BRANDING THE SMALL WONDER: DELAWARE'S DOMINANCE AND THE MARKET FOR CORPORATE LAW

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INTRODUCTION

> "Here, corporate law is an industry that is important unto itself, and we know that if we are perceived as unfair, it matters."[1]
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> — *Vice Chancellor Leo E. Strine*

In the world of brands, Ritz-Carlton reflects luxury, Volvo reflects safety, iPod reflects cool,[2] and Delaware reflects "business friendly" among other key associations, such as judicial competence, apolitical decision making, flexibility, and understanding corporate complexity.[3] The Delaware brand is to corporate law what Google is to search engines.[4]

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1. John Gapper, *Capitalist Punishment*, FIN. TIMES (London), Jan. 29, 2005, at 16. ("The two key constituencies are stockholders and management, and we more or less go up the fairway because if we go up either side, it would hurt us.").

2. *See* Karen DeYoung, *The Pentagon Gets a Lesson From Madison Avenue; U.S. Needs to Devise a Different 'Brand' to Win Over the Iraqi People, Study Advises*, WASH. POST, July 21, 2007, at A1.

3. Delaware is home to 61% of Fortune 500 companies. HARRIET SMITH WINDSOR, DEL. DEP'T OF STATE, 2006 ANNUAL REPORT 1 (2006) [hereinafter 2006 ANNUAL REPORT], *available at* http://corp.delaware.gov/2006%20Annual%20Report%20with%20Signature%

Brands are of immense value in today's business environment and beyond.[5] Brands have been used to describe products (e.g., Coca-Cola),[6] people (e.g., Al Gore),[7] sports clubs (e.g., Manchester United),[8] countries (e.g., Australia),[9] states (e.g., Florida),[10] and

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20_2_.pdf. More than 70% of all initial public offerings ("IPOs") on U.S. exchanges in 2006 were incorporated in Delaware. *Id.*; *see also* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 350 (2001) ("The aggregated choices of a majority of publicly traded U.S. corporations have resulted in a convergence on the Delaware General Corporation Law as a de facto national corporate law."). William T. Allen, Former Chancellor of the State of Delaware, describes Delaware's preeminence:

> My speculation is that the entrepreneurs and venture capitalists that choose Delaware have it right. The IPO market and the secondary market trust the system of the Delaware corporation law to be systematically fair. That, of course, doesn't mean that all market participants will approve each element of the system—or each court ruling or statutory amendment. Any particular decision may generate disagreement, disapproval or dissent, but year upon year the system taken as a whole plausibly balances deference to management's need for broad discretion in deploying the firm's capital with protection of shareholder basic interest . . . . In doing so, Delaware law provides an outstanding public service to the nation.

William T. Allen, *Whence the Value-Added in Delaware Incorporation?*, CORP. EDGE, (Div. of Corp., Dover, Del.), Fall 1997, at 3, 3 (on file with author). The *Corporate Edge* was a quarterly newsletter published by the Delaware Department of State's Division of Corporations. The newsletter went out of print in 2001.

4. *See* STEPHEN M. BAINBRIDGE, THE COMPLETE GUIDE TO SARBANES-OXLEY: UNDERSTANDING HOW SARBANES-OXLEY AFFECTS YOUR BUSINESS 21 (2007) (referring to Delaware as the Michael Jordan of corporate law). According to a recent *Financial Times* and Millward Brown Optimor study, Google is the top global brand. MILLWARD BROWN OPTIMOR, 2007 BRANDZ: TOP 100 MOST POWERFUL BRANDS 10, *available at* http://www.scribd.com/doc/36187/Millward-Brown-Optimor_BRANDZ-Top-Brand-Ranking-Report; John Gapper, *Global Brands: Companies Feel Benefit of Intangibles*, FIN. TIMES (London), Apr. 23, 2007, at 1. Other brands making up the top five include General Electric, Microsoft, Coca-Cola, and China Mobile. OPTIMOR, *supra* at 10.

5. *See* RITA CLIFTON ET AL., BRANDS AND BRANDING 28–30 (2003) (providing graphs from studies intended to show the contribution of brand value to share price); Gapper, *supra* note 4, at 1 (asserting the "proportion of intangible assets to shareholder value at Fortune 500 companies has steadily risen, from about 50 per cent in 1980 to 70 per cent today"). The ratio of brand value to share price may change from company to company and industry to industry. *See* CLIFTON ET AL., *supra*, at 28–30.

6. *See* INTERBRAND, BEST GLOBAL BRANDS 2006, at 11 (listing Coca-Cola as the number one global brand), *available at* http://www.ourfishbowl.com/images/surveys/BGB06Report_072706.pdf.

7. *See* Ellen McGirt, *Gore*, FAST COMPANY, July/Aug. 2007, at 71 (describing "how an epic loser engineered what may be the greatest brand makeover of our time").

8. Manchester United is one of the world's most popular sports brands. *See* Paul Hetherington, *Football: Armed Raids as Reds Go to War on Fakes*, SUNDAY MIRROR (London), July 22, 2001, at 60–61, *available at* http://findarticles.com/p/articles/mi_qn4161/is_20010722/ai_n14535046 (citing MORI poll finding Manchester United has over fifty million fans world-wide).

9. THE ANHOLT NATION BRANDS INDEX 4 (2007), *available at* http://www.nationbrandindex.com/documents/NBI_Q2_2007.pdf [hereinafter ANHOLT NATION BRANDS INDEX] (finding that Australia has the 8th nation brand in the world).

cities (e.g., Las Vegas and Paris).[11] In the market for corporate charters, Delaware, particularly its legal regime, is a brand. The Small Wonder's preeminence in the market for corporate charters has lasted for nearly a century and Delaware shows no sign of relinquishing its dominance.[12] Traditional accounts of Delaware's

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10. *See id.* at 6. *See* ANHOLT STATES BRAND INDEX, HOW THE WORLD SEES THE STATES 5 (2006) (finding California and Florida are the top two "state brands" as seen by the world).

11. *See generally* KEVIN LANE KELLER, STRATEGIC BRAND MANAGEMENT: BUILDING, MEASURING, AND MANAGING BRAND EQUITY 10–21 (1998) (describing the range of items that can be branded). There is even a journal dedicated to branding geographic locations. *See, e.g.*, David Gertner, Editorial, *Place Branding: Dilemma or Reconciliation Between Political Ideology and Economic Pragmatism?*, 3 PLACE BRANDING AND PUB. DIPL. 3, 4 (2007), *available at* http://www.palgrave-journals.com/pbljournal/v3/n1/full/6000053a.hml ("Positive brand images have helped many economies boost their exports, and attract investments, businesses, factories, visitors, residents and talented people."). Branding is a way for countries to improve upon a negative image or reinforce a positive perception. In Delaware's case, it is the latter scenario. Notwithstanding, it is possible for something with low quality to have significant brand loyalty. *See* DAVID A. AAKER, MANAGING BRAND EQUITY: CAPITALIZING ON THE VALUE OF A BRAND NAME 39 (1991). Experts note "[c]ountry brands have both intangible and tangible elements, such as the products or services of the particular country." György Szondi, *The Role and Challenges of Country Brands in Transition Countries: The Central and Eastern European Experience*, 3 PLACE BRANDING AND PUB. DIPL. 8,9 (2007), *available at* http://www.palgrave-journals.com/pb/journal/u3/n1/full/000044a.hml.

12. According to the Delaware Division of Corporations, more than 280,000 companies are incorporated in Delaware. Division of Corporations, Delaware Department of State, About Agency, http://www.corp.delaware.gov/aboutagency.shtml (last visited Mar. 29, 2008). Among these are 50% of all publicly traded companies and 60% of Fortune 500 companies. *Id.* It is also important to note that between 82 and 90% of relocating firms choose Delaware. *See* William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 718 (1998). Some commentators suggest that Delaware is not a monopolist. They contend that, if Delaware was a monopolist and the market for corporate charters was non-competitive, then one would expect Delaware to at least attract virtually all the corporate charters of large publicly held corporations. *Id.* at 726. But, the percentage of corporations in Delaware (i.e., only 50% publicly traded firms) is evidence of some degree competition. *But see* Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 579, 582 (2002) (contending that Delaware is a monopolist according to the Herfindahl Index used in the antitrust context). Perhaps the important question is whether Delaware's controlling approximately 50% market share creates enough market discipline to result in efficient or adequate law. This article does not address this question, in part, because of the skepticism concerning the use of competition as a proxy for optimal law. Although "monopoly" is simply a descriptive term for market power, it often has a negative association. *See* Ralph S. Brown, Jr., *Advertising and the Public Interest: Legal Protection of Trade Symbols*, 57 YALE. L.J. 1165, 1171 n.23 (1948) (noting the term "monopoly" has unavoidable negative associations).

"The Small Wonder" is a nickname for the state of Delaware due to its size, the contributions it has made to the country as a whole, and its beauty. Delaware Department of State, Delaware Facts and Symbols, Delaware Government, http://portal.delaware.gov/del facts/gov.shtml (last visited Mar. 29, 2008). Delaware ranks 49th in physical size among U.S. states and it is the 45th most populous state. THE WORLD ALMANAC 2008, at 559 (2008). Delaware has dominated other states in charter competition since the 1920s. As

dominance—race-to-the-bottom theories, race-to-the-top theories, and their progeny—provide an incomplete descriptive assessment of charter competition. Yet, the branding discussion provides an important missing chapter in the story of Delaware's sustained dominance. Unlike the proliferation of race theories over the past thirty years, active debate exploring the connection between branding[13] and Delaware's competitive advantage[14] in the corporate charter context is underdeveloped.

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early as 1899, Delaware had fashioned a general incorporation law, which allowed it to capitalize on the charter market when New Jersey renounced its role as the leading incorporation jurisdiction. The exodus of corporations from New Jersey to Delaware stemmed from Woodrow Wilson's election as Governor of New Jersey in 1910. Wilson's passage of employer liability legislation, known as the "seven sisters" legislation, led to the exodus. Notably, Wilson is also associated with progressive legislation during his presidency, such as the Clayton Act of 1914. *See* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 664–65 (1974) (describing Delaware besting New Jersey in the market for corporate charters); Christopher Grandy, *New Jersey Corporate Chartermongering, 1875-1929*, 49 J. OF ECON. HIST. 677, 688 (1989) (showing a graph depicting Delaware overtaking New Jersey in the market for corporate charters); E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163, 166–67 (2004) [hereinafter Veasey, *Center of Universe*] (describing the exodus of firms from New Jersey to Delaware).

13. *See* Victor Fleischer, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1582 (2006) [hereinafter Fleischer, *Brand New Deal*] (noting branding has received little attention from legal scholars outside of the trademark area); *see also* Shahar J. Dilbary, *Famous Trademarks and the Rational Basis for Protecting "Irrational Beliefs"*, 14 GEO. MASON L. REV. 605 (2007) (addressing branding in the trademark context); Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, 12 HARV. NEGOT. L. REV. 137 (2007) [hereinafter Fleischer, *MasterCard IPO*] (describing the branding effect of legal infrastructure); D. Gordon Smith, *The "Branding Effect" of Contracts*, 12 HARV. NEGOT. L. REV. 189 (2007) (discussing branding effects in the contractual context).

14. *See generally* Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998) (arguing indeterminate case law enhances Delaware's position in the charter market). Kamar's article offers the most developed discussion of competitive advantage in corporate law literature. He asserts that Delaware has several competitive advantages that other states find difficult to replicate. *Id.* at 1908. Moreover, Kamar argues that indeterminacy in Delaware's fiduciary duty case law enhances Delaware's market position. *Id.* In making the above claims, Kamar raises the possibility that Delaware uses its judge-oriented corporate law to stifle its rival jurisdictions. However, Kamar's account is not the only articulation of the indeterminacy principle. Ian Ayres identified a similar concept with respect to amendments of the corporate code:

> Among many legitimate motivations, Delaware may similarly be moved to enact innocuous and arbitrary amendments to its corporate law in order to generate additional rents and make its code more difficult to copy . . . . [T]he Delaware bar may prefer seemingly innocuous change that gives rise to additional litigation. New statutes often give rise to an initial wave of clarifying litigation so that the Delaware bar (much like the bluebook editors) may have an additional incentive to lobby for statutory change.

Ian Ayres, *Supply-Side Inefficiencies in Corporate Charter Competition: Lessons from Patents, Yachting and Bluebooks*, 43 U. KAN. L. REV. 541, 558 (1995); *see also* Douglas M.

A fair question one might ask is, "Why has branding been largely ignored in the discussion of Delaware's dominance?" The short answer is skepticism surrounding the branding concept. This skepticism is rooted in the belief that (i) consumers, with imperfect information, are duped into making decisions based upon intangible factors, and (ii) producers use branding to insulate their market share from price competition and create barriers to entry, which distort competition.[15] But, this view of branding is too negative, narrow, and paternalistic.[16]

The Delaware brand is more than mere marketing or advertising; it is a mixture of tangible and intangible elements that firms value.[17] The Delaware incorporation decision is the purchase of a branded product. The purchase of a branded product actually involves the purchase of two bundled products—a tangible product (i.e., physical product and performance characteristics) and an intangible product (i.e., psychological associations and perceptions related to what the brand represents, which may or may not relate to performance characteristics). Successful brands, in most cases, must reflect truth or risk being discredited.[18] For Delaware, this could mean corporate migration or federal preemption. This article does not focus on how Delaware actively works to cultivate its brand,[19] but simply acknowledges the undeniable im-

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Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 90–92 (1990) (describing the Delaware corporate bar and its influence on corporate law); Carney, *supra* note 12, at 724 n.40 (discussing how "uncertainty is income enhancing" for Delaware lawyers). Kamar's indeterminacy story simply switches the principal character from Ayres' story (the corporate bar) to the judiciary. Both accounts suggest "Delaware may have an incentive to differentiate its product for the sake of differentiation itself." Ayres, *supra* at 559; *cf.* Kamar, *supra* at 1911 ("Delaware can thus profit from adopting ambiguous legal standards, even if they render Delaware law suboptimal.").

15. *See* Fleischer, *Brand New Deal*, *supra* note 13, at 1630; *see also* Brown, *supra* note 12, at 1169, 1180–84 (adopting a narrow and negative view of branding).

16. This limited vantage point views branding as useful only to the extent it provides information concerning the product or service. Similarly, the economic purist would view information as the only useful function of branding. *See* Brown, *supra* note 12, at 1169 ("Most advertising [or branding], however, is designed not to inform, but to persuade and influence.").

17. *Cf.* Fleischer, *Brand New Deal*, *supra* note 13, at 1604 ("Branding . . . is more than marketing.").

18. *See* AAKER, *supra* note 11, at 97 (noting actual quality must translate into perceived quality).

19. Delaware's governmental actors, particularly the Delaware Secretary of State's Division of Corporations, actively market Delaware business formation within the United States and in overseas markets. *See* HARRIET SMITH WINDSOR, DEL. DEP'T OF STATE,

pact of branding effects on incorporation decisions and U.S. corporate governance.

As mentioned above, Delaware supplies a service or product that corporations demand[20] in the form of a package.[21] The incorporation decision can be described as the purchase of a state's corporate law regime.[22] Corporate managers, assisted by lawyers, usually determine where a company should incorporate. In the United States, the law of the state of incorporation, and not the operational headquarters, governs the internal affairs of the corporation.[23] In essence, the perpetuation of the internal affairs doctrine results from an informal arrangement between the federal government and the states because Congress has the ultimate authority over interstate commerce via the Commerce Clause.[24] Therefore, Congress, within its discretion, can preempt aspects of state corporate law.

The incorporation decision is akin to some form of cost-benefit calculus involving myriad criteria. The balance of such factors frequently leads firms to choose Delaware. Generally, the incorporation decision occurs in two scenarios: (i) new incorporations involving initial public offerings ("IPOs") and (ii) reincorporations involving mergers or other ownership changes.[25] Pre-IPO incorporations are relatively costless compared with after a firm goes

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DIVISION OF CORPORATIONS, 2005 ANNUAL REPORT 1 (2006), *available at* http://corp.delaware.gov/2005%20doc%20ar.pdf. ("Over the last five years, Governor Ruth Ann Minner, and I along with other Delaware officials, have logged tens of thousands of miles to share Delaware's incorporation story around the world, from North America to Europe to Asia."). Irrespective of whether state actors make a concerted effort to brand the jurisdiction, however, the effects are the same. Moreover, the strength of the Delaware brand arguably reduces the need to actively market the legal regime.

20. *See* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 228 (1985) [hereinafter Romano, *Law as a Product*].

21. The distinction between what constitutes a product or service experience is often blurred. One may take a stereo home, but not a restaurant. *See* CLIFTON ET AL., *supra* note 5, at 105–06.

22. Under this scenario, Delaware law provides the rules and the judicial system provides the procedures. Within this regime there are multiple actors, such as the judiciary, the corporate bar, and the Division of Corporations. This is an oversimplification, but useful nonetheless.

23. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (1971) referring to § 303. For example, although Coca-Cola's operational headquarters is in Georgia, its internal affairs are governed by Delaware law.

24. U.S. CONST. art. I, § 8, cl. 3.

25. *See* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1568–70 (2002) [hereinafter Daines, *Incorporation Choices*].

public.[26] Reincorporations generally require a vote by the shareholders and other regulatory requirements, such as the preparation of a proxy statement and sponsoring a general shareholder vote.[27] Studies reveal the incorporation decisions of publicly traded firms are not necessarily a choice between Delaware and fifty other jurisdictions, as traditionally envisioned by race competition theorists.[28] Instead, firms experience the more limited choice between Delaware and their home state, i.e., the site of principal operations.[29] Empirical studies show Delaware faces no formidable rival for incorporations of publicly traded firms, especially when firms decide to incorporate out-of-state.[30] Therefore, state competition for corporate charters is best described as a "leisurely walk" rather than a vigorous sprint.[31] The incorporation decision, like most purchase decisions, is seldom based upon total or perfect information. In product or service markets, competing firms produce products or services that have points of parity and points of differentiation.[32] In many cases, competing products share many of the same tangible features.[33] Even where a product's physical characteristics distinguish it from competing products, competing firms can, in most cases, replicate these tangible points of differentiation. As a result, many markets are characterized by a trend toward commoditization. Branding,

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26. Stephen P. Ferris, Robert M. Lawless & Gregory Noronha, *The Influence of State Legal Environments on Firm Incorporation Decisions and Values,* 2 J.L. ECON. & POL'Y 1, 10 (2006).

27. *Id.*

28. *See* Bebchuk & Hamdani, *supra* note 12, at 575; Daines, *Incorporation Choices*, *supra* note 25, at 1562.

29. *See* Bebchuk & Hamdani, *supra* note 12, at 575–76 (describing the impact of home-state bias). A number of studies have attempted to uncover why firms incorporate in their home state as opposed to incorporating out-of-state. Explanations for the home-state bias include, but are not limited to, local favoritism, lower transaction costs, and the preferences of law firms advising on IPOs. *See id.* at 573–74.

30. *See id.* at 566–67 tbls.1 & 2.

31. *See id.* at 554–55. The lack of significant market discipline does not adequately address the question of whether Delaware law is optimal.

