THE MODERNIZATION OF CORPORATION LAW, 1920-1940

Harwell Wells*

INTRODUCTION

What forces shape corporation law? The basic framework that produces corporation law in the United States is readily apparent. Under the United States' system of corporate law federalism,[1] each state has the power to make its own laws concerning how corporations are to be governed, and a corporation may then select which state's law will regulate its internal affairs by incorporating in that state, even if the corporation is based elsewhere.[2] Identifying this framework does not, however, explain how such basic arrangements set in motion the complex processes that have over the past century produced modern corporation law.

When explaining corporation law's evolution, scholars have identified as overwhelmingly important a consequence of corporation law federalism:

* J.D., Ph.D., Assistant Professor of Law, Temple University Beasley School of Law. My thanks to Jane Baron, David Hoffman, Gregory Mark, Lawrence Mitchell, Robert Thompson, and Wyatt Wells, for helpful comments, Sarah Maguire and Josette Oakley for excellent research assistance, and the Temple University Beasley School of Law for research support for this project. Special thanks to John Necci and his staff at the Temple University Law Library and to Pegeen Bassett of the Northwestern University Law Library for locating material on Illinois corporation law.

1. *See* Gregory Mark, *The Court and the Corporation: Jurisprudence, Localism, and Federalism*, 1997 SUP. CT. REV. 403 (providing a historical account of the development of corporate law federalism); Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 J. CORP. L. 99, 100 (2004) (noting that the United States' corporate law federalism allows for state innovation in corporate governance). For corporations with publicly traded securities, federal securities laws also play a significant role, especially since the passage of the Sarbanes-Oxley Act. Sarbanes-Oxley Act, 15 U.S.C. § 7201 *et seq.* (2002). *See generally* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005) (arguing that the Sarbanes-Oxley Act is a piece of poorly conceived, ineffective legislation that works against the beneficial system of corporate federalism).

2. The corporation's choice of law occurs under the well-recognized internal affairs doctrine. *See* Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006) (discussing the internal affairs doctrine, its origins, and its effect upon state competition for incorporation).

the opportunity it creates for states to compete for incorporations.[3] A state presumably benefits when a corporation chooses to incorporate in it, and it has long been apparent that some states have in some historical periods consciously competed to attract incorporations.[4] Presumably, states have competed by changing their corporate laws to attract corporations that might otherwise incorporate elsewhere. While a number of states have competed for corporate charters, Delaware has proven the clear winner in this competition, and is now legal home to a majority of the publicly traded corporations in the United States.[5]

Although scholars agree that states have competed for incorporations, they disagree on the particulars; corporation law experts still spar over the effects of this competition, disputing whether the laws that such competition produced favor corporate management or shareholders,[6] and whether states still compete for incorporations at all or whether most have abandoned the field to Delaware.[7] Scholars have also disagreed over why particular states seek to attract incorporations; earlier accounts focused on the benefits that accrued to a state's citizens when taxpaying corporations relocated there and presumably reduced the tax load for ordinary taxpayers,[8] while more recent accounts have sought to identify interest groups within a state that particularly benefit from the legal presence of newly incorporated (or reincorporated) firms.[9] Despite the different

3. The notion of competition for corporate charters is ubiquitous in corporate law scholarship. *See, e.g.*, Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793, 1794 (2006) ("One of the fundamental questions facing corporate law scholarship concerns regulatory competition."); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporate Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1797 ("One of the most important questions in U.S. corporate law is whether competition in the corporate charter market represents a 'race to the top' or a 'race to the bottom.'").

4. Although scholars dispute whether states now compete for incorporations, such competition certainly occurred in the past. *See infra* Part III (chronicling changes in state corporation laws since the 1920s).

5. According to the State of Delaware's Division of Corporations, more than 50% of all publicly traded U.S. corporations, and more than 60% of the Fortune 500, are incorporated in Delaware. Delaware Division of Corporations, http://corp.delaware.gov (last visited Feb. 21, 2009).

