option protected the value of the shareholder's original investment. Beginning in 1919, Delaware corporations began amending their charters to eliminate pre-emptive rights. Thereafter, management fear of "collapsing" the market in new securities issues remained the single practical constraint on self-favoritism. 120

Next challenged were shareholder's dividend rights. With the classification of stock, the board of directors "inherent" power to declare or not to declare dividends took on an unexpected meaning. Directors now "inherently" had the right to favor or prejudice particular shareholders each quarter. In 1928, this rule was taken to a new extreme when the Supreme Court of Delaware affirmed that even if a shareholder had purchased stock in reliance upon a guaranteed annual dividend specified in the charter, the board could subsequently amend the charter and not honor this "vested right". 122

By amendments in 1927 and 1929, the Delaware Legislature went further. "Blank Stock" was created. This permitted financiers to organize a corporation with large blocks of authorized but unissued stock whose "voting powers, designations, preferences, . . . or rights" could be subsequently fixed by the board of directors. Similarly, "stock purchase options" could be issued prior to the public offering of shares. Such warrants permitted favored investors to buy corporate stock at a designated price any time during a specified term of years or in perpetuum when the market price of the stock rose sufficiently above the option price to guarantee the warrant-holder a risk-free profit. And "nimble" dividends were permitted. Under certain circumstances, directors could pay shareholders dividends out of the capital they had paid in for their shares. 125

^{119.} Gray v. Portland Bank, 3 Mass. 363 (1807).

^{120.} Ripley, supra note 84, at 38-39, 42-44; and Berle and Means, supra note 45, at 133-35, 160-65.

^{121.} Berle, 20 Am. Econ. Rev., at 61-65; and Berle and Means, supra note 45, at 136-38.

^{122.} Davis v. Louisville Gas & Elec. Co., 142 A. 654 (Del. 1928). See A. Berle, 120 Am. Econ. Rev. at 61-65; and Berle and Means, supra note 45, at 136-38.

^{123.} Berle, 29 COLUM. L. REV., at 563-64; and J. Flynn, Why Corporations Leave Home, The Atlantic Monthly, September, 1932, at 268.

Home, The Atlantic Monthly, September, 1932, at 268.
124. Berle, 29 Colum. L. Rev., at 565-70; Berle, 20 Am. Econ. Rev., at 64; and Berle and Means, supra note 45, at 167-70.

^{125.} Berle, 29 Colum. L. Rev., at 573-76; Berle and Means, supra note 45, at 152-56.

The cumulative effect of these many broad financial mechanisms was, in the words of Columbia Law School's Adolf Berle, to accord management "the power of confiscation . . . by using them or a combination of them, appropriately, the profits of the enterprise and also in considerable measure the underlying assets may be shifted from one group of stockholders to another." ¹²⁶

Even more important than the financial structure of the largest corporations was the relation of the corporation to society as a whole. By 1932, when Adolf Berle and Gardiner Means published *The Modern Corporation and Private Property*, their seminal study of the United States economy and corporate law, there had evolved a "corporate system" far removed from the atomized Jacksonian economy.

This transformation involved the concentration of economic power and the dispersion of stock ownership. The two hundred largest non-banking corporations combined assets amounted to \$81 billion or 49.2 percent of the wealth held by over 300,000 non-banking corporations.¹²⁷ In the largest corporations, thousands, sometimes hundreds of thousands, of individuals owned shares so that in a majority of the largest corporations no single individual held an important proportion of the total ownership.¹²⁸

Correspondingly, stock dispersion and legal devices such as non-voting stock and stock pyramiding had vested control of at least 177 of the largest 200 corporations in owners of a minority of the outstanding shares. To be more specific, Berle and Means calculated that in 23 percent of the largest 200 corporations a minority shareholder or group possessed a large enough block to own "working control" of the corporation. That is, their 15 or 20 or 25 percent of voting shares could invariably attract sufficient support from the dispersed majority to form a 51 percent or greater faction. In 21 percent of these largest 200 corporations, control was the result of a legal device; while in 44 percent, a management group with trivial shareholdings maintained control through the propinquities of the proxy system. 120

Underlying this entire corporate system was the opera bouffe in Delaware. For some 42,000 corporations, including more than one-third of the industrial corporations listed on the New York Stock Exchange, Delaware was "home." In one office alone of the Industrial

^{126.} Berle, 20 Am. Econ. Rev., at 65.