32. Kevin Keller asserts "[p]oints of difference are those associations that are unique to the brand that are also strongly held and favorably evaluated by consumers." KELLER, *supra* note 11, at 116. Alternatively, "[p]oints of parity, on the other hand, are those associations that are not necessarily unique to the brand but may in fact be shared with other brands." *Id.*

33. *Id.* at 117. For example, cola drinks often share the same physical properties and components. Yet, Coke and Pepsi maintain significant market share.

however, offers a powerful point of differentiation and serves as a key decision-making heuristic.

Delaware's exceptional performance in the chartering market, like an individual firm in a product or service market, results from multiple sources of competitive advantage—particularly differentiation advantages.[34] The Delaware brand is a type of differentiation advantage, which explains Delaware's dominance and why Delaware's legal regime is not a commodity. If Delaware's legal regime were a commodity, one would expect firms to be indifferent to the regime and base their decisions on features such as price, convenience, and other tangible characteristics without a concern for the brand.[35] This is not the case in the state charter market where the Delaware brand creates a long-term competitive advantage. Facing a downward sloping (i.e., inelastic) demand curve, Delaware can extract a higher price or premium than other states in the charter market because of its brand.[36] These higher prices take the form of franchise taxes and attorney's fees.[37] Unlike other states, Delaware's corporate charter business operates as a profit center and is a significant part of Delaware's economic viability.[38] Delaware serves the high-end market segment of large publicly traded firms.

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34. Differentiation advantages are competitive advantages based upon the unique attributes of a service or product as opposed to a cost advantage. For a discussion of differentiation advantages, see discussion *infra* Part III.A.2.

35. *See* AAKER, *supra* note 11, at 39.

36. *See* Carney, *supra* note 12, at 726.

37. *Id.*

38. Franchise taxes range from a minimum of $35 to a maximum of $165,000. *See* Division of Corporations, Delaware Department of State, How to Calculate Franchise Taxes, http://corp.delaware.gov/frtaxcalc.shtml (last visited Mar. 29, 2008). As expected, large publicly held corporations, those with the most authorized shares, absorb most of the tax burden. *See id.* For over thirty years, the amount of franchise taxes as a percentage of total Delaware tax revenues has remained above 15%. Roberta Romano, *Competition for Corporate Charters and the Lasson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 845 (1993) [hereinafter Romano, *Competition for Corporate Charters.* Delaware's chartering business accounts for a significant percentage of state revenues. In 2006, business franchise taxes constituted approximately 16.2% of Delaware's state revenues. Specifically, franchise taxes accounted for $512.3 million of a total revenue of $3,169.9 million. *See* DIV. OF ACCOUNTING, DELAWARE DEP'T OF FIN., COMPREHENSIVE ANNUAL FINANCIAL REPORT 110, 136 (2006) [hereinafter COMPREHENSIVE ANNUAL FINANCIAL REPORT], *available at* http://accounting.delaware.gov/2006cafr.pdf. Including LLC/LP annual tax, business entity fees, and UCC fees, the Division of Corporations revenues amounted to $665.3 million in 2006. 2006 ANNUAL REPORT, *supra* note 3, at 2. This is 21% of total tax revenues. *See id.* Franchise taxes increased from $357.7 million in 1997 to $533.6 million in 2001, before falling slightly to $512.3 million in 2006. *See* COMPREHENSIVE ANNUAL FINANCIAL REPORT

Most of the debate surrounding Delaware's dominant position in state charter competition focuses on race-to-the-top versus race-to-the-bottom theories, en route to determining whether corporate federalism results in optimal corporate law.[39] As a general matter, race-to-the-top theories contend Delaware's success in the corporate charter market reflects the qualitative superiority of its law.[40] Race-to-the-top theories presume manager and shareholder interests converge in the long run because managers realize promoting shareholder wealth lessens the likelihood of bankruptcy and takeover, which threaten managerial incumbency. This model, of course, assumes an efficient market and the absence of other confounding factors.

Alternatively, race-to-the-bottom theorists assert that states, in order to attract incorporating firms, adopt minimum standards that limit manager accountability to the dismay of shareholders.[41] Due to these minimum standards, race-to-the-bottom theo-

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at 136. Meanwhile, the number of filers of franchise taxes increased from $216,735 in 1997 to $254,538 in 2001, before decreasing to $239,824 in 2006. *See id.*

39. *See generally* Cary, *supra* note 12, at 666 (asserting state competition is a race-to-the-bottom benefiting management, sometimes at the expense of shareholders, and that this state of affairs demands a greater federal role); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 256 (1977) (asserting state competition is a race to the top benefiting shareholders); *see also* Bebchuk & Hamdani, *supra* note 12, at 556 (asserting Delaware has a monopoly on out of state charters); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1064 (2000) (asserting Delaware sustains its advantage through judge-made corporate law); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN L. REV. 679, 684 (2002) [hereinafter Kamar, *Myth*] (asserting Delaware is the only state to truly compete for incorporations); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1208 (2001) (asserting Delaware employs price discrimination through franchise taxes and litigation-intensive substantive law); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1578 (2005) (asserting that Delaware and the federal government complement each other by working on the areas the other cannot regulate as effectively); Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2494 (2005) [hereinafter Roe, *Delaware's Politics*] (asserting the relationship between Delaware and federal actors is more important than any state-to-state race); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 590 (2003) [hereinafter Roe, *Delaware's Competition*] (asserting there can be no pure state-to-state race because of the threat of federal intervention).

40. *Cf.* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956) (predicting competition between states will lead to an efficient match between demands of citizens for public goods and public goods supported by the state).

41. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 557, 559 (1933) (Brandeis, J., dissenting in part) ("Lesser States, eager for the revenue derived from the traffic in charters, had removed safeguards from their own incorporation laws . . . . The race was one not of diligence but of laxity."); Cary, *supra* note 12, at 663 ("Delaware is both the sponsor and the victim of a system contributing to the deterioration of corporation standards. This un-

rists often argue further federalization is necessary to protect shareholder interests from managerial shirking. Federalization can take place in two ways: (i) via the creation of a federal chartering option or (ii) preemption via federal lawmaking, as is currently done.[42] Despite having different views concerning the optimality or sub-optimality of Delaware law, race theories attempt to explain, although incompletely, the motivations of lawmakers and corporate managers.[43]

This article, through an analysis of branding effects in the chartering market, offers a new paradigm to explain Delaware's sustained dominance. By addressing Delaware's value-producing activities in the aggregate—both tangible and intangible—this article provides novel insight into how companies approach their incorporation decisions. This article concludes that the strength of the Delaware brand has significant implications not only for Delaware and incorporating firms, but also for U.S. corporate governance.

Part I briefly addresses the limitations of existing corporate regulatory competition theories. This section argues existing regulatory competition theories tend to overstate the explanatory power of competition; understate the impact of intangible factors on incorporation decisions; and devalue or denigrate the judicial role by characterizing every decision by Delaware courts as defensive, calculating, rent-seeking, or opportunistic.

Part II demonstrates that the Delaware brand is one of the most important and most overlooked competitive advantages explaining Delaware's dominance. This article adopts a broad definition of "brand," which reflects both the tangible and intangible aspects of a product or service experience. This section argues the Delaware brand generates positive benefits for Delaware and incorporating firms. The benefits for incorporating firms may include psychological benefits independent of Delaware's tangible

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happy state of affairs stem(s) in great part from the movement toward the least common denominator . . . ."); *see also* Roe, *Delaware's Competition*, *supra* note 39, at 594–96 (explaining the race-to-the-bottom theory).

42. *See* Roe, *Delaware's Competition*, *supra* note 39, at 607–34 (discussing the displacement of state corporate law).

43. Recent theories explaining Delaware's dominance, like Mark Roe's political account of federal-state interaction, cast doubt on the explanatory power of traditional race theories. *See generally* Roe, *Delaware's Politics*, *supra* note 39.

performance characteristics. These intangible attributes have received less emphasis in the charter competition literature.

Part III first explains the operation of competitive advantage. There are two broad categories of competitive advantage—cost advantages and differentiation advantages. This article contends that differentiation advantages, such as the Delaware brand, play a pivotal role in incorporation decisions. Secondly, this section explores Delaware's multiple sources of differentiation advantage, which are tangible and intangible. Tangible elements of the Delaware legal regime include a flexible corporate statute; case law and precedent; a specialized and proficient court system; and a stable political climate. Outside of Delaware's judicial system (i.e., case law and judiciary) and its stable political climate, Delaware's tangible differentiation advantages can be replicated by rival jurisdictions. Delaware's intangible elements, however, are not easily replicated and include reputation, visibility to top management, time-in-business, customer lists, competitors, academic curriculum, and discursive debate. These tangible and intangible elements are the building blocks of the Delaware brand.

Finally, Part IV explores the implications of the branding story on the corporate regulatory competition debate. These implications are: (i) the branding discussion provides a more compelling account of Delaware's dominance than traditional theories; (ii) maintaining the strength of the Delaware brand, in part, depends on the perception that the Delaware judiciary engages in principled lawmaking; (iii) the Delaware brand is extremely durable and resilient, which enables Delaware to maintain its competitive edge even during periods of turbulence, as well as prevent extensive federal encroachment; and (iv) the strength of the Delaware brand contributes to the overall strength of U.S. corporate governance.

I. LIMITATIONS OF EXISTING EXPLANATIONS FOR DELAWARE'S PREEMINENCE

Delaware's dominance in the corporate charter competition gives rise to one incontrovertible fact: large publicly traded firms have, and continue to have, a strong preference for Delaware's legal regime. The crucial inquiry is "why?" Existing regulatory

competition theories, such as race theories and their progeny, provide some, but not all, of the answers to this vexing question.[44]

The first shortcoming of traditional theories of corporate regulatory competition is they provide an incomplete descriptive account of Delaware's dominance and overstate their explanatory value. Contrary to the assertions of both Delaware proponents and detractors, the presence or lack of competition provides neither a comprehensive qualitative assessment of Delaware corporate law nor a justification for federal intervention. The actual lack of robust competition undermines race-to-the-top theorists' claims that Delaware's law is dominant because it is the best on the market.[45] On the other hand, race-to-the-bottom theorists assume Delaware panders to management by adopting minimum standards at the expense of shareholders. The diversity of Delaware judicial decisions and empirical data, however, do not support this assumption either.[46] Thus, competition alone is not an

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44. *See Fisch*, *supra* note 39, at 1062 (discussing factors that weaken the explanatory power of regulatory competition theories. Factors that weaken the explanatory power of regulatory competition theories include: (i) minor differences in substantive law across jurisdictions; (ii) empirical analysis fails to demonstrate superiority or inferiority of Delaware law; and (iii) Delaware seems immune from competition. *See id.* With respect to the third factor one must consider the federal government as a potential threat. *See* Kahan & Rock, *supra* note 39, at 1584 (asserting Delaware is at the forefront of state-made corporate law and subject to change only if highly motivated parties act through Congress); Roe, *Delaware's Politics*, *supra* note 39, at 2499 (describing Delaware as leading other states in making corporate law, though there is the possibility of federal displacement).

45. *See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1767 (2006) [hereinafter Hamermesh, *Policy Foundations*]; *see also* Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 752 (1987) [hereinafter Romano, *State Competition*] (adopting a position close to Winter's position that state competition is beneficial); Winter, *supra* note 39, at 251–52 (asserting state competition is a race to the top benefiting shareholders); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 917 (1982) (asserting shareholders would not agree to incorporate in a state that was biased against them).

46. *See* Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 525 (2001) [hereinafter Daines, *Firm Value*] (finding higher Tobin's Q measurements for Delaware's corporations); Daines, *Incorporation Choices*, *supra* note 25, at 1560 (noting the impact of Delaware reincorporation on share price); Romano, *Competition for Corporate Charters*, *supra* note 38, at 848 (noting several studies have found positive price effects following Delaware incorporation); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32, 33 (2004) (finding statistical evidence that firms incorporated in Delaware were worth more than non-Delaware firms between 1991-1996, but that this trend subsided after 1996); Allen, *supra* note 3, at 3 (asserting that reincorporation normally results in an immediate increase in stock price). *But see* Lucian Bebchuk, Alma Cohen & Allen Ferrel, *What Matters in Corporate Governance?*, (Harvard Law Sch. John M. Olin Center, Discussion Paper No. 491, 2004) [hereinafter Bebchuk, Cohen & Ferrel, *What Matters?*], *available at* http://ssrn.com/abstract=593423 (finding six pro-entrench-

adequate proxy for the substantive superiority or inferiority of Delaware corporate law. Scholars continue to struggle with the question of whether Delaware corporate law is substantively superior to other jurisdictions. As a result of the difficulty in ascertaining the substantive superiority of Delaware corporate law, there has been a proliferation of non-substantive theories to explain Delaware's preeminence.[47] The answer to the substantive question of quality is complicated because it depends on a number of variables, including: (i) the type of corporate decision at issue—ownership, enterprise, and oversight;[48] (ii) the observer's vantage point—i.e., management, shareholders, institutional shareholders, creditors, or other stakeholders; (iii) the desired policy value—efficiency or fairness; (iv) inter-temporal considerations—short-term versus long-term impact on business value; and (v) the lack of consensus on interpretive methodologies used by judges—formalism, pragmatism, or legal realism. At a minimum, Delaware's dominance reflects a clear preference for its brand and a degree of congruence between the values embodied in its law and business values. But, business values alone (e.g., efficiency) do not equate to optimal law. The branding account of state charter

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ment aspects of corporate governance have a negative effect on shareholder value).

47. *See* Fisch, *supra* note 39, at 1062–64; *see also* John C. Coffee, Jr., *The Future As History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U.L. REV. 641, 703 (1999) (describing a herding theory for analyzing Delaware's preeminence); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 469 (1987) (describing an interest-group theory for analyzing Delaware's preeminence); Roberta Romano, *Corporate Law and Corporate Governance*, 5 INDUS. CORP. CHANGE 277, 277–79 (1996) [hereinafter Romano, *Corporate Law*] (describing a transaction cost method for analyzing Delaware's preeminence). Interest-group theories assert that rent-seeking interest groups make calculated moves to attract charters. These theories contend interest group concerns are outcome determinative. Some commentators assert that any movements by Delaware courts are due to the threat of federal intervention. *See* Roe, *Delaware's Competition*, *supra* note 39, at 591–92; Roe, *Delaware's Politics*, *supra* note 39, at 2494; *see also* Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 7–8 (2005) (asserting the duty of good faith evolved in the "*sturm und drang* in corporate governance" after the public scandals of Worldcom, Enron, and Tyco brought into question the current American corporate governance model).

48. *See generally* E. Norman Veasey, *The Defining Tension in Corporate Governance In America*, 52 BUS. LAW. 393, 394 (1997) [hereinafter Veasey, *Defining Tension*] (discussing the types of decisions Delaware courts address, which include enterprise, ownership, and oversight decisions). Enterprise decisions are standard decisions made by management, such as the decision to build a foreign production plant or what products to produce. *See id.* Ownership decisions involve ownership changes, such as mergers, acquisitions, and corporate takeovers. *See id.* Oversight decisions concern managers' monitoring role, such as ensuring employees execute their responsibilities in compliance with the law. *See id.* Delaware common law duties reflect an attempt to balance corporate efficiency with equitable principles.

competition acknowledges that different stakeholders may perceive the Delaware brand differently based upon their own needs and agendas.[49] In short, the branding account of Delaware's domination is an intermediate theory, which resides between accounts of efficient competition and accounts citing other determinants, such as politics, history, and interest groups.

Secondly, existing explanations for Delaware's dominance focus on tangible institutional factors, such as Delaware's court system, to the exclusion of intangible factors, such as reputation and customer lists. Therefore, existing approaches underestimate the role intangible attributes of Delaware's legal regime play in firm incorporation decisions. It is the interaction of tangible and intangible attributes that account for Delaware's sustained dominance and create the unique Delaware brand.

Finally, theories of corporate regulatory competition have a tendency to underestimate the prospect of principled judicial lawmaking. In the search for an alternative explanation for Delaware's sustained dominance—such as the threat of federal intervention, corporate migration, tax revenues, interest groups, or politics—there is a tendency to minimize the role of principled judicial lawmaking.[50] Principled lawmaking occurs when Delaware judges analyze the complex cases before them, acknowledge precedent, and balance competing values, such as efficiency, equity, authority, and accountability.[51] This process is apolitical and

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49. *See* CLIFTON ET AL., *supra* note 5, at 81.

50. But, all moves made by Delaware courts cannot be defensive. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 372–73 (Del. 2006) (deciding not to take a prescriptive or proscriptive approach to corporate legal compliance in contrast to Sarbanes-Oxley reforms at the federal level); *see also* Hamermesh, *Policy Foundations*, *supra* note 45, at 1770 n.93 (noting that the Delaware Supreme Court's remand of Brehm v. Eisner, 746 A.2d 244 (Del. 2000) predated Enron).

51. E. Norman Veasey describes the Delaware approach:

> The enabling model, patterned after the Delaware approach, is based on a few fundamental statutory guideposts and latitude for private ordering, with primary reliance on self-governance centered around judicial decisionmaking in applying fiduciary duties to fact-intensive settings.
>
> A word of caution is that the judge-made law must not be of a free-wheeling or ad hoc quality. It must involve a disciplined and stable stare decisis analysis based on precedent and a coherent economic rationale. The private ordering aspect of it must provide ex ante the contractual stockholder protections deemed important, as distinct from ex post judicial rewriting of the contractual framework.

E. Norman Veasey, *Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2179–80 (2001) [hereinafter Veasey, *Aspirations*]; *see also* Kahan & Rock, *supra* note 39, at 1612 (describing Delaware

earnest. Any model of corporate regulatory competition must acknowledge that every movement or decision by the Delaware judiciary (i.e., the Delaware Court of Chancery and the Delaware Supreme Court) is not defensive, calculating, rent-seeking, or opportunistic. Whether or not one agrees with a particular decision should not color the entire perception of Delaware's legal regime and its judicial actors. William Cary's seminal race-to-the-bottom article asserted the Delaware judiciary was conflicted and could not be expected to deliver objective and independent pronouncements.[52] Cary's view is too negative. Maintaining the strength of the Delaware brand is contingent on the perception of a Delaware judiciary engaged in principled lawmaking. Otherwise, a perception of strong judicial bias would raise the threat of federal preemption. For this reason, principled judicial lawmaking is an indispensable element of the Delaware brand and brand maintenance provides positive incentives for Delaware legal actors.[53]

II. THE DELAWARE BRAND

If one were to poll MBA students around the country and ask them the simple question, "If you want to incorporate a business, where do you do it?," many students would answer Delaware "because it is business-friendly and most publicly traded companies choose to incorporate there." But, Delaware is not the only business friendly jurisdiction, nor is it, according to some accounts, the most business friendly.[54] Notably, the same group of students would not be able to provide a detailed account of Delaware's unique features.[55] This basic illustration reflects the importance of perception and the role intangibles play in the decision-making process. These widely held perceptions illustrate that Delaware's legal regime has brand status. Yet, the Delaware brand is one of the most important and most overlooked differentiation advan-

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judge-made law as technical and apolitical because it is created by experienced appointed judges rather than through legislative and political processes).

52. *See* Cary, *supra* note 12, at 670.

53. *See* discussion *infra* Part II.B.3.