6. *See infra* Part I (discussing the debate about whether state competition produces a "race to the top" or "race to the bottom).

7. *See, e.g.*, Lucian Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 554-55 (2002) (noting that Delaware, contrary to conventional wisdom, faces little competition from other states in the market for incorporation); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporation Law*, 55 STAN L. REV. 679, 684 (2002) (positing that Delaware is the only state that makes significant efforts to attract incorporation).

8. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 YALE L.J. 663, 668 (1974).

9. *See, e.g.*, Jonathan Macey & Geoffrey Miller, *Toward an Interest-Group Theory of*

opinions among scholars, the debates share a basic assumption that competition for charters was the fundamental engine that produced today's corporation law.[10]

This Article complicates this view through an account of many states' adoption of self-consciously "modern" corporation laws during the 1920s and 1930s.[11] Although scholars have almost completely overlooked this development,[12] the movement to adopt modern corporation laws in these decades throws sharp light on larger presumptions about the evolution of corporation law. While inter-state competition for corporate charters is an important element in the story, this account reveals that competition was not the only driver of legal change. This Article shows how their drafters designed these new laws, not merely to attract corporations, but to protect shareholders, and how they aimed less to attract out-of-state incorporators than to retain incorporations of corporations already located there. Interest groups were certainly involved in drafting and adoption—the laws gained great support from state bar associations—but alongside these local interest groups worked legal reformers, and the laws were the product not only of local needs but of broader national trends and of an interstate network promoting corporate law innovation. In short, this Article shows that competition was not the whole story of corporation law's evolution.

Yet, this Article also shows the inescapable effect of state competition. The "modern" corporation laws that this era produced were ultimately less radical, and more similar to the laws of Delaware, than their

Delaware Corporation Law, 65 TEX. L. REV. 469, 472 (1987) (finding that the corporate bar in Delaware benefits most from Delaware's dominant position in attracting incorporation).

10. Though it should be noted that some scholars now believe interstate competition is no longer the driver of corporation law. *See, e.g.*, Bebchuk & Hamdani, *supra* note 7, at 554-55 (arguing Delaware's position is too dominant to fall within interstate competition).

11. At the time observers clearly noticed that such a movement was underway. *See* E. Merrick Dodd, *Statutory Developments in Business Corporation Law, 1886-1936*, 50 HARV. L. REV. 27 (1936) (analyzing the development of corporation law in Massachusetts and Illinois over a fifty-year period); Wiley B. Rutledge, Jr., *Significant Trends in Modern Incorporation Statutes*, 22 WASH. U. L.Q. 305, 310-12 (1937) (finding that the prevailing trend among states was less regulation and more autonomy for the corporation). *See generally Modernization of Corporate Statutes: A Symposium*, 12 WISC. L. REV. 417 (1937) (explaining Wisconsin's efforts in the mid-1930s to modernize its corporation law using other states' modernization efforts as a model); Ray Garrett, *Model Business Corporation Act*, 4 BAYLOR L. REV. 412, 415-18 (1951) (chronicling various states' modernization efforts from 1927 to 1951).

12. There is one notable exception, which is now almost forty years old. J. WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970 70-76 (Univ. Press of Va. 1970). Indeed, few legal historians have focused on modern corporations at all. *See* Gregory A. Mark, *The Corporate Economy: Ideologies of Regulation and Antitrust, 1920-2000*, *in* 3 THE CAMBRIDGE HISTORY OF LAW IN AMERICA 614, 646-50, 872-73 (Michael Grossberg & Christopher Tomlins eds., Cambridge Univ. Press 2008).

drafters may have wished. In some cases, states would not adopt reformist provisions out of fear that they would spark an exodus to a "chartermongering" state (sometimes explicitly identified as Delaware). This Article argues neither that these reform efforts were completely successful, nor that they were thwarted by the threat of Delaware's competition; instead, this Article presents a more nuanced account in which reformers strove to produce shareholder-protective laws for corporations based in-state, while acutely aware that they labored in the shadow of Delaware.