^{127.} BERLE and MEANS, supra note 45, at 19, 30, 32-34, 37.

^{128.} Id. at 47-49, 52.

^{129.} Id. at 66-111.

^{130.} Flynn, supra note 123, at 270. See also Larcom, supra note 44, at 175-76; and C. Ward, Delaware's "Black Flag": An Answer to John T. Flynn's Article in September (1932) Atlantic Monthly Entitled "Why Corporations Leave Home," a pamphlet published by the Corporation Service Company, Wilmington, Del. (1932).

Trust Building in Wilmington, 12,000 separate corporations claimed their existence; and in the lobby of that very same building, 12,000 separate corporations posted their names in identical picayune lettering in a determined attempt to comply with the General Corporation Law's requirement that a corporate sign be "displayed". Each day, six, or twelve, sometimes several dozen annual shareholder meetings were held in the good offices of the corporation trust companies — for many corporate lawyers had amended their companies' by-laws to require that such meetings be held in Delaware when they concluded that Wilmington was so inconvenient a location that few shareholders would ever attend. And each day two to half a dozen proxy holders for each corporation holding a meeting would arrive and solemnly call the shareholders to order. With strict regard to all statutory formalities, they would nominate and elect directors — an office boy of the trust company often serving as the required resident agency — then they would carefully total their proxies and five minutes later adjourn, management having successfully re-elected itself.181

There was only one legal fiction more empty than that of the annual shareholders meeting in Wilmington. And that was the role of the legislature in Dover. In return for corporate franchise taxes and related fees which averaged 25 percent of Delaware's total state revenues from 1913-1934, 132 the legislature had abdicated its responsibilties as a lawmaker. Typically, amendments forwarded by New York attorneys were rushed through House and Senate committees in "five minutes" and enacted by the full General Assembly within days. 133

In 1929, the weaknesses in the financial structure of many large corporations were unexpectedly revealed in the stock market crash.¹⁸⁴

The Crash

In 1929, the weaknesses in the financial structure of many large corporations were revealed in the stock market crash.

Between 1920 and 1933 approximately \$50 billion of new securities were sold in the United States. By 1933, fully half or \$25 billion had become worthless. The aggregate value of all shares listed on the New York Stock Exchange had been \$89 billion on September 1, 1929. In the next two months the aggregate value fell by \$18 billion. At one point in 1932 the aggregate value was down to \$15 billion, a loss of \$74 billion in two and one half years. Bond losses increased the

^{131.} Flynn, supra note 130.

^{132.} Constitutionalizing, supra note 26, at 535-78.

^{133.} G. Harrington, The Legislative History of the Delaware General Incorporation Act of 1899 to 1933, 1933, (Masters Thesis on file with Harvard Law School Library, Cambridge, Massachusetts).

^{134.} Landis, quoted in RIPLEY, supra note 84, at 32-33.

total drop in values to \$93 billion. 135 Public confidence in the nation's stock markets and leading corporations had been undermined by reports of leading financiers and brokerage houses manipulating stock prices through "pool" operations and "bear" raids; bribing journalists to tout unsound securities; benefitting corporate "insiders" and "preferred lists" of public officials by the sale of stock at a lower price than that offered to the public; publishing misleading financial statements; and the complete unwillingness of the stock exchanges to assume responsibility for curbing fraud and high pressure salesmanship. 136

The response of the federal government was to enact broad changes in the regimen of corporate and securities law. The Securities Act of 1933, ¹⁸⁷ aptly nicknamed the "truth in securities" law was rushed through Congress in Roosevelt's first 100 days and became effective on July 7, 1933, a date roughly corresponding to the low point in the stock market and the general economy. It required all corporations issuing new securities to file a registration statement informing investors of material information about the business, finances, and the management of the issuing corporation and penalizing misrepresentation, deceit, or fraud in the sale of securities.