54. *See generally* Ferris, Lawless & Noronha, *supra* note 26, at 8 (acknowledging that Delaware does not have the highest legal environment measure ("LEM") score, which is used to indicate a state's reputation for timely response to new developments in corporate law).

55. *See* discussion *infra* Part III.

tages explaining Delaware's dominance. This section explores the importance of branding in the corporate charter context.

A. *Toward a Definition of Branding*

Although "branding" is important to business strategy and is a popular term in the business lexicon, it has received only minor consideration by legal scholars, particularly in the corporate governance context.[56] Nonetheless, branding concepts are applied to a range of items from geographical locations to persons. In addition, numerous studies illustrate how brands allow firms to secure high profits and sustain customer demand.[57] Despite its undeniable importance, branding, at times, seems like an amorphous concept without a precise definition.[58] In a narrow sense, branding describes advertising, marketing activities, and intangible assets like trademarks and other intellectual property. This narrow perspective underestimates the broader impact of branding. Such a narrow view can also lead to the formation of a negative view of branding as synonymous with opportunistic behavior, which preys upon customer information asymmetries. This negative view is misconceived and misplaced in the corporate charter context.

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56. *See, e.g.*, Fleischer, *Brand New Deal*, *supra* note 13, at 1582–83, 1588–89. Victor Fleischer is the only legal scholar to offer significant discussion of branding effects in the corporate law context.

57. *See* CLIFTON ET AL., *supra* note 5, at 27–30.

58. *See* THE OXFORD ENGLISH DICTIONARY 488 (J.A. Simpson & E.S.C. Weiner eds., 2d ed. 1989) (defining brand as "the impression of a product in the minds of potential users or consumers"); THE RANDOM HOUSE DICTIONARY 254 (Stuart Berg Flexner ed., 2d ed. 1987) (defining brand as "kind, grade, or make, as indicated by a stamp, trademark, or the like" and "a kind or variety of something distinguished by some distinctive characteristic"); WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 268 (Philip Babcock Gove ed., 1993) (defining brand as "a class of goods identified as being the product of a single firm or manufacturer"); *see also* CLIFTON ET AL., *supra* note 5, at 13 (providing two more definitions of brand). Brands are not just difficult to define. Their impact is difficult to measure. *See id.* at 28–29; *see also* AAKER, *supra* note 11, at 21–26 (describing five different tests for measuring the value of a brand); V. Srinivasan, Chan Su Park & Dae Ryun Chang, *An Approach to the Measurement, Analysis, and Prediction of Brand Equity and Its Sources*, 51 MGMT. SCI. 1433, 1434 (2005) (asserting brand value can be measured by examining three factors: brand awareness, attribute perception biases, and nonattribute preference).

In a broad sense, branding describes a range of elements that form a complete service or product experience.[59] The branding concept has traditionally focused on points of differentiation, i.e., unique benefits, which set a product or service apart from the competition.[60] According to Michael Porter, branding is a "higher-order" competitive advantage.[61] Higher-order advantages like branding require more "advanced skills and capabilities such as specialized and highly trained personnel, internal technical capability, and, often, close relationships with leading customers."[62] This article adopts a broad definition of branding, which views the purchase of a branded product as the purchase of two bundled products—a tangible product (i.e., physical product) and an intangible product (e.g., psychological associations and perceptions related to what the Delaware brand represents, which may not relate to tangible features).[63] Kevin Keller provides the following insights on brands:

> A brand is a product but one that adds other dimensions differentiating it in some way from other products designed to satisfy the same need. These differences may be rational and tangible—related to product performance of the brand—or more symbolic, emotional, or intangible—related to what the brand represents.
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> . . . .
>
> The key to branding is that consumers perceive differences among brands in a product category.[64]

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59. *See generally* Natalie Mizik & Robert Jacobson, *Talk About Brand Strategy*, HARV. BUS. REV., Oct. 2005, at 24, 26 (discussing the effect of brand differentiation); Roland T. Rust, Valarie A. Zeithaml, & Katherine N. Lemon, *Customer-Centered Brand Management,* HARV. BUS. REV., Sept. 2004, at 110, 116–17 (explaining that customer equity is made of value equity, brand equity, and relationship equity, and examining the drivers of brand equity); Kirsten D. Sandberg, *Building Brand: A Road Map*, HARV. BUS. REV., July 2001, 9, 9 (discussing the importance of customer awareness and experience in branding).

60. *See* Kevin Lane Keller, Brian Sternthal & Alice Tybout, *Three Questions You Need To Ask About Your Brand*, HARV. BUS. REV., Sept. 2002, at 80, 81 [hereinafter Keller, *Three Questions*]. Brand studies show that the most important predictor of new product success and broad product awareness is having a point of differentiation. *See* AAKER, *supra* note 11, at 158; *see also* Brown, *supra* note 12, at 1177 ("A differentiated brand, like a patent, a secret process, control over distribution channels, or control of raw materials, is a safeguard against the risks of competition.").

61. *See* MICHAEL E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS 50 (1990) [hereinafter PORTER, NATIONS].

62. *Id.*

63. *Cf.* Dilbary, *supra* note 13, at 607–09 (asserting customers receive three bundled products when purchasing a branded product).

64. KELLER, *supra* note 11, at 38 (emphasis added).

Some brands create competitive advantage primarily through product and technological innovation (e.g., Sony),[65] whereas other brands create competitive advantage predominately through non-product-related factors (e.g., Gucci).[66] In the latter category, intangible image associations differentiate the product and, in certain cases, may be the only significant distinguishing feature in a specific product category.[67]

By analogy, Delaware's ability to provide a unique branded customer experience explains its dominance and favor among large publicly traded firms. Delaware's brand equity is tied both to tangible aspects of its service and to various intangible factors.[68] Firm perceptions of the Delaware brand may be created unintentionally or intentionally.[69] Irrespective of whether Delaware proactively attempts to build its own brand, the effects are the same.[70]

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65. Examples of Sony innovation include the Sony Walkman and Playstation. Sony invests in product development and technology.

66. *See* KELLER, *supra* note 11, at 5. Gucci relies heavily on luxury branding and image to differentiate its products.

67. *See id.*

68. *See* Kevin Lane Keller, *The Brand Report Card*, HARV. BUS. REV., Jan. 2000, at 147–48 [hereinafter Keller, *Brand Report Card*] (asserting brands provide a product, but also an image, a service, and many other tangible and intangible factors). David Aaker defines brand equity as a "set of brand assets and liabilities linked to the brand—its name and symbols—that add value to, or subtract value from, a product or service. These assets include brand loyalty, name awareness, perceived quality, and associations." AAKER, *supra* note 11, at 269. According to David Aaker, there are multiple dimensions of brand equity: brand loyalty, awareness, perceived quality, and associations. *Id.* at 17–20 (explaining various elements of brand equity). These dimensions are often interconnected. Perceived quality reflects the idea that a product's visibility is the result of quality. *See id.* at 18. Associations reflect the idea that a visible spokesperson or symbol would only endorse or reflect a quality product. *Id.* Awareness simply suggests that a recognized name matters. *See id.* at 19. Brand loyalty reflects the idea that it is more expensive to gain new customers, but it is inexpensive to keep old ones, even if switching costs are low. *See id.* This situation most likely occurs because of some degree of customer satisfaction with the brand. *See id.* Brand loyalty differs from other dimensions, because it does not exist in the absence of a prior use experience. Thus, brand loyalty is a key component of brand equity, for the following reason:

> If customers are indifferent to the brand and, in fact, buy with respect to features, price, and convenience with little concern to the brand name, there is likely little equity. If, on the other hand, they continue to purchase the brand even in the face of competitors with superior features, price, and convenience, substantial value exists in the brand and perhaps in its symbol and slogans.

Id. at 39. Existing customers can provide brand exposure and reassurance. *Id.* at 19.

69. This article neither concludes nor attempts to answer the question whether Delaware actively engages in aggressive branding of its legal regime. The strength of the Delaware brand may actually suggest Delaware spends less in cultivating its brand.

70. *See* CLIFTON ET AL., *supra* note 5, at 20 ("Reputation is paramount, and companies

B. *The Beneficiaries of Branding*

1. Producers

Brands create value for producers like Delaware. For producers, branding creates differences among products in a category, which results in profits. Yet, the importance to producers of maintaining a strong brand is not simply to extract a premium price in the form of franchise taxes or attorney's fees; it is to secure future demand.[71] In this sense, branding from the producer perspective is prospective.[72] Branding arguably has three functions—to inform, to secure demand, and to persuade.[73] The former two functions are much less controversial than the latter. As a practical matter, it is often difficult to disentangle these functions. For producers, a brand is a potent device to distinguish one's product from competitors and create an aversion to substitutes.[74] In addition to insulating producers from competition, brands are durable sources of competitive advantage, which provide added protection in the event of product or service failure.[75] In sum, brands allow producers to secure profits, secure future demand, and withstand periods of turbulence.

2. Customers

From the customer perspective, strong brands create customer value because they reduce both the effort and risk involved with purchase decisions.[76] Thus, customers will search less externally and think less internally.[77] But, the value of a brand to customers is not limited to its ability to limit search costs or to impart information to customers concerning the functional qualities of a service or product.

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that are known for the quality of their products and services, their integrity and the transparency of their actions are the ones best placed to sustain a competitive advantage.").

71. *See* Dilbary, *supra* note 13, at 622–23.

72. *See id.* at 608.

73. *See* Brown, *supra* note 12, at 1183.

74. *See id.* at 1177.

75. *See* KELLER, *supra* note 11, at 53–58 (discussing the impact of brands in periods of crisis and Tylenol's rebound from a tampering scandal).

76. *See* Dilbary, *supra* note 13, at 620.

77. *See* KELLER, *supra* note 11, at 7.

A strong brand provides value independent of signaling functional properties; it has an added psychological dimension.[78] These psychological or emotional responses to a brand, in some cases, can be more important than the physical response to the actual product. Coca-Cola's ill-fated 1985 attempt to introduce a new Coke formulation illustrates this phenomenon.[79] In response to a popular Pepsi advertising campaign,[80] Coca-Cola decided to change its product formulation to match the sweeter Pepsi taste. This effort proved disastrous and led to a revolt by Coca-Cola's core customers. Here, Coca-Cola failed to view its brand in its entirety and disregarded the psychological, emotional, and relational associations customers had with the product.[81]

Another illustration of the psychological impact of brands is the purchase of groceries from Whole Foods. Whole Foods arguably provides a healthier product than standard grocery stores with its organic and preservative-free produce. But, other grocery stores have created organic food sections to compete with Whole Foods and more will follow. Yet, Whole Foods' customers will not migrate to standard grocery stores because of the intangible psychological aspects of the brand. A purchase from Whole Foods continues to have a completely different psychological impact than a purchase from a standard regional or national grocery store. The Whole Foods experience gives the purchaser greater psychological well-being—reinforcing one's sense of health, environmental, and social consciousness.[82]

The purchase of a hybrid automobile is another illustration of branding's psychological impact. For many purchasers, the hybrid purchase is not simply about fuel efficiency and reducing costs. Instead, it is about conserving the environment, reinforcing one's environmental credentials, and eradicating a sense of "green guilt," the idea that one is not making an adequate sacrifice to

78. *See* Dilbary, *supra* note 13, at 608.

79. *See* KELLER, *supra* note 11, at 5–6 (citing Patricia Winters, *For New Coke, "What Price Success?"* ADVERTISING AGE, Mar. 20, 1989, at S-1 to S-2).

80. Pepsi's popular commercials showed blind taste tests, where unsurprisingly consumers demonstrated a strong preference for Pepsi. *See id.* at 6. Coke even conducted its own tests of the new formulation on 190,000 consumers who preferred the new formulation to the old. *Id.*

81. *See id.*

82. Similarly, a diamond ring in a Tiffany & Co. blue box has a different psychological impact than a similar ring from JC Penney.

preserve the natural environment for future generations.[83] Indeed, psychological pleasure and satisfaction are a part of the brand experience. Purchase decisions can be an emotive response. For example, the purchase of perfume or cologne may evoke feelings of romance. Thorstein Veblen acknowledged that consumer behavior is not always rational, but influenced by a need for pecuniary emulation.[84] The value of a brand may also stem from how others (i.e., non-users) perceive the good.

One of the most important psychological impacts brands have is the creation of security and peace of mind for purchasers. Customers and brands may share a bond or "implicit understanding" whereby, in exchange for the consumer's loyalty, the brand will behave a certain way and provide "utility through consistent product performance."[85] In this sense, brands protect the customer's *ex ante* expectations concerning the service.[86] This situation resembles the concept of credible commitment in the incorporation context. The above examples highlight the importance of intangible branding effects and how consumers willingly pay a hefty premium for goods that perhaps have more tangible points of parity than points of differentiation.[87]

The psychological impacts of brands lead some commentators to question their actual value:

> The [neoclassical] economist, whose dour lexicon defines as irrational any market behavior not dictated by a logical pecuniary calculus, may think it irrational to buy illusions; but there is a degree of that kind of irrationality even in economic man; and consuming man is full of it.

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83. Similarly, the purchase of a luxury automobile (e.g., Mercedes Benz) may reinforce feelings of lavishness, refinement, and success to consumers and others. *See* Mercedes-Benz Advertisement, TRAVEL & LEISURE, July 2007 ("I love this car. But I love what it stands for even more.") (back cover) (on file with author).

84. *See* THORSTEIN VEBLEN, THE THEORY OF THE LEISURE CLASS 68–69 (Random House 1934) (1899) (articulating the concept of conspicuous consumption).

85. KELLER, *supra* note 11, at 8.

86. *See* Dilbary, *supra* note 13, at 608.

87. Kevin Keller asserts that "[p]oints of difference are those associations that are unique to the brand that are also strongly held and favorably evaluated by consumers." KELLER, *supra* note 11, at 116. Alternatively, "[p]oints of parity, on the other hand, are those associations that are not necessarily unique to the brand but may in fact be shared with other brands." *Id.* at 117.

> The taint of irrationality may be dispelled by asserting flatly that the utility of a good, that is, its capacity to satisfy wants, is measured exactly by what people will pay for it. If, as is undeniably the case, consumers will pay more for an advertised brand than for its unheralded duplicate, then consumers must get more satisfaction out of the advertised brand.[88]

The overarching question of whether a brand has a positive or negative impact on customer utility is often a matter of perspective. Yet, one potential metric, although not dispositive, would be the ratio of tangible brand attributes to intangible ones. Thus, a high ratio of intangibles could suggest limited customer utility.

3. Delaware

Similar to a popular brand in product or service markets, Delaware's brand allows it to secure profits (e.g., franchise taxes and attorney's fees), secure future demand, and withstand periods of turbulence. In addition to being perceived as business friendly, the Delaware brand has other key associations, such as judicial integrity and competence; the understanding of corporate complexity; flexibility; and apolitical decision making. For Delaware and its government actors, there is a need to preserve these core associations in order to maintain the strength of the Delaware brand. As with most strong brands, the Delaware brand blends tangible and intangible elements. Delaware's legal regime is akin to an experience or credence good (e.g., certain medical treatments) whose actual benefits are difficult to ascertain objectively through visual inspection and sometimes even through experience.[89] Under such circumstances, jurisdictional brands become a significant factor in the firm decision-making process. In addition, the Delaware brand makes incorporating firms feel more secure than other jurisdictions. This security is the belief that the Delaware legal regime and its various actors will continue to meet the ever-changing needs of the business community in a non-politicized manner. Here, the feeling of security or peace of mind is an important attribute of Delaware's service even where it is not directly related to a tangible characteristic or rationale.[90]

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88. Brown, *supra* note 12, at 1181.

89. Also, to the extent the incorporation decision is a purchase of services, assessing quality is more difficult given the greater variability across this category.

90. *See* Dilbary, *supra* note 13, at 608, 621–23.

Incorporating firms may even choose Delaware based upon perceptions held by third parties. For example, firms incorporate in Delaware usually as a result of an IPO or expansion via merger or acquisition. Given this context, a firm's Delaware incorporation communicates to equity markets that the firm has major league growth ambitions.[91] Empirical studies show Delaware incorporation may create a "Delaware effect," i.e., an increase in share price.[92] Admittedly, given the sophistication of firms making incorporation decisions, it is reasonable to question whether the psychological impact of the Delaware brand is sizeable. But, whether the Delaware brand is more firmly rooted in performance-related factors or non-product-related ones, it remains a powerful decision-making heuristic that corporate managers use as a risk reduction strategy.

III. COMPETITIVE ADVANTAGE IN THE STATE COMPETITION CONTEXT

In order to compete in product or service markets, firms perform a range of activities that create buyer value.[93] These activities are the building blocks of competitive advantage, which is essential to sustaining above average firm performance in competitive markets. Dominant firms, competitors, and buyers are the key players in the competitive advantage story. In the market for corporate charters, Delaware acts as a dominant firm, other states are the competitors, publicly traded corporations are the buyers, and the incorporation decision is the purchase of a legal regime. The following subsections outline Delaware's competitive advantage and facets of its brand in greater detail.

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91. *See* Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 COLUM. L. REV. 1931, 1963 (1991).

92. *See* Subramanian, *supra* note 46, at 32–34, 50.

93. *See* MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE xvi, 131 (1985) [hereinafter PORTER, COMPETITIVE ADVANTAGE]; *see also* PORTER, NATIONS, *supra* note 61, at 40.

A. *Core Aspects of Competitive Advantage*

1. Competitive Advantage

Although the existing state charter competition literature acknowledges Delaware's competitive advantage, it fails to adequately explain it. This failure is due in part to the tendency to overemphasize a small facet of charter competition at the expense of analyzing Delaware's competitive advantage in the aggregate. Therefore, before embarking on a more detailed description of Delaware's competitive advantages, it is necessary to discuss some core concepts. Competitive advantage is simply an advantage a firm exercises over its competitors.[94] In general, there are two types of competitive advantage: cost advantage and differentiation advantage.[95] A state has a cost advantage if the cumulative cost of performing all value-producing activities is lower than the analogous costs in rival jurisdictions.[96] In short, states with a cost advantage can produce valuable outputs at a lesser cost than rival jurisdictions.[97] A state has a differentiation advantage when it provides something unique and valuable to corporations beyond a low price.[98] Although Delaware possesses both types of competitive advantage, this paper will focus on differentiation advantages, which are the primary source of Delaware's preeminence.

2. Differentiation

In order to maintain a competitive advantage, Delaware must seek forms of differentiation or uniqueness that corporations

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94. Delaware is a dominant firm in the market for corporate charters because it exercises significant control over the current supply and perhaps potential sources of market expansion that make it difficult for rival jurisdictions to imitate the many competitive advantages Delaware possesses. *See* Carney, *supra* note 12, at 718 n.8.

95. *See generally* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 3 (stating that cost leadership and differentiation are two basic types of competitive advantage). Harvard Business School professor Michael E. Porter offers a thorough analysis of competitive advantage in his seminal book. *See id.* at xv–xvii. This paper extrapolates from his analysis. His analysis of competitive advantage is not the only possible analysis, but nonetheless it is very useful for illuminating how competitive advantage operates in the context of state charter competition.

96. *See id.* at 97.

97. *See, e.g.*, Romano, *State Competition*, *supra* note 45, at 720–23 (providing cost-based explanations for Delaware's competitive edge).

98. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 120.

value. In theory, the basic calculation Delaware performs when differentiating itself is the comparison between the costs of being unique with the cost of being equal to other rival jurisdictions. Differentiation allows the state of Delaware to command a premium price,[99] sell more of its product at a given price, and gain supplemental benefits, such as reputation and greater loyalty from corporations during seasonal and cyclical downturns.[100] Differentiation is a broad concept not limited to tangible characteristics such as quality and performance. Instead, differentiation encompasses both tangible value in use and intangible perceived value. Delaware's position in the chartering market is a result of both tangible and intangible value to corporations. A key differentiation advantage for Delaware is its brand.

3. Creating Buyer Value Through Tangible and Intangible Criteria

Corporations utilize two types of criteria when assessing a jurisdiction's value: (i) tangible use-related criteria and (ii) intangible criteria based upon perception. Tangible criteria reflect functional attributes of a jurisdiction, such as institutional factors, performance characteristics, substantive law, policies, and procedures. Intangible criteria include factors such as reputation, market share, customer lists, time-in-business, and visibility to top management.

Delaware creates value for incorporating firms through both tangible and intangible criteria.[101] To achieve adequate differentiation and maintain its competitive advantage, Delaware cannot rely solely on tangible criteria—it must also use intangible criteria to signal its uniqueness to firms. A firm's incomplete knowledge of jurisdictional value heightens the impact of differentiation and branding.[102] For this reason, differentiation has the greatest impact in the IPO context. Some signals of value require expenditures by the jurisdiction while others reflect goodwill or

99. *See* Romano, *Competition for Corporate Charters*, *supra* note 38, at 845 (asserting Delaware regularly receives over 15.5% of its revenues from franchise taxes).

100. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 120. Michael Porter uses the concepts of use criteria and signaling criteria, which are similar to the concepts of tangible and intangible criteria.

101. *See* discussion *infra* Part III.B.

102. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 138–39.

reputation built over time.[103] Thus, jurisdictions can signal or communicate value in an active or passive fashion. The communication of value, however, does not necessarily cease upon purchase or incorporation. States may work to reinforce firm perceptions of value even after purchase.[104]

Finally, intangible criteria may or may not relate to tangible properties of the product or service.[105] The value of intangible criteria are not limited to reducing search costs; they may also increase demand for the product or service itself.[106] Intangible criteria may have a positive psychological impact independent of the functional attributes of the underlying product or services.[107] In short, a combination of tangible criteria and intangible criteria is ideal for sustaining corporate value and competitive advantage.

4. Sustainability

Sustainability of competitive advantage hinges on the continued perception of value from firms. The sustainability of differentiation strategy is linked to finding durable sources of uniqueness that are protected by barriers to imitation from competition. When it comes to Delaware's differentiation advantages, barriers to imitation give other state competitors a moving target, or more accurately, several moving targets.[108] Overall, there are four scenarios that result in sustainable differentiation; they occur when (i) the state's sources of differentiation involve barriers; (ii) the state's sources of differentiation are multiple; (iii) the state's unique activities raise the cost of switching because corporations often tailor or invest in the jurisdiction to exploit its uniqueness; and (iv) the state's brand creates an aversion to substitute jurisdictions.[109]

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103. *See id.* at 139.

104. The concept of credible commitment in the state competition literature falls into this category. *See* Kamar, *supra* note 14, at 1935–36; *see also* discussion *infra* Part III.B.2.f.

105. *See* Dilbary, *supra* note 13, at 622–23; *see also* discussion *infra* Part III.B.2.

106. *See* Dilbary, *supra* note 13, at 623.

107. *See id.* For a discussion of these psychological benefits see discussion *supra* Part II.B.2.

108. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 20. Delaware may or may not choose to preemptively act in response to changing corporate circumstances.

109. Branding effects could also fall into the first two categories. But, branding is a higher order differentiation advantage and deserves separate treatment.

B. *Sources of Delaware's Differentiation Advantage*

Delaware's legal regime is not a commodity, but a branded product or service. In a competitive market for services, there is a tendency toward imitation and uniformity; however, innovation eliminates the threat of absolute uniformity in the market.[110] The fact that numerous jurisdictions have replicated Delaware's corporate code, and yet are unable to even begin to challenge Delaware's preeminence suggests at least two things: (i) substantive law is only one of many factors creating value, both actual and perceived, for corporations; and (ii) Delaware continues to do a better job of creating value for the majority of incorporating and reincorporating firms (irrespective of potential market imperfections). The following analysis of Delaware's competitive advantage and multiple sources of differentiation explains Delaware's dominance and consistent demand from incorporating firms. Although the Delaware brand is a distinct differentiation advantage, the following differentiation advantages—tangible and intangible—are elements of the Delaware brand.[111]

1. Tangible Use-Related Criteria that Create Buyer Value

A jurisdiction's policies, procedures, and institutions are examples of tangible criteria that create corporate value. Compared to rival jurisdictions, several of Delaware's internal features are unique. This does not mean, however, they are sustainable and cannot be replicated. The following section identifies Delaware's sources of differentiation, which are attributable to tangible criteria.

a. Advanced and Flexible Corporate Statute

An "advanced" and "flexible" corporate statute is one reason for Delaware's preeminence.[112] Delaware adopted its first modern

110. *See* Carney, *supra* note 12, at 728–29.

111. Branding can also be considered a distinct type of differentiation advantage.

112. *See* Division of Corporations, Delaware Department of State, About Agency, *supra* note 12; *see also* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993) [hereinafter ROMANO, GENIUS]. Professor Romano asserts:

> The genius of American corporate law is in its federalist organization. In the United States, corporate law, which concerns the relation between a firm's shareholders and managers, is largely a matter for the states. Firms choose

corporation statute in 1899 and since that time the Delaware legislature has amended the statute hundreds of times.[113] In reality, however, the Delaware Bar Association's Section on General Corporation Law is responsible for revising the General Corporation Law.[114] Members of the Section and its subcommittees carefully study and make suggestions concerning proposed amendments to the Delaware General Corporation Law.[115] The General Assembly, in most cases, adopts the amendments recommended by the Section.[116] In this fashion, Delaware's General Corporation Law is continually amended by the Bar Section on General Corporation Law and the General Assembly. The "close working relationship" between the Delaware General Assembly and the corporate bar works to ensure a swift response to corporate needs in the form of a flexible statute.[117] This collaboration also reveals the

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> their state of incorporation, a statutory domicile that is independent of physical presence and that can be changed with shareholder approval. The legislative approach is, in the main, enabling. Corporation codes supply standard contract terms for corporate governance. These terms function as default provisions in corporate charters that firms can tailor more precisely to their needs. Firms therefore can particularize their charters under a state code, as well as seek the state whose code best matches their needs so as to minimize their cost of doing business.

Id. at 1.

113. Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 896 (1990); *see also* Hamermesh, *Policy Foundations*, *supra* note 45, at 1752 (noting the basic content of the Delaware General Corporation Law ("DGCL") has been virtually unchanged for the past forty years).

114. Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 971 (1995).

115. *Id.* at 971–72. After receiving reports from the subcommittees, the Council of the Section decides whether to adopt or reject the bill. *Id.* at 972. If the Council approves the bill, the bill proceeds to the Executive Committee of the Bar Association and then to Delaware's General Assembly. *Id.* The Delaware Constitution requires a supermajority vote for a modification of the Delaware Corporation Code which makes it difficult for outside interests to change the code. *Id.* at 974–75.

116. *Id.* at 972. The Delaware General Assembly is composed of roughly twenty-one senators and forty-one representatives. State of Delaware, Delaware General Assembly, Legislative Info, Know Your Legislators, http://legis.delaware.gov/legislature.nsf/Lookup/Know_Your_Leg islators?open&nav+leginfo (last visited Mar. 29, 2008). Since 1966, no member of the General Assembly has been a corporate lawyer and furthermore only nine members have been lawyers. *See* Alva, *supra* note 113, at 897 n.54. Despite the code's importance, there is not a specific committee within the legislature devoted "largely or exclusively to corporate matters." *Id.* at 897. For example, amendments to the General Corporation Law are reviewed by the Judiciary Committee. *Id.* at 897–98. This absence of members of Delaware's Corporate Bar from the General Assembly may suggest that its members lack the knowledge to make informed decisions about Delaware corporate law and perhaps serves as evidence of the General Assembly's lack of involvement in drafting the corporate code.

117. *See* Kaouris, *supra* note 114, at 973.

significant degree of private and public interaction in the corporate lawmaking process.[118]

As mentioned above, the General Assembly plays a lesser role in the actual drafting of the General Corporation Law. Instead, the General Assembly's role is limited to enacting corporate legislation and deferring to recommendations from the corporate bar and the Division of Corporations.[119] Accordingly, most of the debate, amendment, and lobbying with regard to the Delaware General Corporation Law takes place within the Corporate Law Section.[120] Here, in-house attorneys, out-of-state Delaware attorneys, corporate managers, and corporation service companies provide input.[121] The specialized local bar in Delaware acts as "protector[ ] and guardian[ ] to the statutory law of corporations."[122]

Despite the flexibility of the corporate statute, its substance is not a durable source of competitive advantage because it is easily duplicated in other states. This has already happened in a number of states,[123] but states that have adopted similar statutory provisions are not nearly as successful in enticing corporations as Delaware.[124] Even states that have adopted more management-friendly statutory provisions (e.g., allowing for stronger anti-takeover measures) do not rival Delaware.[125] One reason for this discrepancy is that Delaware's Corporate Bar, an expert group, has unmatched authority in the corporation law amendment

118. *See* Hamermesh, *Policy Foundations*, *supra* note 45, at 1758–59 (discussing the "symbiotic and trust-based relationship" between the Delaware Bar and General Assembly). Furthermore, Hamermesh observes that the Delaware Bar leaves parochial client interests behind when proposing corporate legislation. *See id.* at 1758.

119. *See* Kaouris, *supra* note 114, at 971–72.

120. *See id.* at 971–75; Alva, *supra* note 113, at 900–01.

121. *See* Alva, *supra* note 113, at 900–01.

122. Allen, *supra* note 3, at 4.

123. *See* Carney, *supra* note 12, at 731–36 (providing a lengthy discussion of uniformity among state corporate statutes).

124. *See* Kaouris, *supra* note 114, at 1004; *see also* Carney, *supra* note 12, at 718 (asserting Maine and Nevada have tried to compete, but have failed to attract a significant amount of charters); Cary, *supra* note 12, at 665–66 (describing attempts by other states to emulate Delaware's statutory scheme in order to attract corporations).

125. *See* Ferris, Lawless & Noronha, *supra* note 26, at 17–18 (acknowledging that despite Delaware's preeminence, it does not have the most management-friendly legal climate). This study measured states' long-term reputation for adopting statutes that enhance managerial power. Surprisingly, Delaware was behind Pennsylvania, Tennessee, Wisconsin, New York, Virginia and Nevada. *Id.* Therefore, it is not accurate to characterize Delaware as overly pro-management.

process compared to other states. Within this environment, Delaware's legislature can respond to corporate innovations.[126] Despite the ability to respond, actual changes to the Delaware General Corporation Law ("DGCL") over the past forty years have been conservative.[127] This conservatism results in deference to the judicial branch to incrementally sketch corporate law through the judicial process.[128] Delaware exhibits a "preference for general, nonprescriptive, and nonproscriptive rules."[129] In a sense, the statutory scheme acts as a "guidepost[ ]."[130]

b. Case Law and Precedent

Delaware's flexible and responsive corporation statute is buttressed by a well developed body of case law. Delaware's Court of Chancery has over a two hundred-year-history that demonstrates "the [c]ourt's ability to adapt principles of equity developed centuries ago to ever-changing economic circumstances and legal relationships."[131] Delaware Court of Chancery and Delaware Supreme Court rulings establish precedents which provide greater predictability, allowing corporations to make planning decisions with greater confidence.[132] Unlike Delaware's corporate statute, Delaware's case law and precedents are unique and not easy to duplicate.

Commentators have correctly observed Delaware's strong preference that corporate law should be developed through a common law decision-making process.[133] This preference is particularly

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126. *See id.* at 18 (asserting companies consider not only the content of corporate law, but also a jurisdiction's reputation for innovation).

127. *See* Hamermesh, *Policy Foundations*, *supra* note 45, at 1772. Lawrence Hamermesh observes:

> Looking back over the forty years since the landmark 1967 general revision of the Delaware General Corporation Law, one of course observes many statutory changes. What appears on further reflection, however, is just how few of those changes have involved any dramatic effect on the governance of publicly held corporations. Many of the statutory changes have been technical, and very few have attracted any academic attention.

Id.

128. *See id.* at 1776–78.

129. *Id.* at 1779.

130. *See* Veasey, *Aspirations*, *supra* note 51, at 2179.

131. William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792–1992*, 18 DEL. J. CORP. L. 819, 819–20 (1993).

132. *See* Kaouris, *supra* note 114, at 977.

133. *See* Fisch, *supra* note 39, at 1075–81; Kahan & Rock, *supra* note 39, at 1610–11

apparent in the fiduciary duty area where such duties by nature are equitable and fact driven.[134] At the heart of this preference is the belief that issues involving "complex facts cannot and should not be reduced to black letter codification."[135] As a result of the legislature's preference against regulatory prescription and its deference to the judicial branch, Delaware courts are often the first responders to corporate law controversies.[136] The dockets of the Delaware Supreme Court and Court of Chancery are driven by plaintiffs and not political upswings. Delaware's judge-made law "reduces the likelihood of a populist challenge to its preeminence."[137] Judge-made law appears more neutral and distanced from the political process than legislative enactments. Delaware court decisions—with majority, concurring, and dissenting opinions, along with supporting rationale—arguably deserve greater respect than pronouncements from other government branches whose procedures may appear more ad hoc, arbitrary, and less transparent.[138]

Some commentators argue Delaware's case law is indeterminate to bolster the claim that Delaware law lacks qualitative value.[139] This claim is overstated.[140] Instead, indeterminacy in

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(characterizing Delaware corporate law as a "throwback" and "determinedly old-fashioned").

134. *See* E. Norman Veasey, Shawn Pompian & Christine Di Guglielmo, *Federalism vs. Federalization: Preserving the Division of Responsibility in Corporation Law*, THE SEC. REP., (ABA Section of Bus. Law Comm. on Fed. Regulation on Sec., Chi., Ill.) Fall 2005, at 77, 94.

135. Hamermesh, *Policy Foundations*, *supra* note 45, at 1777; *see also* Kamar, *supra* note 14, at 1915; Veasey, Pompian & Di Guglielmo, *supra* note 134, at 97.

136. *See* Hamermesh, *Policy Foundations*, *supra* note 45, at 1782.

137. Kahan & Rock, *supra* note 39, at 1612.

138. *But see* David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127, 129–30 (1997) [hereinafter Skeel, *The Unanimity Norm*] (asserting the norm for the Delaware Supreme Court is unanimous decisions, which increase the possibility of "cycling" effects).

139. *See, e.g.*, Kamar, *supra* note 14, at 1939–46 (implicating that interest group preferences account for indeterminacy); Branson, *supra* note 14, at 112 (asserting pro-shareholder decisions result from the interest group influence of plaintiff lawyers that make up the Delaware establishment).

140. Vice Chancellor Leo Strine disagrees with the characterization of Delaware law as overly indeterminate and inefficient:

> Instead, I advance the proposition that much of Delaware corporate law's indeterminacy and litigation intensiveness is an unavoidable consequence of the flexibility of the Delaware Model, which leaves room for economically useful innovation and creativity. That is, reducing the indeterminacy of Delaware corporate law by moving closer to the Mandatory Statutory Model might also impair its central emphasis on corporate empowerment and pri-

Delaware law reflects the complexity of modern corporations and the "ongoing struggle to apply the law and concurrently do equity."[141] Delaware corporate law cannot be labeled under a unitary value, such as efficiency or fairness. It embodies a range of competing values that may appear inconsistent depending upon context. Former Chief Justice E. Norman Veasey astutely observes, "The Delaware courts decide so many important cases that there is bound to be room for academic and practitioner praise, criticism, and sometimes uncertainty."[142] The Delaware courts' attempts to address the above-mentioned complexity is reflected in the business judgment rule and fiduciary duty jurisprudence.

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vate ordering, to the detriment of social welfare.

Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1259 (2001) [hereinafter Strine, *Exquisite Jewel*]; *see also* Fisch, *supra* note 39, at 1083–85 (asserting indeterminacy has benefits as well as costs); Romano, *Law as a Product*, *supra* note 20, at 274 (asserting the majority of managers, in-house counsel, outside counsel, and others surveyed prefer Delaware re-incorporation partly for case law and precedent). In addition, some scholars assert that Delaware case law vacillates back and forth in response to various interest groups and scandal. *See, e.g.*, Branson, *supra* note 14, at 111–12; Griffith, *supra* note 47, at 58–68. Former Chief Justice E. Norman Veasey provides the following alternative explanation for movements in Delaware law:

> Our courts do not have a political agenda that vacillates from time to time to favor one litigant over the other. Delaware courts today are not any more "pro-stockholder" and less "pro-director" than they were in the past, or vice versa. The expectations of director conduct have evolved over the years, including in the post-Enron era, but that does not mean the courts have begun to take on a political agenda to favor stockholders over directors. That evolution in director expectations is a function of the development of the common law reflecting changing business mores and sharper pleading in corporate litigation, focusing more precisely on process. Delaware courts are balanced and objective, and the business judgment rule is alive and well.

Veasey, *Center of Universe*, *supra* note 12, at 169.

141. Hamermesh, *Policy Foundations*, *supra* note 45, at 1762; *see also* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 683 (2005) [hereinafter Strine, *Delaware Way*]. Vice Chancellor Strine asserts:

> [E]quitable review is situationally-specific and proceeds in the common law fashion. The case at hand is decided and the law is thereby evolved incrementally. Although that can lead to what some scholars like to call indeterminancy [sic]—i.e., some residual uncertainty—it also allows space for the judiciary to pull back in future cases if a prior decision turns out, *in the wake of experience*, to have been unwise.

Id. (emphasis added).

142. Veasey, *Center of Universe*, *supra* note 12, at 170.

i. The Business Judgment Rule

The touchstone of Delaware corporate law is the business judgment rule, which promotes corporate efficiency. Under Delaware law, there is the presumption that directors have acted independently, on an informed basis, in good faith, and with an honest belief that their decision is in the best interests of the corporation.[143] This presumption can be rebutted if the process, independence, or good faith of directors is compromised; or the decision cannot be attributed to a rational business purpose. Delaware law provides directors with considerable discretion to manage the affairs of the corporation. This discretion, however, is not unfettered. This discretion is pragmatic because it allows for inter-temporal business planning (i.e., short term vs. long term) and can accommodate failing corporate strategies as well as extensive philanthropic endeavors.[144]

ii. Common Law Fiduciary Duties

Delaware common law fiduciary duties (i.e., loyalty and care) reflect an attempt to balance corporate efficiency with equitable principles. These common law standards are malleable, allowing Delaware courts to engage in a mild form of contextualism.[145] A

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143. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Robert Clark describes the business judgment rule as follows:

> The rule is simply that the business judgment of the directors will not be challenged or overturned by courts or shareholders, and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply.