Part I of this Article reviews recent debates over the production of corporate law and identifies the specific corporate law debates to which the Article contributes. Part II discusses the crucial developments that led to the movement to modernize state law, and focuses on both the changes in corporation law between the 1880s and 1920, and the changes in capital markets and share ownership in the 1920s that further convinced reformers of the need for new statutes. Part III examines the motives behind states' legal reforms and the ways that local reform efforts linked together within a loose national network for reform. Part IV looks at specific statutory reforms, documents why states adopted them, and assesses the degree to which they succeeded. Part V follows the reform movement into the 1930s, and explains how the movement survived the federal government's intervention in corporation law reform through that decade's federal securities acts.

I. COMPETITION AND THE PRODUCTION OF CORPORATION LAW

A bedrock assumption of corporate law scholarship is that states compete for charters, and that such competition propels the development of corporate law.[13] This assumption lies at the heart of perhaps the most widely debated question in the field: whether this competition has led states to offer laws that enhance shareholder value or merely enrich management.[14] Commentators often sum up this inquiry as whether state competition produces a "race to the bottom" (i.e., a rush to adopt manager-friendly laws that do not benefit shareholders), or a "race to the top" (i.e., states jockeying to provide corporation laws that enhance the value of a corporation and therefore benefit shareholders).[15] Observers have recognized for over a hundred years that at least some states have changed

13. Although, a few iconoclastic scholars, such as those discussed *supra* note 3, recently challenged this assumption.

14. Bebchuk & Hamdani, *supra* note 3, at 1794.

15. *See generally* McDonnell, *supra* note 1, at 103-09 (providing a useful overview of the debate over who benefits from state competition).

their corporation laws to attract out-of-state incorporators.[16]

The modern debate, however, caught fire in the early 1970s with the publication of William Cary's article, *Federalism and Corporate Law: Reflections upon Delaware*.[17] The article restated a long-held belief of many corporation law critics: that the need to compete for incorporations led Delaware to produce a corporation code that empowered managers (who had the power to choose where to incorporate) at the expense of shareholders (who did not) and that other states changed their laws in similar fashion to compete with Delaware.[18] In the late 1970s, Ralph Winter challenged this belief when he argued that state law competition instead produced a race to the top.[19] Because public corporations needed to raise funds in the capital markets, he reasoned, their managers could not afford to adopt a legal regime that disadvantaged shareholders, as this would drive up their costs of capital, lower share price, and invite a hostile takeover.[20] Winter soon enlisted supporters in the fight; notably, Roberta Romano bolstered the claim that state competition tended to maximize shareholder value through a series of rigorous empirical studies of corporate valuation and the diffusion of corporate law innovations,[21] while Daniel Fischel, and Frank Easterbrook promoted similar ideas in their work on the law and economics of corporation law.[22] By the late 1990s, the new consensus was that state competition for charters produced a race to the

16. *See, e.g.*, Liggett v. Lee, 288 U.S. 519, 542-43 (1933) (Brandeis, J., dissenting) (setting out an early version of the "race to the bottom" argument).

17. Cary, *supra* note 8, at 663. One observer believes that Delaware's revision of its corporation law code in 1967 sparked the modern scholarly debate. Lawrence Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1752-56 (2006).

18. *See* Cary, *supra* note 8, at 665-66 (complaining that the Model Business Corporation Act was watered down in response to competition from Delaware).

19. *See* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL ST. 251 (1977) (arguing that state corporation law sufficiently protects shareholder rights, constantly moves towards optimality, and remains a better option than federal regulation); Ralph K. Winter, *The "Race to the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526, 1528-29 (1989) (defending the position that state corporation law does not foster a "race to the bottom," but rather produces efficient corporate regulation and shareholder protection).

20. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 15 (Foundation Press 2002).

21. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225, 265-73 (1985); Sanjai Bhagat & Roberta Romano, *Empirical Studies of Corporate Law*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 945 (A. Mitchell Polinsky & Steven Shavell eds. 2007).

22. FRANK EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (Harv. Univ. Press 1996); Daniel R. Fischel, *The 'Race to the Bottom' Revisited: Reflections on Recent Developments in Delaware Corporation Law*, 76 NW. U. L. REV. 913 (1982).

top.[23]

In recent years, other scholars have provided new takes on the theme of state competition and corporate law evolution. Lucien Bebchuk and Assaf Hamdani, and Marcel Kahan and Ehud Kamar, argue that contemporary state competition is overblown—in Kahan and Kamar's word, a "myth."[24] While acknowledging that competition may once have propelled the development of corporation law, they assert that today Delaware reigns largely unopposed and other states lack any serious incentive to compete with it for charters.[25] To the extent that states compete, they do so only for incorporations from firms already based in-state;[26] almost no state apart from Delaware still seeks to attract the incorporations of out-of-state firms.[27] Other scholars have recast competition in other ways. Mark Roe attempted to refocus the debate by claiming that, while other states no longer compete with Delaware, a sort of competition still occurs between Delaware and the federal government, given that the threat of federal intervention can always curb Delaware's ability to provide corporation law.[28] All of these contentions, however, are still contentious; Romano recently argued that states compete for corporation charters and cited as evidence the diffusion of innovative provisions in state corporation laws.[29]

A different facet of the debate focuses on *how* states—particularly Delaware—craft their corporation laws, and which groups within states significantly influence the process. In the first round of scholarship, race-to-the-bottom scholars identified the beneficiaries of competition (and the villains of the piece) as Delaware and its citizens.[30] Delaware produced manager-attractive corporation law, so the reasoning went, and in return

23. Subramanian, *supra* note 3, at 1799.

24. *See* Bebchuk & Hamdani, *supra* note 7, at 565-66 (noting that companies incorporate in states with large populations and big economies); Kahan & Kamar, *supra* note 7, at 684-85 (arguing that other than Delaware, states do not compete for companies to incorporate within their respective states).

25. Kahan & Kamar, *supra* note 7, at 724-25. Notably, Kahan and Kamar take no position as to whether such competition occurred in the past.

26. Bebchuk & Hamdani, *supra* note 7, at 568-72.

27. There is one interesting exception: Nevada appears to compete with Delaware for close corporation incorporations. Kahan & Kamar, *supra* note 7, at 716-17.

28. *See* Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591-92 (2003) (describing how the federal government can influence and even take away Delaware's chartering business); *see also* Bebchuk & Hamdani, *supra* note 3, at 1794-95 (arguing that the federal government should take a more active role in corporate law matters); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1575-76 (2005) (examining the relationship between state and federal corporate lawmaking).

29. Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 210-11, 214 (2007).

30. Cary, *supra* note 8, at 664, 668-69.

received taxes from the corporations eager to incorporate there and take advantage of its laws.[31] In the late 1980s, the work of Romano, and subsequently Jonathan Macey and Geoffrey Miller, revised and extended this account.[32] As part of a larger project, each scholar identified specific groups as the “producers” of Delaware corporation law—in Macey and Miller’s words, “the interests within the state that stand to benefit . . . from the state's chartering system.”[33] Macey and Miller identified the Delaware bar as the prime beneficiary of, and the in-state interest group best placed to promote, Delaware’s corporation-friendly law.[34] Similarly, Lawrence Hamermesh’s fascinating “inside” account of the production of Delaware law identified the Delaware legislature and the State Bar Association as the makers of that state’s corporation code, and cited an “inherent conservatism”—not the desire for corporate revenues—as the lodestone of Delaware’s corporation lawmaking.[35]

Despite the long debates, few scholars have taken a fine-grained look at the actual, historical process of state competition for incorporations, and the ways that particular states have crafted their corporation laws in response to competitive pressures.[36] The most sweeping recent accounts of the evolution of corporation law in the late nineteenth and early twentieth centuries, Herbert Hovenkamp’s *Enterprise and American Law, 1836-1937*, and Morton J. Horowitz’s *The Transformation of American Law, 1870-1960*, largely eschew detailed analysis of specific state innovations, and instead focus on more abstract legal and constitutional discourse concerning corporations.[37] When scholars focus on competition and

31. Although Cary identified various groups, including the Delaware legislature and judiciary, that contributed to Delaware’s preeminence, he attributed the same goal to all of them: “revenue for the state of Delaware.” *Id.* at 668.