The Securities Exchange Act 138 became law on June 6, 1934. The Act, first, required all "national securities exchanges" to establish rules providing for the expulsion, suspension, or disciplining of members who violated standards of fair dealing and protection of investors. Second, it authorized the Federal Reserve Board to set limitations on the amount of margin (that is, credit) which may be extended for the purpose of purchasing securities. Third, it required corporations whose securities are listed for public trading on a national security exchange to file a registration form with the exchange and file periodic reports. Fourth, it authorized regulation of proxy solicitations "as necessary or appropriate in the public interest or for the protection of investors". Fifth, it proscribed certain forms of insider trading and insider short sales and required all statutorily defined insiders to report on their securities transactions. And sixth, the 1934 Securities Exchange Act created the Securities and Exchange Commission (SEC) and armed it with sufficient remedial powers to enforce the 1933 and 1934 laws.

^{135.} L. Loss, Securities Regulation 120 (1961); and Securities and Exchange Commission 25th Annual Report at xiv-xv.

^{136.} SECURITIES AND EXCHANGE COMMISSION 25TH ANNUAL REPORT NY-XVI; R. DEBEDTS, THE NEW DEAL'S SEC, THE FORMATIVE YEARS 9-24 (1964); and H. CHERRINGTON, THE INVESTOR AND THE SECURITIES ACT 2-14 (1942).

^{137. 48} Stat. 74 (1933), as amended, 15 U.S.C. § 77 (1970).

^{138. 48} Stat. 881 (1934), as amended, 15 U.S.C. § 78 (1970).

The Public Utility Holding Company Act¹³⁹ was adopted in 1935. Earlier that year the Federal Trade Commission (FTC) completed its comprehensive study of the public utility industry. In 101 volumes, the FTC documented that some 20 holding companies controlled 98.5 percent of all interstate electricity transmission while 11 companies controlled 80 percent of all natural gas pipeline mileage. Complex corporate structures had been pyramided one on top of the other through the issuance of securities burdened with overvalued assets, mountainous debts, excessive capitalization, mysterious service charges, and deceptive publicity. During the late 1920's the utility empires of Insull, Kreuger, Hopson, Morgan, and others had floated over \$5 billion worth of securities; many of which were not to improve utility properties but to purchase the voting shares of independent operating companies. This consolidation resulted in geographically far-flung utility systems organized without regard to the integration or coordination of related properties. The collapse of the market in 1929 swiftly resulted in the collapse of the top-heavy financial structures of many of the public utility holding companies. From September 1929 to April 1936, 53 holding companies with approximately \$1.7 billion of securities went into receivership. An additional 23 companies with about \$535 million of securities defaulted on interest payments and sought readjustment plans. 140 The Public Utility Holding Company Act of 1935 required the restructuring of the utility systems into integrated local companies, the simplification of their financial structure, and new accounting standards.

Studies by the SEC completed in 1936 led to amendment in that year of the 1934 Securities Exchange Act to give the SEC regulatory authority over certain unlisted securities¹⁴¹ and in the 1938 Maloney Act over over-the-counter brokers.¹⁴² Almost simultaneously, Yale Law School professor — later Justice — William O. Douglas completed an eight volume study of protective and reorganization committees pursuant to section 211 of the 1934 Securities Exchange Act.¹⁴³ The detailed disclosures of that study resulted in enactment of Chapter X of the Federal Bankruptcy Law¹⁴⁴ and extension of the disclosure

^{139. 49} Stat. 803, as amended, 15 U.S.C. § 79 (1970).

^{140.} Federal Trade Commission Report summarized in Securities and Exchange Commission 25th Annual Report at xvi-xviii. See also Securities and Exchange Commission 17th Annual Report at 62-63; and Loss, supra note 135, at 131.

^{141.} See § 12 of the Security Exchange Act of 1934; 15 U.S.C. § 78e (1970).

^{142. 52} Stat. 1070 (June 25, 1938), 15 U.S.C. §§ 780–3(1971), as amended (Supp. I, 1975).

^{143.} SECURITIES AND EXCHANGE COMMISSION 4TH ANNUAL REPORT.