ROBERT CHARLES CLARK, CORPORATE LAW § 3.4 (1986); *see also* FRANKLIN A. GEVURTZ, CORPORATION LAW 278–79 (2000) ("The idea underlying the rule is that courts should exercise restraint in holding directors liable for (or otherwise second guessing) business decisions which produce poor results or with which reasonable minds might disagree. This seems to be a sensible notion. After all, business decisions typically involve taking calculated risks.").

144. *See generally* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005) (arguing corporate social responsibility initiatives are permitted pursuant to the broad discretion under Delaware law).

145. Delaware courts resolve cases across a range of factual contexts and are not constrained by bright-line rules. *See* Veasey, *Defining Tension*, *supra* note 48, at 393–94 (discussing the types of decisions Delaware courts review, such as enterprise, ownership, and oversight); *see also* E. Norman Veasey, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA L. REV. 1399 (2005) [hereinafter Veasey, *What Happened*] (discussing the wide range of corporate cases heard by Delaware courts). Generally, Delaware fiduciary duty law addresses

recent example of this approach can be found in the Delaware Supreme Court's decision in *Stone v. Ritter*, which addressed the issue of director oversight responsibility for corporate legal compliance.[146] Firm legal compliance decisions, unlike other types of board decisions, have a strong operational component and involve a litany of decisions made by various employees throughout a firm. For this reason, director oversight of corporate legal compliance cannot be evaluated effectively through a rigid formulaic or mandatory approach. Delaware's contextualized standards-based approach to director oversight of corporate legal compliance is a sharp contrast from the mandatory prescriptive rule-based approach under Sarbanes-Oxley ("SOX").[147] At first glance, SOX's prescriptive rules appear more stringent than Delaware common law standards addressing director oversight responsibility for corporate legal compliance. Although SOX establishes certain requirements for directors, it "fails to impose any legal sanctions on directors who do not comply with their responsibilities under the Act."[148] Meanwhile, under Delaware law, the threshold of liability for directors is extremely high, yet the prospect of personal liability is real.[149] To provide a simple illustration, directors could ig-

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three categories of decisions: enterprise, ownership, and oversight. Veasey, *Defining Tension*, *supra* note 48, at 394. Enterprise decisions are standard decisions made by management, such as the decision to build a foreign production plant or what products to produce. *See id.* Ownership decisions surround ownership changes such as mergers, acquisitions and corporate takeovers. *See id.* Oversight decisions concern managers' monitoring role, such as ensuring employees execute their responsibilities in compliance with law. *See id.*

146. 911 A.2d 362, 364 (Del. 2006). In *Stone*, plaintiff shareholders filed a derivative suit alleging that fifteen directors and former directors of AmSouth breached their fiduciary duty of oversight resulting in $50 million in fines and civil penalties for AmSouth. *Id.* at 364–65. The actual penalties stemmed from the failure of bank employees to file mandatory reports in compliance with federal regulations. *Id.* at 365. Ultimately, the Delaware Supreme Court upheld the decision of *In re Caremark Int'l Inc.*, 698 A.2d 959 (Del. Ch. 1996) en route to affirming the Chancery Court's decision to dismiss the complaint. *Id.* at 369–73. Despite upholding the dismissal of the underlying complaint, the court's decision in *Stone* does more than simply pay lip-service to the prospect of director liability.

147. *See generally* 15 U.S.C. § 7262 (Supp. V 2000). The prescriptive bright-line rules under SOX have been criticized for failing to differentiate between larger and smaller firms. *See* Veasey, Pompian & Di Guglielmo, *supra* note 134, at 77, 94–95 (highlighting the one-size-fits-all shortcoming of SOX reforms); *see also* Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 395–96 (2005) (asserting the necessity for director liability in the oversight area citing limitations of state and federal corporate law); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1527–29 (2005) (explaining SOX's shortcomings as a product of crisis-mode legislation).

148. Fairfax, *supra* note 147 at 406.

149. *See Stone*, 911 A.2d at 372; *Caremark*, 698 A.2d at 967.

nore clear violations of environmental law or red flags and fail to implement measures in light of these clear risks, thus violating their good faith obligations and duty of loyalty under Delaware law. Such conduct could give rise to personal director liability under Delaware law, but not necessarily under SOX. Under *Stone*, directors may be liable for an utter failure to implement legal compliance systems across a wide array of legal categories (e.g., anti-corruption, government procurement, and environmental) or ignoring red flags signaling significant risks. Decisions like *Stone* and the emerging good faith jurisprudence under Delaware law illustrate that Delaware courts are not indifferent to equity interests.[150]

c. The Specialized and Proficient Court System

Delaware's court system features a separate equity court from which appeals go directly to the Delaware Supreme Court.[151] The Court of Chancery's jurisdiction is limited largely to business matters, such as contracts, fiduciary duties, trusts and estates, and corporate law matters.[152] The Court of Chancery has a national reputation for its sophistication and expertise in handling corporate cases.[153] The special attributes of the Court of Chancery's adjudication are its speed and expertise, which require experience.[154] In a sense, the Chancery Court functions as a quasi-arbitrator, whose services are purchased via Delaware incorporation.[155] As former Chancellor William T. Allen asserts, "It is not

150. *See* Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 248–49 (2006) (asserting the Disney jurisprudence established a new standard of good faith to address culpable actions); *see also* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (highlighting the importance of equity); ATR-Kim Eng. Fin. Corp. v. Araneta, No. 489-N, Del. Ch. 2006 LEXIS 215, at *70–71 (Del. Ch. Dec. 21, 2006) (finding directors liable for breaching their duty of loyalty by failing to implement any monitoring system as required by *Stone* and *Caremark*); *see also* Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004) (discussing the evolution of Delaware's standard of good faith as applied to management).

151. Delaware is one of three states that continue to have a division between law and equity. *See* Alva, *supra* note 113, at 902–03. Approximately 70% of the cases before the Delaware Court of Chancery are corporate matters. This steady flow of cases enhances judicial quality and experience. *See* Kamar, *supra* note 14, at 1926 n.68.

152. *See* Allen, *supra* note 3, at 4.

153. *See* Kaouris, *supra* note 114, at 975.

154. *See* Allen, *supra* note 3, at 4.

155. *See* Roe, *Delaware's Politics*, *supra* note 39 at 2501 ("Hence, one could say that investors and managers make Delaware corporate law and that they then bring in the

unusual for the validity of a hugely complex corporate decision to be determined in Chancery within 60 days. . . ."[156] Moreover, "[f]ew if any courts can match the speed and intensity" of the Court of Chancery in adjudicating corporate matters.[157] Delaware has one chancellor and four vice chancellors who sit individually without juries.[158] The chancellors and vice chancellors are appointed by the governor and confirmed by the senate for a period of twelve years.[159] Although most Court of Chancery decisions do not receive appellate review, the Delaware Supreme Court plays a key role by swiftly handling Court of Chancery appeals and rendering influential decisions. There are five Delaware Supreme Court justices—one chief justice and four associate justices.[160] Similar to the Court of Chancery, Delaware Supreme Court justices are appointed by the Governor and confirmed by the state senate for twelve-year terms.[161] The Delaware State Constitution mandates a political balance or bipartisan judiciary.[162] As a result, "[t]hree of the justices must represent one of the major political parties while the other two justices must be members of the

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Delaware judges—selected by bar committees—to arbitrate their disputes.").

156. Allen, *supra* note 3, at 4. Former Chancellor Allen also cites the merger of Time and Warner Communications as his most vivid memory of the court's speed and intensity. Allen notes:

> [A]fter after about six or eight weeks of feverish discovery and briefing, I had only five or six days to write what turned out to be a lengthy and complex opinion. The appeal of my decision was determined in less than a month and a multi-billion dollar transaction could move forward with much less legal risk.

Id. Speed is also an attribute of the Delaware Supreme Court. For example, in 2005 the average time from submission to disposition was 39.6 days. *See* First State Judiciary, 2005 Annual Report and Statistical Information for the Delaware Judiciary, http://courts.delaware.gov/AOC/Annual%20Reports/FY05/Supreme/Supreme%20AR05-web.htm. Furthermore, Delaware Supreme Court Internal Operating Procedures impose a ninety-day final opinion deadline following submission. *See* DEL. SUP. CT. INTERNAL OPERATING P. x(3), *available at* http://courts.Delaware.gov/Rules/?iops.pdf (last visited Mar. 29, 2008). Parties may also request an expedited disposition.

157. *See* Allen, *supra* note 3, at 4.

158. Delaware Judicial Information Center, First State Judiciary—Court of Chancery Judges, http://courts.delaware.gov/Courts/Court%20of%20Chancery/?jud_ off.htm (last visited Mar. 29, 2008).

159. *Id.*

160. Delaware Judicial Information Center, First State Judiciary—Delaware Supreme Court Justices, http://courts.delaware.gov/Courts/Supreme%20Court/?justices.htm (last visited Mar. 29, 2008).

161. *Id.* These twelve-year terms are often renewed.

162. *See* DEL. CONST. art. IV, § 3; *see also* Veasey, *Center of Universe*, *supra* note 12, at 166–67.

other major political party."[163] For over twenty-five years, Delaware's governor has selected judges from a list of candidates screened by a bipartisan Judicial Nominating Commission.[164] Unlike other states where corporate cases are heard by numerous judges in courts of general jurisdiction, Delaware limits corporate litigation to two courts and ten judges. Some commentators contend this creates greater stability and predictability.[165] Arguably, Delaware judges have even more legitimacy than federal judges due to their experience and developed corporate expertise.[166] Delaware's proficient court system is an enduring form of competitive advantage, which is extremely difficult to replicate. Even before a state can develop a specialized court system with experienced and highly skilled judges,[167] the state must have a signifi-

163. Delaware Judicial Information Center, First State Judiciary—Delaware Supreme Court Justices, *supra* note 160. The Court of Chancery maintains a similar political balance. *See* DEL. CONST. art. IV, § 3.

164. *See* Veasey, *Center of Universe*, *supra* note 12, at 166–67. As a result, corporations do not contribute to judicial campaigns in Delaware.

165. *See* Kaouris, *supra* note 114, at 977. Former Chancellor Allen asserts "[t]he presence of a large body of work from a relative small body of judges greatly facilitates the process of interpretation and prediction." Allen, *supra* note 3, at 4; *see also* ROMANO, GENIUS, *supra* note 112, at 40.

166. Kahan & Rock, *supra* note 39, at 1612. Whether corporate decisions are made by Delaware or federal judges, however, may be of little importance.

167. Delaware Supreme Court and Chancery Court judges have significant expertise and experience. For the biographies of current Chancery Court judges, see Delaware Judicial Information Center, First State Judiciary—Court of Chancery Judges, *supra* note 158. Delaware Chancery judges tend to have a wealth of experience before being appointed to the Chancery. Chancellor Chandler served as Vice Chancellor for eight years before being appointed Chancellor. *Id.* Vice-Chancellor Strine served as counsel to Governor Thomas Carper for five years before being appointed. Vice Chancellor Lamb served as a Special Counsel in the Office of General Counsel at the Securities and Exchange Commission ("SEC"). *Id.* Most of the Chancery judges also practiced at prominent Delaware law firms. *See id.*

Delaware Supreme Court Justices also have extensive experience. For biographies of current Delaware Supreme Court Justices, see Delaware Judicial Information Center, First State Judiciary—Delaware Supreme Court Justices, *supra* note 160. Chief Justice Myron Steele was a resident judge of the Delaware Superior Court for four years, a Vice Chancellor for six years, and a Delaware Supreme Court Justice for four years before being appointed Chief Justice. *Id.* Justice Berger served as Vice Chancellor for ten years. Justice Jacobs served as Vice Chancellor for eighteen years. Justice Ridgely served as a trial judge on the superior court for twenty years. *Id.* Justice Holland has served on the Supreme Court for twenty-two years. *Id.* In 1986, he became the youngest person ever appointed to the Delaware Supreme Court. *Id.* Many of the justices have also written books, articles, taught as adjunct professors, and worked at prominent Delaware law firms. *See id.*

cant number of corporate franchises and cases[168] to create opportunities to build a body of jurisprudence.[169]

d. The Service-Oriented Division of Corporations

The Division of Corporations is often overlooked as a factor contributing to Delaware's success in the charter market. The Division of Corporations, which falls under the office of the Secretary of State, offers valuable professional assistance to corporations. Swift and accommodating service may be necessary in closing corporate transactions. In response to this reality, the Division of Corporations offers expedited services, such as providing speedy processing for corporate filings. For example, companies can incorporate within as little as one, two, or twenty-four hours.[170] Moreover, backlogs are almost nonexistent. Handling such a large volume of filings over the years has led to the efficient use of institutional apparatus and technology to improve the Division's services.[171] The Division of Corporations takes a business-like approach, as opposed to a bureaucratic one, by marketing itself and the State of Delaware as a business-friendly jurisdiction.[172]

e. An Interested and Specialized Bar

Members of Delaware's corporate bar operate as specialized local experts. The hiring of Delaware lawyers by corporations or other large New York law firms is a quality and cost-saving measure. With specialized expertise and experience, Delaware

168. *See* Kaouris, *supra* note 114, at 1004–05. Furthermore, "[e]ven in large states, such as California, New York, and Texas, where corporate lawyers abound and where there is a wealth of legal precedent, the states have not created court systems which can handle complex corporate matters quickly and efficiently." *Id.*

169. *See generally* DELAWARE SUPREME COURT: GOLDEN ANNIVERSARY 1951–2001, at 81–131 (Randy J. Holland & Helen L. Winslow eds., 2001) (discussing the corporate law jurisprudence in Delaware); Delaware Department of State, Division of Corporations, Frequently Asked Questions, http://www.corp.delaware.gov/faqs.shtml (last visited Mar. 29, 2008).

170. *See generally* Delaware Department of State, Division of Corporations, Frequently Asked Questions, *supra* note 169.

171. *See* William J. Reif, *Delaware Service*, CORP. EDGE, (Div. of Corp., Dover, Del.), Summer 1996, at 4, 4 (on file with author).

172. An example of this approach to marketing was the publication of *The Corporate Edge Newsletter*. *The Corporate Edge* was published by the Delaware Department of State. *See, e.g.*, CORP. EDGE (Div. of Corp., Dover, Del.), Spring 2001 (on file with author).

corporate lawyers increase the certainty of corporate planning. This assertion seems even more credible when one considers the critical role the corporate bar plays in drafting and amending the General Corporation Law.[173] Also, it is less expensive for corporations and New York firms to hire a smaller specialized firm that will assign a limited number of associates or a partner to tackle what for them is a routine task. For example, in the corporate takeover context, because so many target corporations are domiciled in Delaware, targets and acquirers alike retain local Delaware counsel to advise them on a particular legal issue or to participate in the fast-paced litigation of the Delaware court system. Moreover, as a consequence of institutional alignment, out-of-state litigants may have an incentive to retain local counsel, who have developed a rapport and familiarity with the ten judges who hear corporate cases.[174] The Delaware corporate bar is a close-knit group exemplifying civility. Preserving one's reputation is extremely important among this small group. When corporations enlist the aid of smaller Delaware firms, they are receiving or, at a minimum, perceiving, an insider advantage.[175]

f. Institutional Alignment and Stable Political Climate

Institutional alignment and a stable political climate contribute to Delaware's competitive advantage. The relationship between the Delaware corporate bar, the General Assembly, the Division of Corporations, and the judiciary is best described as symbiotic.[176] There is a significant amount of "collegial interac-

173. *See* Macey & Miller, *supra* note 47, at 506–09 (identifying Delaware's corporate bar as the premiere interest group shaping Delaware corporate law).

174. *See* Skeel, *The Unanimity Norm*, *supra* note 138, at 160–61. Skeel asserts that "[i]t usually pays to retain a lawyer who knows, and is known and respected by, the supreme court." *Id.*

175. Delaware's largest corporate law firms have an impressive list of corporate clients. *See, e.g.*, Potter Anderson & Corroon LLP: Representative Clients, http://potterandersonson.com/about-matters.html (last visited Mar. 29, 2008); Morris Nichols: Representative Clients, http://www.mnat.com/firm-clients.html (last visited Mar. 29, 2008). Skadden, Arps, a major Wall Street law firm, has established a branch office in Wilmington, DE. Skadden lawyers often litigate cases in the Court of Chancery and the Delaware Supreme Court. *See* Wilmington Nature of Practice—Skadden, Arps, http://www.skadden.com/Index.cfm?contentID=49&officeID=22 (last visited Mar. 29, 2008).

176. *See* Kamar, *supra* note 14, at 1940; *see also* E. Norman Veasey, "*I Have the Best Job in America*," DEL. LAW., Winter 1995, at 20, 23 [hereinafter Veasey, *Best Job*] (asserting that the Delaware Supreme Court has "excellent relations with the other two branches of state government"). E. Norman Veasey, the former Chief Justice of the Delaware Supreme Court, comments on Delaware's cooperative atmosphere:

tion" between influential groups in Delaware, such as the relationship between Delaware's judiciary and the local bar, as well as the above-mentioned deference the General Assembly gives to the corporate bar.[177]

Delaware does not have many legislative pressures to disrupt the development of law. There is a lack of pressure from interest groups such as unions, environmental groups, institutional shareholders, and local communities.[178] If Delaware is associated with any particular industries or products, it is most likely chemicals, credit cards, and corporate law. Historically, companies such as DuPont and MBNA were top employers in the state of Delaware.[179] These companies have played a paternalistic role by providing economic security to employees and having a significant philanthropic presence in Delaware communities.[180] As a consequence, the security of many Delaware residents is often tied to the success of companies having significant operations within the state. Therefore, the absence of cogs in the wheels of

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> Delaware's size as the "small wonder" gives us an enormous advantage, particularly when coupled with the intelligence, approachability, cooperation and integrity of our public office holders. All three branches of government in Delaware are keenly aware of the reputation of the judicial branch of government and of the enormous contribution that the judicial branch makes to Delaware's economy and to the well-being of our citizens. Delaware's judicial branch must, however, continuously explain and justify its processes to the other two branches and to the citizenry. We are making that effort. But, we need the help of the organized Bar, and we need for the other two branches of government to examine, advise, hear and support us.

Id. at 22.

177. *See* Skeel, *The Unanimity Norm*, *supra* note 138, at 160. William Cary viewed such interaction as problematic. *See* Cary, *supra* note 12, at 687–88.

178. Reincorporating in Delaware does not result in a significant loss of local employment, which is the case in other states. *See* Carney, *supra* note 12, at 719. Rarely is Delaware the principal place of business.

179. DuPont and MBNA have been the two largest private employers in Delaware over the last decade. In 1997, they combined to employ 23,850 residents, or 6.52% of Delaware's entire workforce. *See* COMPREHENSIVE ANNUAL FINANCIAL REPORT, *supra* note 38, at 142. The next largest employer employed 5,500 workers. *Id.* In 2006, following Bank of America's purchase of MBNA, DuPont and Bank of America combined to employ 17,986 workers, or 4.06% of Delaware's entire workforce. The next largest employer employed only 7,289 workers. *Id.*

180. *See, e.g.*, Access Philanthropy—MBNA Foundation, http://accessphilanthropy.com/funderinnews.php?funderID=307 (last visited Mar. 29, 2008) (describing the MBNA Foundation and its goals to promote education, human services, and the arts in Delaware and other communities). After Bank of America purchased MBNA, the MBNA Foundation became part of their charitable program. *See* Press Release, Bank of America, Bank of America Completes MBNA Merger (Jan. 1, 2006), http://newsroom.bankofamerica.com/index.php?s=press_releases&item=7245.

Delaware's legislative and judicial system limits business uncertainty and increases Delaware's overall responsiveness to business needs, reducing the amount of bureaucratic failure.

The political climate in Delaware is mildly conservative and "marked by high respect for incumbency and a distrust of violent swings."[181] The longstanding political careers of Thomas Carper, Joseph Biden, William Roth, and Michael Castle are a testament to the Delawarean preference for stability.[182] Similar values affect the development of corporate law.[183] Predictability and continuity are values both investors and management desire. Two events in the development of Delaware corporate law demonstrate the enduring presence of these values: (i) the wave of takeover statutes enacted in the late 1980s; and (ii) the monumental *Smith v. Van Gorkom*[184] decision and its aftermath. In the former scenario, the Delaware legislature passed one of the most moderate takeover statutes in the nation when other states had already passed more restrictive laws.[185] In the latter scenario, the Delaware Supreme Court overturned a Chancery Court decision to find a corporate

181. Allen, *supra* note 3, at 3.

182. These politicians have served the state of Delaware in an array of political capacities over the past half-century. The sum of their time in political office exceeds 117 years. For the biographical information of Thomas Carper, Joseph R. Biden, William Roth, and Michael Castle see Congressional Biographical Directory, http://bioguide.congress.gov/biosearch/biosearch.asp (last visited Mar. 29, 2008). Delaware's preference for incumbency and political stability can be seen from the number of politicians who are re-elected to the same or different representative positions. For example, Joseph Biden has served in the United States Senate from 1972 to the present. Biden-Biographical Information, http://bioguide.congress.gov/scripts/biodisplay.pl?index=B000444 (last visited Mar. 29, 2008). Michael Castle served as Deputy Attorney General of Delaware for two years, as a representative to the Delaware House of Representatives for two years, as a Delaware state senator for eight years, as Lieutenant Governor of Delaware for four years, as Governor for eight years, and as a member of the United States House of Representatives from 1993 to the present. Castle-Biographical Information, http://bioguide.congress.gov/scripts/biodisplay.pl?index=C000243 (last visited Mar. 29, 2008). Tom Carper served as the Delaware State Treasurer for eight years, as a member of the United States House of Representatives for ten years, as Governor of Delaware for eight years, and as a United States Senator from 2001 to the present. Carper-Biographical Information, http://bioguide.congress.gov/scripts/biodisplay.pl?index=C000174 (last visited Mar. 29, 2008). Prior to his death in 2003, William Roth served as a representative to the United States House of Representatives for three years and as a senator in the United States Senate for thirty years. Roth-Biographical Information, http://bioguide.congress.gov/scripts/biodisplay.pl?index=R000460 (last visited Mar. 29, 2008).

183. *See* Romano, *Competition for Corporate Charters*, *supra* note 38, at 855–56 (describing Delaware's hesitance to adopt takeover legislation).

184. 488 A.2d 858 (Del. 1985).

185. *See* Romano, *Competition for Corporate Charters*, *supra* note 38, at 855.

board personally liable for breaching their duty of care.[186] In response to the *Van Gorkom* decision, the Delaware legislature passed section 102(b)(7) of the Delaware General Corporation Law, which allows shareholders to approve charter amendments waiving director liability for inattention.[187] Delaware's mildly conservative political climate favoring stability and institutional alignment is an enduring source of value for corporations.

g. Network Externalities

Wide use of Delaware law ensures it will be used in the future due to the "network and learning externalities that accrue to firms incorporated in the state."[188] An example of a positive network externality would be the use of Microsoft operating systems that continue to command significant market share (irrespective of product superiority) due to existing or already pre-existing wide use. Likewise, the more widely Delaware corporate law is used, the more valuable it becomes to each corporation. When firms are subject to the same legal benchmarks, this increases predictability in judicial decision making. Legal uniformity among corporation also "facilitates securities pricing by making comparisons with other securities on the market easier."[189] Firms value legal uniformity and predictability. Aside from existing wide use, Delaware's position is also the result of past use that led to the development of comprehensive case law and quality legal services.[190] Ehud Kamar describes these effects as "learning externalities" because they do not depend on the extent of current use.[191] In sum, existing wide use and extensive past use of Delaware law is valuable to corporations.

The foregoing examples illustrate the significant role tangible criteria play in attracting incorporating firms. Delaware has one

186. *Van Gorkom*, 488 A.2d, at 893. In *Van Gorkom*, the Delaware Supreme Court held that the directors of Trans Union Corporation breached their duty to make an informed decision about a proposed merger and as a result found the directors personally liable for damages. *Id.*

187. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2001); Allen, *supra* note 3, at 3.

188. Kamar, *supra* note 14, at 1923. Here, Ehud Kamar uses the telephone as an example whereby the more extensive the telephone network is, the higher the value becomes for each user. *See id.*

189. *Id.* at 1924.

190. *See id.*

191. *See id.*

group largely responsible for drafting amendments to the corporate code, only ten judges hearing corporate cases, and one executive office participating in corporate matters by rapidly processing corporate filings. These tangible use-related factors make Delaware more attractive to corporations by providing a stable basis for corporate planning and efficiency.[192] Most of the tangible differentiation advantages enumerated herein—with the exception of the judiciary, case law, and political climate—are prone to replication and are not enduring sources of Delaware's competitive advantage. The incorporation decision, however, is not limited to tangible use-related criteria or performance characteristics. Equipped with imperfect information, companies must also consider intangible criteria that signal jurisdictional value.

2. Intangible Criteria Signaling Value to Incorporating Firms

Corporate law, in general, is uniform among many states. The principal difference lies in the "pace of innovation."[193] In addition to having tangible internal features lowering business costs, Delaware boasts more indirect or intangible criteria creating firm value.[194] Intangible criteria (related to what the Delaware brand represents) are essential elements of the Delaware brand, which may or may not require continued expenditures from the state of Delaware.[195]

a. Reputation

Companies often reincorporate in Delaware to expand the overall scope of their operations either through an IPO or merger and acquisition activity.[196] In either scenario, the firm will benefit from tangible use-related sources of value. In addition, Delaware incorporation sends a signal that a company has "big-time ambitions" in the large issues market.[197] Some experts have observed

192. *See* Alva, *supra* note 113, at 919 (summarizing Delaware's efficiency advantage).

193. *See* Carney, *supra* note 12, at 717.

194. In the context of the Delaware Brand, these intangible criteria may also have a positive psychological impact. *See* discussion *infra* Part III.B.2.

195. This suggests that Delaware's market position is not necessarily a function of anti-competitive behavior.

196. *See* Gordon, *supra* note 91, at 1963.

197. *See id.*

how Delaware's reputation for corporate efficiency and friendliness may positively impact stock price; however, these studies are inconclusive.[198] Delaware's judiciary has a reputation that, in some cases, can only be developed through the use of the court system.[199] The judiciary's decisions serve as public demonstrations of judicial skill and allow the "courts to communicate their skills continuously to the public."[200] Constant adjudication enhances Delaware's reputation. Even if other states recruited expert judges, it is unlikely this would lead to an instant boost in reputation.[201] Delaware's international reputation for understanding novel legal business issues contributes to the overall perception of U.S. corporate governance.

b. Time-in-Business

Delaware has a time-in-business advantage, which translates into a lasting reputation. Delaware is viewed as a pioneer and perennial leader in the market for corporate law. This perception is hard for other competitors to overcome.[202] Similar to Coca-Cola in the cola market, IBM in the personal computer market, and Daimler-Benz in the luxury car market, buyers assume time-in-business reflects quality and experience.[203] Such a response is rational because, when faced with the uncertainty of another rival jurisdiction, a firm will gravitate toward comfort and familiarity

198. *See* Daines, *Firm Value*, *supra* note 46, at 525 (finding higher Tobin's Q measurements for Delaware's corporations); Daines, *Incorporation Choices*, *supra* note 25, at 1560 (noting the impact of Delaware reincorporation on share price); Romano, *Competition for Corporate Charters*, *supra* note 38, at 848 (noting several studies have found positive price effects following Delaware incorporation); Subramanian, *supra* note 46, at 33 (finding statistical evidence that firms incorporated in Delaware were worth more than non-Delaware firms between 1991-1996, but that this trend subsided after 1996); Allen, *supra* note 3, at 2 (asserting reincorporation normally results in an immediate increase in stock price). *But see* Bebchuk, Cohen & Ferrel, *What Matters?*, *supra* note 46 (finding six pro-entrenchment aspects of corporate governance have a negative effect on shareholder value).

199. *See* Kamar, *supra* note 14, at 1925–26.

200. *Id.* at 1935. Former Chief Justice E. Norman Veasey notes that Delaware's reputation "is driven primarily by the national respect for our Court of Chancery and Supreme Court, as well as the historic and current initiatives of the General Assembly and the Governor in providing modern statutes and outstanding service to Delaware corporations." Veasey, *Best Job*, *supra* note 176, at 21; *see also* Kahan & Rock, *supra* note 39, at 1612 (describing perception of Delaware judge-made law as technical and apolitical).

201. *See* Kamar, *supra* note 14, at 1935 (discussing the lengthy process of attaining "the judicial advantage").

202. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 186.

203. Coca-Cola is more than 120 years old and the majority of the world's most valuable brands have existed for more than fifty years. *See* CLIFTON ET AL., *supra* note 5, at 28.

that stems from choosing a proven and identifiable product. Delaware's time-in-business allows it to play a greater role in defining corporate standards and shaping the competitive agenda.

c. Market Share and Customer Lists

The fact that most Fortune 500 companies are chartered in Delaware is itself a signal of value and quality. The list of firms incorporated in Delaware serves as a preferred customer list. Given this preferred list of customers, firms will likely assume Delaware is "better informed about the optimal formulation of the law due to its prolonged preeminence."[204] Some corporations may follow others as an alternative to incurring the search costs in finding a more advantageous jurisdiction. A similar rationale goes into individual decision making processes whereby people rely on information from others when making everyday business decisions, such as enlisting the services of a doctor or a mechanic.[205] Thus, the fact that so many successful large firms have incorporated in Delaware cultivates further demand.[206] This may result from a genuine belief concerning Delaware's tangible value or a desire to be held in the same esteem as other Delaware corporations.[207]

d. Academic Curriculum and Scholarly Debate

Widespread use of Delaware corporate law and its preeminence as the most desirable corporate domicile "invariably" make Delaware a central part of business law curriculum in the nation's law schools.[208] Virtually every textbook used to teach corporate law to American law students recognizes Delaware's preeminence.[209]

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204. Kamar, *supra* note 14, at 1938.

205. *See id.* States may copy Delaware statutory law because they believe Delaware has invested more resources and expertise in developing their law.

206. *See* AAKER, *supra* note 11, at 19 (asserting existing customers can provide brand exposure and reassurance).

207. Coffee, *supra* note 47, at 703 (describing a herding theory for analyzing Delaware's preeminence). One can also marshal a similar herding argument to explain, in part, why so many states emulate Delaware statutory law. *See* discussion *supra* Part III.B.1.a.

208. *See* Lawrence A. Hamermesh, *Why Students Learn Delaware Corporate Law*, CORP. EDGE, (Div. of Corps., Dover, Del.) Fall 1997, http://web.archive.org/web/20040516050604/www.state.de.us/corp/lawstudt.htm.

209. *See, e.g.*, R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, at F-1 (3d ed. 1998); ROBERT CHARLES CLARK, CORPORATE LAW § 13.6, at 584–88 (1986); CONTEMPORARY ISSUES IN CORPORATE

This phenomenon dates back prior to the 1950s.[210] Undoubtedly, lawyers play a role in the incorporation decision. As a result, lawyers advising incorporating firms will often prefer law that is familiar. This usually creates two options—incorporating either in their home state or in Delaware.

Scholarly debate also draws attention to Delaware's advantages. But, even when the scholarly analysis is not laudatory, it nonetheless draws attention to Delaware. In addition to adding to Delaware's mystique, corporate law scholarship may act as an additional check on Delaware legal actors. No other state comes close to attracting the attention Delaware receives from corporate legal scholars. Only the federal government (e.g., the Securities and Exchange Commission ("SEC")) attracts more attention than Delaware as evidenced by the recent volume of SOX-related articles. Such emphasis ensures tomorrow's corporate lawyers will be versed in Delaware law. Meanwhile, "[a]massing a similar body of knowledge with respect to some other jurisdiction's corporate law would require a radical reformation of the corporate law curriculum and an expensive retooling of the nation's corporate bar."[211] The unchallenged emphasis on Delaware law operates as free advertising and signals Delaware's jurisdictional superiority to lawyers and corporations.

In addition, Delaware judges are prolific authors on corporate governance matters[212] and often participate in conferences and

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GOVERNANCE, at xiii–xiv (D.D. Prentice & P.R.J. Holland eds., 1993) (listing case citations from various countries, including nineteen U.S. cases, seven of which are from Delaware); MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 68 (8th ed. 2000); FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.2, at 42-43 (2000); THOMAS LEE HAZEN & JERRY W. MARKHAM, CORPORATIONS AND OTHER BUSINESS ENTERPRISES 2 (1st ed. 2003); THOMAS R. HURST & WILLIAM A. GREGORY, CASES AND MATERIALS ON CORPORATIONS 124 (2d ed. 2005); ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 1.08, at 13 (1st ed. 1999); LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS § 3.01, at 50 (3d ed. 1996); *see also* Cary, *supra* note 12, at 671 ("Every corporation law casebook for students is filled with Delaware decisions because it is the state where great companies are organized and where there is the most corporate experience to draw upon.").

210. *See* DELAWARE SUPREME COURT: GOLDEN ANNIVERSARY 1951–2001, *supra* note 169, at 82 (discussing Delaware's impressive body of corporate and fiduciary law taught as leading authorities in U.S. law schools).

211. Hamermesh, *supra* note 208.

212. *See* Kahan & Rock, *supra* note 39, at 1603 n.117 (listing twenty-three publications by Delaware judges); Hamermesh, *Policy Foundations, supra* note 45, at 1759 n.38 (listing three more recent articles by Delaware judges).

symposia around the world.[213] In these fora, judges, practitioners, and academics engage in discursive discussion where views and insights are exchanged.[214] Some scholars contend this process creates an outlet for dissatisfaction thereby providing the judicial version of comment procedures and lobbying.[215]

e. Visibility to Top Management

Delaware is highly visible to managers of large corporations. In addition to asserting that managers (and perhaps the lawyers advising them) control the incorporation decision, race theorists explicitly and implicitly suggest Delaware's judicial and legislative pronouncements are directed to catch the eye of top management.[216] Disputes in Delaware courts adorn the pages of major newspapers and capture the attention of the national and global business community.[217] Brand experts contend news coverage

213. *See* Hamermesh, *Policy Foundations, supra* note 45, app. at 1788–92 (providing an impressive list of engagements by various members of the Delaware Supreme Court and the Court of Chancery).

214. *See* Strine, *Exquisite Jewel*, *supra* note 140, at 1270–71. Vice Chancellor Leo Strine further acknowledges Delaware judges do not operate in a vacuum: "Our courts are also responsive to 'constituent pressures,' which often take the form of learned commentary on our corporation law." *Id.* at 1270.

215. *See* Kahan & Rock, *supra* note 39, at 1614. One could also characterize these gatherings as marketing activities by Delaware state actors.

216. Some race-to-the-bottom theorists contend such communication is often at the expense of shareholders. But, a more balanced, and perhaps more accurate view, would suggest that irrespective of whether a response by Delaware courts is deemed pro-management or pro-shareholder, firms will nonetheless acquiesce in a decision due to respect for the courts.

217. *See, e.g.*, Dennis K. Berman, *The Game: Fine Line of Selling, Selling Out, The Firm*, WALL ST. J., Jan. 30, 2007, at C1 (discussing Delaware judges' interest in establishing a new line of cases in corporate governance related to CEO's soliciting buyout deals); Bloomberg News, *Suit Over Sale of Clayton Homes to Buffet*, N.Y. TIMES, June 10, 2003, at C8 (emphasizing Chancery Court's ability to force meetings between companies as part of rulings); Rita K. Farrell, *Lord Black Says Investors Should Decide on Asset Sale*, N.Y. TIMES, July 5, 2004, at C1 (associating the well-known Hollinger case with Delaware); Laurie J. Flynn, *Long Battle Between Oracle and Peoplesoft Shifts to a Delaware Court Today*, N.Y. TIMES, Oct. 4, 2004, at C4 (discussing the *Oracle* case and linking Delaware courts with important business topics including poison pills, good faith, manager responsibility, and deference to business judgment); John Gapper, *Capitalist Punishment*, FIN. TIMES (London), Jan. 29, 2005, Weekend Magazine, at 16 (detailing the history and evolution of the Court of Chancery and why it is generally considered pro-management, but how recent decisions are changing that perception); Francesco Guerrera & Brooke Masters, *Rulings Mean Directors Face New Liability*, FIN. TIMES (London), Feb. 16, 2007, Companies International, at 24 (discussing recent pro-shareholder decisions by Delaware courts); Laura M. Holson, *Ruling Upholds Disney's Payment in Firing of Ovitz*, N.Y. TIMES, Aug. 10, 2005, at A1 (summarizing the issues in the *Disney* ruling and illustrating how Delaware influences corporate governance); Steve Lohr, *Suit Against Hewlett Deal is Dis-*

may be more effective publicity than paid advertising.[218] The *Van Gorkom* decision and the more recent *Disney* litigation illustrate how Delaware court decisions draw considerable attention from the business community.

i. *Van Gorkom*

The monumental 1985 decision in *Smith v. Van Gorkom*[219] followed by the passage of 102(b)(7), signaled to corporate managers that Delaware remained friendly and flexible to corporate needs.[220] In *Van Gorkom*, the Delaware Supreme Court held that the directors of Trans Union Corporation breached their duty to

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missed, N.Y. TIMES, May 1, 2002, at C1 (linking business issues such as disclosure and shareholder voting and a well-known company with Delaware courts); Dan Mitchell, *A Hollywood Moment in Delaware*, N.Y. TIMES, Aug. 13, 2005, at C5 (discussing a symposium devoted to Chancellor William Chandler's opinion in the *Disney* case); Floyd Norris, *Will 'Business Judgment' Rule Again in Delaware Courts?*, N.Y. TIMES, June 15, 2001, at C1 (discussing a paper that called for a return to the "business judgment" rule in Delaware and highlighting the importance of Delaware courts); Bruce Orwall & Merissa Marr, *Judge Backs Disney Directors in Suit on Ovitz's Hiring, Firing*, WALL ST. J., Aug. 10, 2005, at A1 (linking Delaware courts to the *Disney* case); Andrew Parker & Sundeep Tucker, *US Judge Attacks Sarbanes-Oxley*, FIN. TIMES (London), July 6, 2005, at 1 (highlighting comments made by a Delaware judge concerning federal corporate governance reforms); Editorial, *Regulating Fantasyland*, N.Y. TIMES, Aug. 12, 2005, at A18 (discussing the *Disney* case and linking the very public case with Delaware); Bob Sherwood, *Delaware Court Sends Wake-up Call*, FIN. TIMES (London), Feb. 28, 2004, Companies, at 5 (discussing the *Hollinger* case and displaying Delaware's importance in shareholder suits); Kaja Whitehouse, *SEC is Allowed Access to Delaware High Court*, WALL ST. J., May 30, 2007, at B3 (discussing Delaware constitutional amendment allowing SEC to bring questions directly to the Delaware Supreme Court, highlighting the importance of Delaware courts to national corporate law).