^{144. 52} Stat. 883 (1938); 11 U.S.C. § 501 (1970).

provisions of the 1933 Securities Act to Trust Indenture bonds. 145 In 1940, a four year study of investment companies concluded that fraudulent representations had become a common practice in that fledgling industry and that investors were being victimized by commissions as high as 30 percent of their net investment. Within months, the Investment Company Act of 1940¹⁴⁷ and the Investment Advisers Act of 1940¹⁴⁸ were enacted. Elsewhere, the SEC invoked its rulemaking discretion to promulgate increasingly detailed rules for management proxy solicitations in 1935, 149 1938, 150 1940, 151 and 1943. 152

Delaware After the Crash

These sweeping federal corporate and securities laws substantially reduced the advantages that states like Delaware could offer firms in their corporation laws. 153 But the federal government had not fully pre-empted the field of corporation law during the 1930's. The opportunity to draft state provisions attractive to corporate management in the interstices of federal law remained. In 1967, Delaware furthered a modern round of state charter-mongering by exploiting this opportunity. The drafting of the 1967 Delaware Revision Statute began in 1963.

After World War II, the corporate laws of over 30 states had been revised to make them more "competitive" with the Delaware General Corporation Law. 154 In the summer of 1963, Delaware's Secretary of State Elisha Dukes received the disturbing news that both New Jersey and Maryland intended to further amend their laws to "out-Delaware" Delaware. Dukes was even more disturbed to

^{145.} Trust Indenture Act of 1939, ch. 411, 53 Stat. 1149 (Aug. 3, 1939), 15 U.S.C. § 77aaa (1971).

^{146.} Securities and Exchange Commission 25th Annual Report at xvii and

^{147. 54} Stat. 789 (Aug. 22, 1940), 15 U.S.C. § 80a-1 (1971).
148. 54 Stat. 847 (Aug. 22, 1940), 15 U.S.C. §§ 80a-51, 52, 80b-1, 2 (1971).

^{149.} SECURITIES AND EXCHANGE COMMISSION 2ND ANNUAL REPORT.

Securities and Exchange Commission 4th Annual Report.
 Securities and Exchange Commission 10th Annual Report, at 51.

^{152.} Id. at 51.

^{153.} Not surprisingly, Delaware's corporate revenues plummeted. In 1929, total corporate revenues had equalled \$5,571,194 or 42.5 percent of total state revenues. In 1935, Delaware's corporate revenues equalled \$2,981,774 or 20.6 percent of the total. In 1945, corporate revenues equalled 16.3 percent of total state revenues; in 1955,

just 7.2 percent. See Constitutionalizing, supra note 26, at 535-38.

154. Cary, supra note 27, at 10-11; Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L.J. 663, 665-68 (1974); and E. Folk, Some Reflections of a Corporation Law Draftsman, 42 Conn. L.J. 409, 409-10, 419 (1968).

^{155.} Interviews with Samuel Arsht, partner, Morris, Nichols, Arsht & Tunnell, Wilmington, Del., January 15, 1975 and Margaret Storey, Executive Vice President, Corporation Service Company, Wilmington, Del., January 16, 1975.

learn that new corporate filings had dropped 19 percent in the first six months of 1963.¹⁵⁶ Corporation franchise taxes declined to a mere 6.6 percent of Delaware's total state revenues. Dukes and later Governor Elbert Carvel treated these developments with the seriousness of a nation facing a foreign threat. Explained Governer Carvel, the problem of corporation revenue is too important to get involved in "wrangling" or "partisan political hassels." ¹⁵⁷

After consultation with the Wilmington bar — which by the end of World War II had supplanted Wall Street as the guardian of the General Corporation Law — and corporation service company officials, Governor Carvel asked the legislature to appropriate \$25,000 to the Secretary of State to study and recommend revisions to Delaware's General Corporation Law. The legislature responded accordingly; the preamble to their law of December 31, 1963 being perhaps the most remarkably candid document in the history of corporate law:

Whereas, the State of Delaware has a long and beneficial history as the domicile of nationally known corporations; and