218. *See* AAKER, *supra* note 11, at 74.

219. 488 A.2d 858 (Del. 1985). The directors were found personally liable for actions deemed to be grossly negligent. *Id.* at 884.

220. In response to the Delaware Supreme Court's decision, the Council of the Corporate Law Section of the Delaware Bar appointed a committee to draft a statute limiting director liability. *See* Alva, *supra* note 113, at 914–16. This bill overwhelmingly passed in the General Assembly "without debate or amendment." *Id.* at 916. Another example of this phenomenon would be Delaware's passage of a very moderate anti-takeover statute amid the passage of stricter laws in other jurisdictions. William J. Carney describes the factors compelling Delaware's moderate response:

> These features of Delaware's response suggest that its legislature was indeed constrained by its concern over investor reactions to these statutes and the effect they would have on the choice of chartering jurisdiction. The adoption of any statute can be seen as a concession to incumbent managers seeking protection and threatening to move to more protective jurisdictions. However, the relative moderation exercised by Delaware in enacting these laws must surely be explained by the effects of a competitive market for charters.

Carney, *supra* note 12, at 755 (footnote omitted); *see also* Skeel, *The Unanimity Norm*, *supra* note 138, at 139 (discussing Delaware's attempt to articulate an intermediate standard of review in the takeover context).

make an informed decision about a proposed merger and as a result found the directors personally liable for damages. *Van Gorkom* delivered a jolt to corporate boardrooms because "to hold that distinguished business leaders breached their duty of care and could be liable for millions of dollars in damages was not something which had happened much before."[221] In addition, *Van Gorkom* may have caused director and officer insurance policies to become more expensive.[222]

ii. *Disney*

A more recent example of Delaware's high visibility is the *Disney* litigation, which addressed executive compensation.[223] The *Disney* decisions involved the controversial fourteen-month tenure of Disney President Michael Ovitz and his $140 million dollar severance package approved by Disney's board.[224] Ultimately, the *Disney* litigation did not result in liability for Disney's directors, who approved Ovitz's compensation.[225] Nonetheless, the decision sent a warning signal to corporate boardrooms.[226] The Chancery Court opinion noted that the conduct of the Disney directors "fell significantly short of the best practices of ideal corporate governance" but was nonetheless in good faith.[227] The Chancery Court decision used colorful language to describe the conduct of Disney CEO Michael Eisner, asserting he "enthroned himself as the omnipotent and infallible monarch of his personal Magic Kingdom."[228] In essence, the court acknowledged the board was "stacked" with friends and acquaintances of Eisner, who were

221. GEVURTZ, *supra* note 143, at 315–16. For the court's reasoning in finding a violation of the duty of care, see *Van Gorkom*, 488 A.2d at 874–78, 884. *See also* Griffith, *supra* note 47, at 12–14 (discussing the legacy of the *Van Gorkom* decision); Laurie P. Cohen, *Lipton Tells Clients that Delaware May Not Be a Place To Incorporate*, WALL ST. J., Nov. 11, 1988, at B7 (discussing prominent corporate attorney's letter in response to controversial *Van Gorkom* decision); Editorial, *Corporate Liability Crisis*, WALL ST. J., Aug. 21, 1986, at 22 (describing *Van Gorkom*); Letter to the Editor, *Directors' Duty to Shareholders*, WALL ST. J., Sept. 12, 1986, at 1 (replying to *Van Gorkom* editorial).

222. *See Corporate Liability Crisis*, *supra* note 221.

223. Brehm v. Eisner, 746 A.2d 244 (Del. 2000); In re Walt Disney Co., 907 A.2d 693 (Del. Ch. 2005).

224. 746 A.2d at 251, 253; 907 A.2d at 697–98.

225. 746 A.2d at 266; 907 A.2d at 779.

226. *See generally* Holson, *supra* note 217; Orwall & Marr, *supra* note 217; *Regulating Fantasyland*, *supra* note 217.

227. 907 A.2d at 697.

228. *Id.* at 763.

"certainly more willing to accede to his wishes."[229] The *Disney* litigation illustrates that, even where a decision does not result in liability for board members, embarrassing details of corporate dysfunction may tarnish a company's reputation.[230] Reputational risk is another salient reason for boardrooms to pay attention to Delaware court pronouncements.[231]

f. Credible Commitment

Credible commitment is the belief that the Delaware legal regime and its various actors will continue to meet the ever-changing needs of the business community in a non-politicized manner. This feeling of security, or peace of mind, is independent of Delaware's tangible features. There is an implicit understanding between the Delaware brand and Delaware firms. Delaware's investment in legal capital (i.e., judicial expertise, case law, a specialized bar, and a business-like Division of Corporations) and its reliance on franchise taxes instills confidence among firms that Delaware will continue to respond to their demands. Delaware's investment in legal capital signals to corporations that Delaware will continue to provide experienced and skilled judges and lawyers to assist corporations.[232] Without the attraction of corporate charters, Delaware's investments in legal capital would lose their value. The political climate in Delaware (characterized by a mild conservatism and distrust of large fluctuations) also serves as an additional guarantee against uncertainty.[233] Delaware's credible commitment is a disadvantage for other states because simply offering better law without attention to intangible criteria will not challenge Delaware's preeminence and competitive advantage. Even if a rival state were to lower franchise taxes to attract charters, this would perhaps make that jurisdiction's

229. *Id.* at 760.

230. *See* Orwall & Marr, *supra* note 217; Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997) ("Delaware courts generate in the first instance the legal standards of conduct (which influence the development of the social norms of directors, officers, and lawyers) largely through what can best be thought of as 'corporate law sermons.'").

231. *See generally* David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811 (2001) (describing shaming in the corporate context).

232. *See* Hamermesh, *Policy Foundations*, *supra* note 45, at 1752–62.

233. *See id.* at 1772–76.

commitment seem less credible compared to that of Delaware.[234] Credible commitment extends beyond merely lowering costs. For Delaware, it is about securing future demand. Credible commitment from the firm perspective is a backward-looking concept that reinforces the *ex ante* expectations and investment of firms. Former Chief Justice E. Norman Veasey expresses the need to signal an enduring commitment: "As business and court management become increasingly complex and other states seek fiercely to compete with us, we have to realize that we need to 'earn our wings every day' to justify that national respect and the respect and trust of our citizens."[235] Thus, Delaware must find ways to sustain its competitive advantage after the incorporation decision. One way of achieving this is through signaling a credible commitment that is not static, but dynamic.[236] Credible commitment provides security for Delaware firms and plays a key role in strengthening the Delaware brand.

g. Competitors

Contrary to what most of the state competition literature suggests, competing rival jurisdictions can enhance Delaware's competitive advantage in several ways.[237] First, the presence of rival jurisdictions actually enhances Delaware's dominance because competitors act as signals of value for Delaware's law—whether good or bad. Delaware's position in front of the competition signals quality to corporate firms. The fact that competition has resulted in statutory uniformity across numerous jurisdictions may signal to corporate firms that Delaware law is superior. Imitators are not held in the same regard as market leaders.[238] Second, rival jurisdictions can serve unattractive categories of buyers.[239] Third, rival jurisdictions lower the threat of federal encroachment. Finally, competitor presence, whether state or federal, increases Delaware's motivation to improve.[240]

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234. *See* Kamar, *supra* note 14, at 1927.

235. Veasey, *Best Job*, *supra* note 176, at 21.

236. *See* Veasey, *Center of Universe*, *supra* note 12, at 168 (listing a number of modernization projects Delaware courts have undertaken).

237. *See* Bebchuk & Hamdani, *supra* note 12, at 589–605.

238. For example, Hyundai is not held in the same regard as Honda.

239. Here, an example would be privately held or small- and medium-sized enterprises.

240. Delaware cannot ignore the presence of rival jurisdictions and the threat of federal

The above-mentioned differentiation advantages—tangible and intangible—contribute to Delaware's dominance. The enumerated advantages above, although distinct, are elements of the Delaware brand. These advantages reveal how Delaware provides a unique customer experience and sustains its market power like a branded product or service.

IV. THE IMPLICATIONS OF BRANDING ON THE CORPORATE REGULATORY COMPETITION DEBATE

Delaware has become the default choice for large publicly traded firms seeking incorporation. The previous sections illustrate how Delaware's dominance is, in part, the result of the Delaware brand—a conglomeration of tangible and intangible elements. To the extent Delaware's legal regime is branded, the Delaware brand has significant implications for the broader corporate regulatory competition debate.

A. *A Compelling Descriptive Account of Delaware's Dominance*

The branding discussion provides a compelling account of Delaware's dominance. An analysis of branding in the corporate charter market illustrates how existing regulatory competition theories provide an incomplete description of state charter competition because they omit one of the most important sources of Delaware's competitive advantage. By recognizing the interaction between tangible and intangible elements, the branding account further illustrates how the explanatory power of traditional corporate regulatory competition theories are overstated. "Messy" or "soft" factors like branding effects show how the abundance or dearth of competition alone cannot serve as a proxy for legal quality or justify further federalization of corporate law.[241] In a sense, the state charter competition debate has morphed into a referendum on Delaware's legitimacy as a de facto regulator of U.S. corporations.[242] Few dispute the importance of legitimacy and even

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government encroachment.

241. *See* David A. Skeel, Jr., *Corporate Anatomy Lessons*, 113 YALE L.J. 1519, 1542 (2004) [hereinafter Skeel, *Corporate Anatomy*] ("The law is simply a piece of a much larger system, and only by looking at the entire system can lawmakers and scholars evaluate any given issue or develop an informed proposal for change.").

242. An overarching concern in the regulatory competition debate is Delaware's legiti-

fewer can define it in a concise manner. Because legitimacy is a complex concept, its measurement is, at best, a speculative exercise. Generally, there are two types of legitimacy: substantive and procedural.[243] From the substantive perspective, legitimacy reflects the belief that particular decisions of the Delaware courts are substantively correct. Substantive legitimacy, however, may vary from group to group, case to case, and methodology to methodology. Accordingly, "[t]here is too much controversy among legal elites, and too little informed endorsement among the mass public, to warrant strong claims of legal [or substantive] legitimacy (as opposed to weak or disputable ones) for the interpretive methodologies that substantially define the judicial role."[244]

Procedural legitimacy hinges on the presence of institutional arrangements that promote safeguards, (e.g., transparency and independence) and prevent abuses of power.[245] From this vantage point, to challenge Delaware's legitimacy "is to question whether it is entitled to obedience" irrespective of the actual outcomes of judicial decisions.[246] The effective functioning of political institutions requires the goodwill of the public. Unlike the legislative or executive branches of government, Delaware courts lack a formal connection to the electorate. This illustrates how Delaware and its courts "must depend to an extraordinary extent on the confidence, or at least the acquiescence, of the public."[247] Without this acquiescence or confidence, the threat of federal preemption would become more imminent.

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macy as a *de facto* regulator of corporations given its small stature. *See, e.g.*, Cary, *supra* note 12, at 695 (questioning Delaware's legitimacy and influence).

243. *See* Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 161 (2007) (asserting corporate governance is akin to procedural legitimacy).

244. Richard H. Fallon, Jr., *Legitimacy and the Constitution*, 118 HARV. L. REV. 1787, 1827 (2005).

245. *See* Coglianese, *supra* note 243, at 161–62.

246. David A. Strauss, *Legitimacy and Obedience*, 118 HARV. L. REV. 1854, 1866 (2005). Kahan and Rock contend the public perception of Delaware law as largely "technocratic" and "apolitical" helps fend off federal intervention. *See* Kahan & Rock, *supra* note 39, at 1611–15.

247. *See, e.g.*, Gregory A. Caldeira, *Neither the Purse Nor the Sword: Dynamics of Public Confidence in the U.S. Supreme Court*, 80 AM. POL. SCI. REV. 1209, 1209 (1986). Although useful, public opinion is not an adequate proxy for legitimacy because it may oversimplify the complex and nuanced concept of legitimacy. For example, the public may disagree with a particular decision, but nonetheless acquiesce and obey the decision out of respect for the institution. Another major criticism is that the public is not that familiar with the Delaware courts and their interpretive practices. *See, e.g.*, Fallon, *supra* note 244 at 1825–26. Whereas public opinion may vary widely, Delaware's institutional legitimacy is more fixed. *See id.* at 1827–29.

In the complex corporate law context, the measure for Delaware's legitimacy should, at a minimum, reflect its ability to balance competing values (e.g., law and equity, or authority and accountability) and mirror the complexity of its subject matter.[248] The Delaware branding account captures this complexity and, as a consequence, "encompasses not only legal rules [and unitary values such as economic efficiency], but also norms, history, and social context."[249]

B. *The Delaware Judiciary's Incentives To Engage in Principled Lawmaking*

Traditional accounts of Delaware's dominance, especially race-to-the-bottom theories, tend to discount the prospect of principled lawmaking by Delaware's judiciary. Principled lawmaking occurs when Delaware judges analyze the complex cases before them, acknowledge legal precedent, and balance competing values, such as efficiency, equity, authority, and accountability. Traditional accounts of Delaware's dominance sometimes denigrate the judicial role by asserting that Delaware's lawmaking, whether good or bad, is simply a defensive measure in response to state-to-state competition or a federal-state rivalry. Delaware's judiciary (i.e., Delaware Court of Chancery and the Delaware Supreme Court), however, is not as defensive, calculating, rent-seeking, or opportunistic as some accounts of regulatory competition indicate.[250] Even if one wholeheartedly accepts these accounts of Delaware lawmaking, one must acknowledge how brand maintenance contributes to the shape of Delaware law. In Delaware's case, brand

248. *See* Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. AND LEE L. REV. 1565, 1587 (1993) (arguing corporate law must acknowledge technical and normative complexity to retain its legitimacy); *see also* DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 6–10 (2005) (highlighting three enduring issues that stifle regulators: risk taking, competition, and complexity of organizations).

249. Skeel, *Corporate Anatomy*, *supra* note 241, at 1522.

250. *See* Hamermesh, *Policy Foundations*, *supra* note 45, at 1772–86. Delaware critics often focus on narrow aspects of Delaware law, such as ownership decisions involving takeovers, to make normative judgments concerning the entire Delaware legal regime and its legitimacy. This narrow approach is flawed because it fails to incorporate the range of corporate decisions covered by Delaware law. *See* Veasey, *Defining Tension*, *supra* note 48, at 394 (dividing corporate governance issues three separate areas: enterprise, ownership, and oversight issues). Ownership issues tend to be the most controversial. *See id.* Takeover defenses fall under this category of decision.

maintenance necessitates principled lawmaking.[251] The Delaware brand is often associated with judicial integrity, competence, the understanding of corporate complexity, flexibility, and apolitical decision making. If Delaware's judiciary is perceived as unbalanced (e.g., biased, ad hoc, arbitrary), offending managers, investors, and other key interest groups, such groups may lobby Congress to act.[252] Stated differently, there are key incentives for Delaware's judiciary to engage in principled lawmaking: namely, averting extensive federal encroachment.[253] The strength of the Delaware brand can and has survived moderate federal incursions, but extensive federal encroachment poses a more serious threat.[254] In sum, maintaining the strength of the Delaware brand is contingent on the perception that the Delaware judiciary engages in principled lawmaking. This perception dissuades federal preemption.

C. *The Sustainability of Delaware's Brand*

The Delaware branding account demonstrates that Delaware's dominance is sustainable and relatively unchallenged by other states. Given the strength of the Delaware brand, the federal government is Delaware's only formidable threat.[255] To maintain its dominance, Delaware must attract new entrants to offset losses from combinations, business failures, and relocations.[256] The vexing question is how Delaware can achieve this. Delaware has sustained its market position as a result of the following: (i) developing sources of differentiation that are hard to duplicate; (ii) utilizing multiple sources of differentiation incorporating and

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251. *See* Veasey, *Aspirations*, *supra* note 51, at 2179 ("A word of caution is that the judge-made law must not be of a free-wheeling or ad hoc quality. It must involve a disciplined and stable stare decisis analysis based on precedent and a coherent economic rationale."); *see also* Kahan & Rock, *supra* note 39, at 1598 (describing Delaware's judge-made law as flexible and fact-intensive while still being based on long-standing fiduciary principles).

252. *See* Roe, *Delaware's Politics*, *supra* note 39, at 2518–19.

253. *See* Gordon, *supra* note 91, at 1967–70 (expressing skepticism that the motivations of Delaware courts, specifically the Delaware Supreme Court, are accurately portrayed by public choice accounts of charter competition).

254. *See* Roe, *Delaware's Politics*, *supra* note 39, at 2498.

255. *See generally*, Roe, *Delaware's Competition*, *supra* note 39, at 600–02; Kamar, *Myth*, *supra* note 39, at 684.

256. *See* Gordon, *supra* note 91, at 1962. A survey revealed that approximately 80% of corporations leaving Delaware reincorporate in their principal state of business. Kaouris, *supra* note 114, at 1000.

reincorporating firms' value; (iii) retaining corporations already heavily invested in Delaware's uniqueness, thus making switching costs too high; and (iv) branding effects, which lower search costs, insulate firms from episodes of turbulence or service failure, and secure future demand. Sustainable competitive advantage and the viability of the Delaware brand require Delaware to continue to develop both tangible and intangible sources of differentiation to attract corporations. Delaware's level of differentiation reflects the cumulative value it creates for incorporating firms.

A key component of Delaware's differentiation is the overall strength of its brand.[257] Therefore, the Delaware brand cannot become a commodity. Once established, top brands become extremely durable.[258] Leading brand studies illustrate top brands are slow to decay,[259] and Delaware is no different. For example, Coca-Cola is more than 120 years old and the majority of the world's most valuable brands have existed for more than fifty years.[260] Although the estimated life span of a corporation is approximately twenty-five years,[261] strong brands can outlive a string of corporate owners. Strong brands also insulate firms against the impact of product failure or turbulence.[262] For example, in the 1980s, a nationwide tampering scandal called into question the safety of the Tylenol brand.[263] Johnson & Johnson, the owner of the Tylenol brand, weathered the storm of controversy by removing its product from retail shelves and providing tamper-proof packaging.[264] Here, the strength of the Tylenol brand insulated its manufacturer from long-term reputational damage and prevented the loss of long-term customer goodwill. One can analogize the Tylenol scenario to the *Van Gorkom* back-

257. CLIFTON ET AL., *supra* note 5, at 43 (asserting brands are tremendous assets that provide long-term competitive advantage).

258. *See* AAKER, *supra* note 11, at 70–71, 84.

259. *See id.*

260. CLIFTON ET AL., *supra* note 5, at 28.

261. *See id.* (citing RICHARD N. FOSTER & SARAH KAPLAN, CREATIVE DESTRUCTION: WHY COMPANIES THAT ARE BUILT TO LAST UNDERPERFORM THE MARKET—AND HOW TO SUCCESSFULLY TRANSFORM THEM (2001)).

262. *See* KELLER, *supra* note 11, at 53–56 (discussing the impact of brands in periods of crisis).

263. *See* David Kaplan, *Franchises Can Windup in Sticky Situation*, HOUS. CHRON., May 25, 2003, Business Section, at 1.

264. *See id.* at 57–60 (discussing Johnson & Johnson's response to the Tylenol tampering scandal).

lash and the subsequent passage of the 102(b)(7) exculpation statute.[265] The *Van Gorkom* decision was largely an unpopular decision in its time and is by today's standards as well.[266] Ultimately, the decision and its aftermath neither caused massive corporate migration nor undermined Delaware's long term dominance. Similarly, the strength of the Delaware brand explains, in part, why Delaware can withstand criticism during periods of corporate scandal, such as the Enron aftermath, only to return to its *ex ante* position.[267] For Delaware, "[t]he good news is that well-established brands can take a lot of punishment before they are irretrievably damaged."[268] In sum, Delaware's historical dominance portends that the Delaware brand is here to stay.[269]

1. The Threat of Rival Jurisdictions

The strength of the Delaware brand creates few options for rival jurisdictions.[270] Some commentators argue that rival states face insurmountable barriers to competition because it is too difficult "for any other jurisdiction to replicate all the advantages Delaware now possesses."[271] Recognizing this, one might expect states not to have many incentives to compete and to become indifferent to innovation.[272] Simple replication will not yield the same benefits for rival jurisdictions because the incorporation decision is a multi-faceted package. Even when faced with Dela-

265. *See* discussion *supra* Part III.B.2.e.i.

266. *See* Fred S. McChesney, *A Bird in the Hand and Liability in the Bush: Why* Van Gorkom *Still Rankles, Probably*, 96 NW. U. L. REV. 631, 631 (2002) ("Considered a legal disaster in 1985, it is judged no less disastrous today.") (footnote omitted).

267. *Cf.* Griffith, *supra* note 47, at 8.

268. Gapper, *supra* note 4.

269. *See generally* Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996) (asserting that conditions existing at the time an institution is formed will influence its functioning far into the future, without respect to efficiency considerations).

270. Despite its limits, competition plays an undeniable role in the creation of corporate law. *See* Carney, *supra* note 12, at 726. Competition provides incentives for Delaware to innovate its law, and almost equally (if not more) important, it lowers the threat of further federal encroachment into Delaware's regulatory sphere—something Delaware and its firms can be happy about. Moreover, rival jurisdictions signal the value of Delaware's package and serve unattractive categories of corporations. Thus, Delaware is not adverse to competition. This does not mean, however, that Delaware does not have an incentive to engage in defensive tactics to sustain competitive advantage.

271. *Id.* at 718 n.8.

272. Other states have fewer incentives to attract corporate charters because franchise taxes do not constitute a significant portion of state revenues as compared to Delaware. *Id.* at 718–19.

ware's dominance, however, there are perhaps still alternatives and potential opportunities. Delaware's failure to live up to the Delaware brand's core associations, such as judicial integrity and flexibility, may create potential opportunities for rival jurisdictions. By ignoring the intangible aspects of its brand, Delaware could become vulnerable to attack from a rival jurisdiction. Delaware's strong brand equity, however, makes this an unlikely scenario. The greatest risk to the Delaware brand remains the prospect of federal preemption.

The most formidable alternative for rival jurisdictions in the charter competition context is to focus or specialize in serving a particular category of corporation that is not served or is underserved by Delaware's legal regime. A focus strategy entails identifying differences in corporate need among different categories of companies and marketing to a distinct niche. There are perhaps three potential categories of corporations that rival states can cater to in the charter market. First, a state may serve private closely held companies that are not served (or are underserved) by Delaware's legal regime.[273] The corporate law literature as well as Delaware's taxation scheme suggest Delaware does not target this segment of the market.[274] A second category of corporations rival jurisdictions can attract are publicly held companies whose principal business operations are located within the particular rival jurisdiction.[275] A survey finding approximately eighty percent of the corporations leaving Delaware reincorporate in

273. *See* Carney, *supra* note 12, at 716 (considering the question of whether states accept "a secondary role as incorporators of truly local, nonpublic businesses"); *see also* Barry D. Baysinger & Henry N. Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179 (1985). An example of privately held companies that rival jurisdictions could target by providing incentives would be internet companies, many of which are privately held. Before interstate banking regulation eliminated its uniqueness, states attempted to attract banks through a favorable regulatory climate and taxes. In fact, Delaware was one of the first states to adopt such banking legislation in 1981. Although many large banks are not private, this example is helpful nonetheless.

274. Delaware's franchise tax fee schedule lays a greater burden on large publicly traded corporations. Franchise taxes are determined using two methods. *See* Delaware Department of State, Division of Corporations, Franchise Tax Calculations, www.corp.delaware.gov/frtaxcalc.shtml (last visited Mar. 29, 2008). The authorized shares method relies almost exclusively on the number of authorized shares. The second method used is the assumed par value capital method, which utilizes a formula incorporating gross assets and all issued shares. *See id.* These methods, coupled with Delaware's reliance on franchise taxes for state revenues, suggest that Delaware is targeting large publicly traded companies. Hence, privately held corporations may be unattractive to Delaware.

275. For a discussion of home-state bias, see discussion *supra* Part I.

their principle state of business supports this proposition.[276] Legislatures in jurisdictions where companies have their principal business activities will be more receptive to treating such corporations favorably because an exodus would result in not only a significant loss of franchise tax revenue, but also a drop in overall employment and investment. Finally, states may attract small and medium-sized enterprises ("SMEs"); however, SMEs are not a high-end market segment and, as a result, states may not wish to target them.

Ultimately, the success of any focus strategy depends on whether the segment of targeted corporations is large enough to support the cost of a jurisdiction's tailored activities.[277] Even if a jurisdiction can serve a particular category of corporation, the cost of doing so may be too high. Assuming it is cost effective for a jurisdiction to focus and specialize, the sustainability of that strategy will depend on three factors: (i) just how different the jurisdiction's focus is from Delaware and other states; (ii) the presence of barriers to imitating the focus strategy and the risk of being out-focused by a jurisdiction with an even narrower focus; and (iii) the risk that corporations will be drawn to other jurisdictions due to a shift in demand brought on by multiple factors, such as changes in the legal environment, competitive behavior, or branding effects.[278]

2. The Federal Threat

As mentioned above, state-to-state competition is not a significant threat to Delaware's dominance, but the threat of further federal encroachment is real. The prospect of federal preemption is more likely than corporate migration to other states. The federalization or preemption of state corporate law would generally operate in two ways: (i) creating a federal chartering option or (ii) preempting Delaware via federal lawmaking, as is currently done. Merely offering a federal incorporation option would not displace Delaware's dominance. Due to the strength of the Delaware brand among key constituencies of managers and shareholders, companies would continue to choose Delaware over the

276. *See* Kaouris, *supra* note 114, at 1000.
277. *See* PORTER, COMPETITIVE ADVANTAGE, *supra* note 93, at 265–69.
278. *See id.*

federal option.[279] However, the latter scenario involving federal preemption via federal lawmaking, depending upon its extent, could displace Delaware's dominance and weaken the Delaware brand, especially to new incorporating firms. Mark Roe describes the potential impact of extensive federal encroachment on Delaware's dominance via lawmaking:

> The state's reputation for good lawmaking would also be hurt if federal authorities regularly displaced it; and if corporate America or the public lost confidence in Delaware, the franchise tax would be threatened. If Delaware authorities lost their esprit, their lawmaking quality would suffer. If too much went federal, the bar and corporate America could conclude that Delaware had lost its relevance. In turn, fewer firms would want to go to Delaware and Delaware's network externalities would weaken, opening up competitive opportunities for other states. At the limit, if Washington made all corporate law, but states still chartered firms, then Delaware couldn't charge more because its charter wouldn't come with any local law. Delaware's tax bonanza would shrivel.[280]

Despite having Commerce Clause powers to preempt Delaware corporate law, the federal government seems reluctant to exercise these powers.[281] Delaware's brand equity among powerful constituencies (e.g., managers and shareholders), in part, explains the federal government's reluctance. Delaware's brand strength helps explain the manager and shareholder reluctance, aversion, or indifference toward greater federal intervention even where federal law may appear to favor their discrete interests. The federal-state interaction story is not simply about Delaware lawmakers fearing preemption. The federal government (e.g., Congress) also fears a backlash from the corporate manager-investor alliance, which arguably yields the greatest power in Washington.[282] Mark Roe's public choice account supports the argument that managers and shareholders—Delaware's primary interest

279. Federalizing all corporate charters could also destroy the Delaware brand, removing any semblance of competition, and Delaware's revenues as well.

280. Roe, *Delaware's Politics*, *supra* note 39, at 2918.

281. *See* Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 WASH. U. L.Q. 445 (1991) (describing the impact of *CTS Corp. v. Dynamics Corp. of America* on corporate law, and how the federal government is still reluctant to pre-empt Delaware and other state law).

282. *See* Jill E. Fisch, *How Do Corporations Play Politics?: The FedEx Story*, 58 VAND. L. REV. 1495 (2005) (describing a case study of FedEx to illustrate how corporations buy and use political power).

groups—have an affinity for the Delaware brand.[283] Thus, the strength of the Delaware brand keeps the federal government at bay. As a practical matter, total preemption is unlikely given the strength of the Delaware brand and its affinity among powerful corporate constituencies. Alternatively, the federal government opts for a measured approach, as reflected in minor or moderate incursions, such as SOX legislation.[284]

D. *The Contribution of the Delaware Brand to U.S. Corporate Governance*

Another serious implication of the Delaware brand is its contribution to U.S. corporate governance. Is the Delaware brand good or bad for U.S. corporate governance? The answer to this question depends on multiple factors, including one's vantage point (e.g., managers, shareholders, or other stakeholders). One might answer this question in the negative, arguing that Delaware's brand is nothing more than a form of market irrationality, which allows Delaware to perpetuate its market power while offering a suboptimal product. Indeed, most brands have the potential to exploit customers—especially where intangible value significantly outweighs tangible performance features. This is not the case, however, with Delaware. Delaware's brand is not simply an illusory marketing ploy; it has valuable content to counterbalance some of its intangible features.[285] Moreover, the threat of federal intervention and preemption operates as an additional

283. Mark Roe asserts that managers and shareholders are the primary interest groups influencing Delaware corporate lawmaking. Meanwhile, federal government lawmaking is more pluralistic, involving more interest groups that reflect populist concerns absent in Delaware. *See* Roe, *Delaware's Politics*, *supra* note 39, at 2518–19. Roe contends Delaware is largely insulated from populist concerns, except to the extent the federal government makes Delaware lawmakers aware. *Id.* These periods of heightened awareness coincide with corporate scandals. Delaware law, however, is malleable enough or provides ample discretion for management to accommodate populist concerns. *See* Elhauge, *supra* note 144, at 742. Even if populist groups are not included in the Delaware corporate lawmaking process, their interests are nonetheless reflected in other types of regulation (e.g., environmental, labor, health and safety). *See* CLARK, *supra* note 143, at § 1.4 (distinguishing between traditional corporate law and other laws affecting corporations). Even if traditionalists contend that such regulations do not fall under the rubric of corporate law, they nonetheless have significant impacts on companies and populist stakeholder groups.

284. An example of a massive encroachment would be a federal statute codifying the fiduciary duties of all U.S. directors.

285. *See infra* Appendix Figure 1. The ratio of Delaware's tangible factors to its intangible ones may provide an indication of the Delaware brand's value to firms.

check and balance on Delaware's potential abuse of its market power.

The Delaware brand not only benefits individual firms, but also strengthens U.S. corporate governance. Delaware, the SEC, and self-regulating organizations, such as the New York Stock Exchange and NASDAQ, share regulatory oversight over most publicly traded firms.[286] Traditionally, Delaware law has governed corporate internal affairs, while the SEC has addressed external issues of securities trading and disclosure. There is considerable debate, however, concerning the appropriate balance.[287] While some critics would describe the current relationship between Delaware and the SEC as a "good cop, bad cop" routine with publicly traded firms, the more accurate characterization is a complementary relationship where both regulators provide security for investors.[288] Delaware's style of corporate governance provides flexibility and eschews a one-size-fits-all approach; yet, it is capable of responding to corporate fraud.[289] Accordingly, "Delaware is more likely to be part of the solution than . . . part of the problem."[290]

Furthermore, damage to the Delaware brand could undermine firm value to the extent that equity markets discount for weak or unpredictable governance structures.[291] Therefore, if the perceived strength of governance structures is reflected in higher

286. *See* Kahan & Rock, *supra* note 39, at 1605–06; *see also* Veasey, Pompian & Di Guglielmo, *supra* note 134, at 77 (describing how Sarbanes-Oxley blurs the traditional lines between Delaware and the SEC).

287. *See id.*

288. Delaware and the SEC share a complementary role in the promulgation of corporate law. The work of the SEC and Delaware legal actors may overlap or inform the other. *See* Whitehouse, *supra* note 217; *see also* Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 879 (2006) (noting the incoherent efforts to articulate appropriate boundaries between federal and state corporate law regimes); Kahan & Rock, *supra* note 39, at 1621–22; Press Release, Delaware Supreme Court, Delaware Constitutional Amendment Enacted Allowing the Securities and Exchange Commission to Bring Questions of Law Directly to the Delaware Supreme Court (May 15, 2007) (on file with author), *available at* http://courts.delaware.gov/Courts/Supreme%20Court/pdf/?deconstamend051507pdf.pdf (explaining a Delaware constitutional amendment allowing the SEC to seek the Delaware Supreme Court's advice on corporate issues requiring a definitive answer interpreting Delaware state law).

289. *See* Larry E. Ribstein, *Markets vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 58–60 (2003) (discussing the advantages of Delaware law and state regulatory competition).

290. *Id.* at 59.

291. *See* Cary, *supra* note 12, at 668–70.

stock prices, the Delaware brand has a positive impact on investors. There is empirical evidence, though inconclusive, showing the positive impact of Delaware incorporation on share price.[292] Such a spike in share price seems logical when one considers that incorporations usually coincide with IPOs or ownerships changes, which are corporate events signaling growth. But, more empirical data is needed to confirm this Delaware effect, or spike, in share price. Additionally, the legal uniformity created by Delaware's dominance also facilitates securities pricing by making firm comparisons easier.[293] To the extent empirical data confirms the positive impact of Delaware incorporation on security pricing, this provides significant evidence of the Delaware brand's positive impact on U.S. corporate governance.[294] Yet, scholars may still argue Delaware is oblivious to populist stakeholder concerns and, therefore, shareholder wealth alone cannot serve as an adequate basis to evaluate the impact of the Delaware brand on U.S. corporate governance.[295] This concern is valid, but overstated when one considers the following mitigating factors. First, the broad discretion provided under Delaware law allows managers to consider populist concerns without being second guessed by courts.[296] Second, federal corporate law may incorporate broader stakeholder

292. *See* Daines, *Firm Value*, *supra* note 46, at 525 (finding higher Tobin's Q measurements for Delaware's corporations); Daines, *Incorporation Choices*, *supra* note 25, at 1560 (noting the positive impact of Delaware incorporation on share price); Romano, *Competition for Corporate Charters*, *supra* note 38, at 848–49 (noting that several studies have found positive price effects following Delaware incorporation); Subramanian, *supra* note 46, at 32 (finding statistical evidence that firms incorporated in Delaware between 1991–1996 were worth more than non-Delaware firms during the same period, though this trend subsided after 1996); Allen, *supra* note 3, at 2 (asserting reincorporation normally results in an immediate increase in stock price); *see also* Bebchuk, Cohen, & Ferrell, *What Matters?*, *supra* note 46.

293. *See* Kamar, *supra* note 14, at 1924.

294. Even in the absence of a public market for their shares, privately held firms exhibit a preference for Delaware incorporation. *See generally* J.C. Dammann & Matthias Schundeln, *The Incorporation Choices of Privately Held Corporations* (Univ. of Tex. Law, Law & Econ. Research, Paper No. 119, 2007), *available at* http://ssrn.com/abstract=1049581.

295. *See generally* Fisch, *supra* note 282 (acknowledging certain stakeholder interests are not reflected in measures of shareholder wealth and questioning the suitability of shareholder wealth as a unitary basis for corporate regulatory decisions).

296. *See generally* Margaret M. Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (acknowledging directors, within their jurisdiction, may consider non-shareholder interests in order to maximize the joint welfare of all firm stakeholders).

concerns.[297] Finally, the panoply of other regulations impacting corporations (e.g., OSHA, ERISA, Clean Air Act, etc.) may address stakeholder concerns.[298] **Any evaluation of the Delaware brand must consider Delaware's interaction with other regulators and bodies of law.**

CONCLUSION

Existing accounts of state charter competition have overlooked a key chapter in the story of Delaware's unchallenged dominance—the Delaware brand. The Delaware brand is a conglomeration of tangible and intangible elements that has significant implications for Delaware, incorporating firms, and U.S. corporate governance. Regulators, academics, and practitioners, whether Delaware proponents or detractors, cannot ignore the branding effects influencing incorporation decisions. Accordingly, those involved in corporate reform efforts, such as further federalization of U.S. corporate law, should carefully consider the potential impacts of a weak Delaware brand.[299]

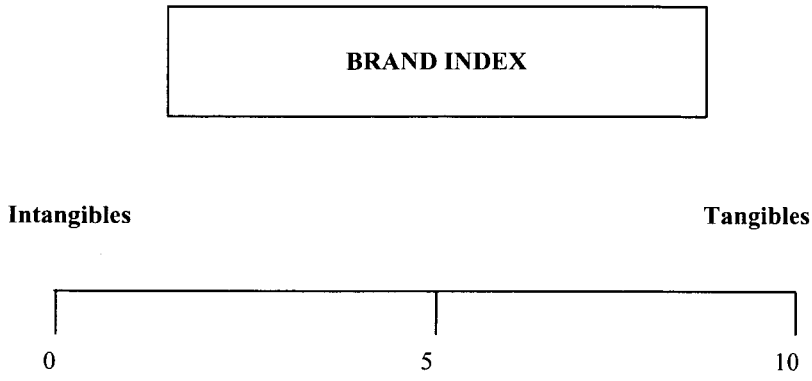
297. *See* Roe, *Delaware's Politics*, *supra* note 39, at 2502–04.

298. *See* CLARK, *supra* note 143, at § 1.4 (distinguishing between traditional corporate law and other laws affecting corporations).

299. Although beyond the scope of this article, the branding story may have broader implications. The branding account may have relevance to the discussion of corporate legal convergence and global competition for corporate law (e.g., listing rules, etc.). *See* Gilson, *supra* note 3, at 330. Countries desiring to attract foreign investment may adopt U.S.-type corporate governance features because of their branding effects and not solely upon tangible performance characteristics. *See* Coffee, *supra* note 47, at 700. In today's competitive business environment, multinational firms have choices and may decide to bypass U.S. incorporation or listing on a U.S.-based exchange. Given the increased competition posed by foreign jurisdictions, branding is especially important to the United States's jurisdictional preeminence.

APPENDIX A

FIGURE 1



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