Whereas, the favorable climate which the State of Delaware has traditionally provided for corporations has been a leading source of revenue for the State; and

Whereas, many States have enacted new corporation laws in recent years in an effort to compete with Delaware for corporate business; and

Whereas, there has been no comprehensive revision of the Delaware Corporation Law since its enactment in 1898 [sic]; and

Whereas, the General Assembly of the State of Delaware declares it to be the public policy of the State to maintain a favorable business climate and to encourage corporations to make Delaware their domicile....¹⁵⁹

Mindful of this resolution, Secretary of State Dukes appointed himself and nine others to a Delaware Corporation Law Revision Commission; the Commission's primary mission being "to ascertain what other states have to attract corporations that we do not have" and then recommend amendments to the existing law.

To say that the Revision Committee was "pro-management" is to put it mildly. The chairman of the Commission was C. A. Southerland

^{156.} Monthly compilations of Division of Corporations, Secretary of State, Dover, Del.

^{157.} Wilmington Morning News, March 5, 1963.

^{158.} Comment, Law for Sale: A Study of the Delaware Corporation Law of 1967, 117 U. Pa. L. Rev. 861 (1969).

^{159.} Quoted in Id. at 861.

who bracketed twelve years of service as Chief Justice of the Delaware Supreme Court with a somewhat more lucrative practice as senior partner and then of counsel to Delaware's largest corporate law firm, Potter, Anderson, and Corroon. S. Samuel Arsht, Henry Canby, Richard Corroon, and Daniel Herrmann were likewise senior partners in corporate law firms. Indeed, they were the leaders of the Wilmington corporate bar. Alfred Jervis and David Jackman were the chief executives of two of the largest corporation service companies. Mrs. Margaret Storey was head of the Corporation Department in the Secretary of State's office. Her full-time job was incorporating companies — as was Elisha Dukes' primary job as Secretary of State. Only the tenth member of the Commission, Irving Morris, was an exception. He was on the Commission in his capacity as a plaintiff's lawyer, since he handled a large percentage of shareholder derivative suits brought in Delaware. 160

The Commission subsequently delegated its authority to a three man drafting committee composed entirely of active corporate lawyers. They were: Richard F. Corroon, senior partner in Potter, Anderson, and Corroon, a law firm whose clients included the Pennsylvania Railroad, the Corporation Trust Company (the largest corporation service company in Delaware), Prudential Life Insurance Company, Metropolitan Life Insurance Company, and the Insurance Company of North America; S. Samuel Arsht, a senior partner in Morris, Nichols, Arsht, and Tunnell, a law firm whose clients included Allis-Chalmers, Christiana Securities (a DuPont holding company), Coca Cola, E. I. DuPont de Nemours & Co., Ford Motor Co., International Latex Corp., Kaiser Aluminum & Chemical Corp., Texaco, United Air Lines, and Warner Bros.-Seven Arts; and Henry M. Canby, a senior partner in Richards, Layton & Finger, a law firm whose clients included General Motors, Aetna Group, Getty Oil, and Shell Oil. 101

The Drafting Committee assumed "full responsibility" for the statute. Although the full Revision Committee had hired Professor Ernest F. Folk to serve as Reporter, the Drafting Committee felt free to reject Folk's recommendations and fully excluded Folk from their deliberations. No such bar precluded this nation's largest corporations. A vigorous correspondence was conducted with leading corporate law firms including New York City's White & Case, Dewey, Ballantine, and Cravath, Swaine, and Moore; and directly with such corporations

^{160.} Id. at 864-65.

^{161.} Id. at 864-65. This point is controverted in Arsht's history, 1 Del. J. Corp. L. at 15-17.

^{162.} Id. at 865-69.

as General Foods and Shell Oil Co., among 125 others. 103 Not only did these letters welcome suggestions, they also "publicized" what one member of the Revision Committee referred to as "the serious effort being made to attract corporations" to Delaware. This publicity proved very effective. Even before the revised statute was written, U. S. Steel Corporation — citing the good business climate — re-incorporated in Delaware, a new client for Morris, Nichols, Arsht, and Tunnell.

Ultimately, the revisions to the Delaware General Corporation Law, the most influential business statute in the country, the closest thing we have to a national corporate law, were drafted in the law office of one S. Samuel Arsht. 164

As Richard Corroon put it, the Revision Committee expected "very little, if any, trouble in the Delaware General Assembly." And for good reason. It is difficult to imagine a less likely body to draft a national corporation law than the Delaware legislature. To this day, the General Assembly serves as a part-time legislature meeting no more than 70 days a year, normally in half-day sessions. Legislators have no secretaries, no staff, and invariably supplement their \$6,000 yearly salary with outside "full time" jobs.

"Simply stated," a commentator wrote about the 1967 Revision Act,

the Commission never expected the legislature to do anything with this law except pass it. One member of the Commission referred to the legislature as 'just a bunch of farmers.' Corroon did attend a caucus of Democratic senators and Canby did attend a caucus of Republican senators. But Corroon was out in fifteen minutes, Canby in three, and neither was asked any questions about the law. 166

The bill was passed unanimously and became effective on July 3, 1967. It was an immediate financial success. According to the January 12, 1969 New York Times,

Delaware began chartering new companies at a record-breaking clip after it revised and liberalized its corporation laws to meet modern needs. Before the revisions were made in July 1967, Delaware was signing up new corporations at an average of 300 a month. . . . [Delaware is now] chartering new corporations at a record rate of 800 a month. . . .

^{163.} Id. at 867-68.

^{164.} Id. at 867-69.

^{165.} R. Corroon, The Proposed New Delaware Corporation Statute, 20 J. LEGAL Ep. 522 (1968). 166. Comment, supra note 158, at 869.

The article concluded with Secretary of State Dukes' statement, "The franchise tax will bring the state about \$21 million in the fiscal year ending June 30." ¹⁶⁷

That was just the beginning. By 1971 corporation franchise taxes and related corporate income represented \$55.5 million out of \$246 million in state revenue collections, approximately 23 percent of the total — the result of a stampede of the leading industrial corporations to Delaware. Of *Fortune* magazine's 1000 largest industrial corporations, 134 reincorporated or incorporated for the first time in Delaware in the years 1967-1974. This meant that by late 1974, Delaware was "home" for 448 of the 1,000 largest corporations — including 52 of the largest 100, and 251 out of the largest 500. These 448 corporations accounted for over 52 percent of the sales of the largest 1,000 manufacturers. 169

A 1974 Report to the Governor of Delaware further highlighted the special relationship between Delaware and the largest corporations. Although Delaware had chartered 76,000 corporations by June, 1974, franchise tax revenues received from the largest 556 corporations equalled 64 percent of all franchise tax revenues; revenues received from the largest 950 corporations equalled nearly 80 percent of the total.¹⁷⁰ Yet the language of Delaware's statute alone cannot fully explain such success. Since 1967, several states including Georgia, Maryland, New Jersey, Ohio, Pennsylvania, Tennessee and Virginia have duplicated some or all of the key provisions of the Delaware statute. As the American Bar Association's Model Business Corporation Act Annotated documents, there is presently little difference between the revised Delaware general corporation law and the statutes employed by New York, Ohio, New Jersey and Pennsylvania - the four runners-up in the large industrial firm incorporation business or the American Bar Association's Model Business Corporation Act which serves as a model for approximately twenty other states.

True, the speed with which Delaware adopted additional "technical" amendments in 1969, 1970, 1973, and 1974 may give corporate executives confidence that as soon as further "liberalizations" of corporate law are conceived, Delaware will be among the first states — if not the first state — to promulgate them. But, Delaware's decisive

^{167.} New York Times article quoted in Id. at 890-91.

^{168.} See Constitutionalizing, supra note 26, at 535-38.

^{169.} Id. at 501-05.

^{170.} Governor's Franchise Tax Study Committee, Final Report to the Governor 6 (1974).

advantage is not her statute alone, but rather the manner in which her judiciary interprets it.

Specifically, court decisions since 1957 have established that:

- * Apparently Delaware imposes no fiduciary duty on the part of officers or directors or majority shareholders in buying stock from the minority or individual stockholders. Cf. Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317 (5th Cir.), cert. denied, 361 U.S. 885 (1959).
- * Delaware grants incumbent management a near unlimited power to cause their corporation to re-purchase its own shares to avoid a take-over by a rival group even when this prevents shareholders from effectively exercising their right to choose between competing management groups. Cf. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964).
- * The Supreme Court of Delaware would not enjoin the dissemination of false and misleading proxy materials, dismissing the issue with the airy statement, "We agree with the chancellor that it would have been preferable to state all the facts." American Harware Corp. v. Savage Arms Corp., 37 Del. Ch. 59, 136 A.2d 690 (1957).
- * The shareholders' age-old appraisal right, or right to sell their shares back to the corporation before it consummates a merger which will substantially alter the character of the corporation the shareholders invested in, has been eliminated for all corporations if the consolidation is formally labelled a "sales of assets." Hariton v. Arco Electronics, Inc., 41 Del. Ch. 74, 188 A.2d 123 (1963).
- * Delaware has consistently refused to protect the rights of minority shareholders in a subsidiary corporation, deferring instead to the "business judgment" of the executives of the parent corporation. See Chasin v. Gluck, 282 A.2d 188 (Del. Ch. 1971); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. Ch. 1971); Getty Oil Co. v. Skelley Oil Co., 267 A.2d 883 (Del. Ch. 1970).
- * Delaware has furthered the decline of the board of directors by refusing to hold directors responsible for knowing or learning about criminal price-fixing practices occurring in the corporation they supposedly manage. See, e.g., Graham v. Allis-Chalmers Manufacturing Co., 40 Del. Ch. 335, 182 A.2d 328 (Ch. 1962), aff'd. 41 Del. Ch. 78, 188 A.2d 125 (1963).

These decisions so outraged Professor William Cary, a former chairman of the Securities and Exchange Commission and author of a leading casebook on corporate law that he published a case by case analysis of Delaware's "deterioration of corporate standards" in the *Yale Law Journal* of March 1974.¹⁷¹ "Perhaps," Cary reasoned, "there

^{171.} Cary, supra note 154. Professor Cary's article has been sharply criticized by the Wilmington corporate bar. See, e.g., D. Drexler, Federalism and Corporate Law:

is no public policy left in Delaware corporate law except the objective of raising revenue... consciously or unconsciously, fiduciary standards and standards of fairness generally have been relaxed. In general, the judicial decisions can best be reconciled on the basis of a desire to foster incorporation in Delaware." In no state is the Supreme Court so dominated by members of the corporate bar. By examining Who's Who in America and the Martindale-Hubbell Law Directory, Professor Cary determined that three of the seven men who served as Justice or Chief Justice of the Delaware Supreme Court between 1951–1973 (Messrs. D. F. Wolcott, C. A. Southerland, and D. L. Herrmann) had previously been senior partners in corporate law firms. A fourth (J. M. Tunnell, Jr.) left the bench to join a corporate law firm. A fifth (C. L. Terry) was a leading supporter of the 1967 Revision Statute during his term as Governor. 1773

This led Professor Cary to the conclusion that the Supreme Court of Delaware lacked sufficient independence or impartiality to judge corporation litigation. Noting that the United States Supreme Court in Ward v. Village of Monroeville, Ohio¹⁷⁴ had held that a petitioner "is entitled to a new trial and detached judge in the first instance," where he had been fined for a traffic violation before a mayor who also had responsibilities for revenue production, Cary argued:

By analogy, the State of Delaware derives a substantial portion, roughly one quarter, of its income from incorporation fees and franchise taxes; in the words of one of its Law Revision Commission members, 'The Franchise Tax dollar is very important... [;] That is one of the reasons for the formation of this committee — to modernize and liberalize the Delaware Corporation Law.' Thus both the courts and the legislature may be said to lack the neutrality and detachment 'to hold the balance, nice, clear, and true,' required in passing upon the complaints of shareholders.¹⁷⁵

Professor Ernest Folk seems to agree. In his view the deterioration of state statutory and decisional corporate law has largely ended its utility. In a 1972 speech, delivered just five years after Folk served

A Misguided Missile, 3 Sec. Reg. J. 374 (1976). It has also been enthusiastically supported. See, Proceedings, The Airlie House Symposium, An In-Depth Analysis of the Federal and State Roles in Regulating Corporate Management, 31 Bus. Law. (1976).

^{172.} Id. at 670.

^{173.} Id. at 690-92.

^{174. 409} U.S. 57 (1972).

^{175.} Cary, supra note 154, at 697-98.

as Reporter for the 1967 Delaware Revision statute, the Professor summarized the need for a new federal corporations law:

State corporation law — both statutory and case law — has seen its day. Statutes have become so broad and sweeping that they let a corporation do just about anything it wants. A modicum of legal skill and common sense enables management to do its will, and to plan around — not to say evade — what few restrictions state law contains. The business judgment rule lets management make drastic and costly mistakes, and the law of fiduciary duty is perceptibly weakening. The devices to control are inefficient: derivative suits sometimes help, but they are only occasional, accidental and full of procedural pitfalls and difficulties. State law has let corporations become a law unto themselves. The interests of shareholders receive weak protection. There is a disposition to say: get out if you don't like management. State law has largely made management responsible to itself, and left management with the power to perpetuate itself in office, short of a proxy fight or a takeover bid. In short, state law does not and cannot exert any real controls. Corporation statutes and most judicial decisions largely tend to reflect the interests and orientation of management, or, to use another popular term, insiders.

If the statute contains some limitations or restrictions, it will be said that these were unintended; and it is likely that they will be eliminated by a statutory amendment. If a judicial decision is restrictive, this is apt to be overturned. In fact the courts tend with some exceptions not to be very restrictive since the policy embodied in most state corporation statutes today is one of great leniency. The watchword for years has been flexibility.

In short, state law has abdicated its responsibility. As a result, so the argument must run, only federal law can handle the situation, and a massive infusion of federal legislation is needed . . . 176

Conclusion

The "pro-management" bias in corporate law-makers in Delaware should not be exaggerated. To ascend to the bench from a corporate firm, or to help draft a statute while representing corporate clients, does not alone guarantee a partisan or meretricious viewpoint. The motives of attorneys and the judiciary, no doubt are various. But I meant by this brief sketch of Delaware's General Corporation Law to outline general tendencies of the law making process in Delaware. Elsewhere, I and co-authors, Ralph Nader and Mark Green, have published a detailed description of the present Delaware law of cor-

^{176.} E. Folk, Does State Corporation Law Have a Future?, J. Ga. S.B., February 1972, at 311-12.

porate governance.¹⁷⁷ That work describes the economic and social consequences of Delaware's present law.

Much additional research would need to be done before a full history of Delaware's General Corporation Law could be written. If time had permitted, I would have liked to have studied the relation of Delaware statutory revisions and court decisions to those in other states much more closely. I would have liked to have read the public statements of each of the major corporations which re-incorporated in Delaware at or around the time of the 1967 revisions. I would like to know more about how judges are appointed in Delaware. I would have liked to describe the relation of Delaware's law to federal court decisions in more detail.

Empirical research would have been particularly useful. Could the investor loss from recent improvident management decisions to merge or expand be quantified? How expensive is it to bring a cause of action in Delaware; relatedly, does this expense deter litigation? What is the relation between the state law of corporate governance and executive decisions on executive compensation, selection of general counsel and outside auditor, compliance with federal ameliorative statutes such as the Equal Employment Opportunity Act or pollution laws, and relations to others in the corporate community such as workers, suppliers, or neighboring communities?

Answers to these questions would deepen understanding of the significance of Delaware's corporation law. But there is a further question of even greater importance that should be posed. Who should study the empirical consequences of state corporation law: state bar association corporation committees or Congress and those affected by corporate law? What is most troubling about Delaware's General Corporation law is that this statute which affects all 215 million Americans is written by a handful of Wilmington attorneys unaccountable to anyone but their corporate clients. Even if one assumes their perfect good faith, a basic question remains. Is this really the way a law should be drafted in a democratic country?

^{177.} Supra note 26.