32. *See generally* Romano, *supra* note 21 (analyzing the factors that fostered Delaware’s preeminence in the reincorporation market); Macey & Miller, *supra* note 9, at 469-70 (examining the connection between Delaware’s revenues from incorporations and firms that take advantage of a favorable legal environment in Delaware).

33. Macey & Miller, *supra* note 9, at 471.

34. *See id.* at 472-73, 509 (“[The] Delaware bar is able to prevail over rival groups in procuring favorable corporate law rules.”). Both Romano’s and Miller and Macey’s accounts are broader than this discussion may indicate, as they also focus extensively on other aspects of Delaware’s legal system that make it an attractive legal home for out-of-state corporations; but for the purposes of this Article, their identification of the Bar as a central interest group is most important.

35. Hamermesh, *supra* note 17, at 1752. Hamermesh’s account focuses on Delaware law reformers’ current aims, and does not ask what goals the drafters of ninety years ago may have had.

36. As Gregory Mark notes, some race-to-the-bottom scholars dipped into the history of state competition for corporate charters, but race-to-the-top scholars avoided historical analysis altogether. Mark, *supra* note 1, at 404.

37. MORTON J. HOROWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870-1960 65-107 (Oxford Univ. Press 1992); HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW,

corporation law, they chiefly look to the early era, when Delaware first gained preeminence. Recently, the legal historian Charles Yablon took a new look at the birth of modern corporation laws in New Jersey, and the consequent competition between it and several other states that aimed to attract out-of-state incorporators between 1890 and 1915.[38] Similarly, in his recent book, *The Speculation Economy*, Lawrence Mitchell examined the origins of New Jersey's early dominance as a chartering state.[39] A handful of other studies also examined the diffusion of corporation law innovations and incorporations later in the century.[40]

Although illuminating, these historical studies highlight tremendous gaps that still exist in our knowledge of how state corporation laws developed and changed over time, and the role that various factors, including state competition, played in creating today's corporate law regimes. The abovementioned studies focus on the foundational era of modern corporation law, and understandably concentrate on the active competition for incorporations among Delaware, New Jersey, and competitor states in the years before 1920.[41] What is missing are accounts of how the law evolved after Delaware leapt ahead of its competitors in the 1910s, how the law evolved in states that did not compete nationally for corporate charters, and how changing social, economic, and political contexts—not just state competition—may have shaped its further development. Among other things, this Article aims to fill those gaps, not merely to supplement the historical record, but to provoke reconsideration of standard accounts of the development of corporation law.

1836-1937 11-64 (Harvard Univ. Press 1991). This is not to criticize either work, but just to point out that the authors did not purport to provide a detailed history of state law innovations.

38. Charles M. Yablon, *The Historical Race*, 32 J. CORP. L. 323, 347-58 (2007).

39. LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 30-56 (Berrett-Koehler Publishers 2007).

40. Two studies deserve special note: Roberta Romano's examination of the diffusion of state corporation law innovations that began in the 1960s, Romano, *supra* note 29, at 209, and Bebchuk and Hamdani's fascinating study showing that publicly traded corporations not legally domiciled in Delaware tend to distribute in different states. Bebchuk & Hamdani, *supra* note 7, at 565-69.

41. Apart from the works by Yablon and Mitchell, discussions about early competition can be found in CHRISTOPHER GRANDY, NEW JERSEY AND THE FISCAL ORIGINS OF MODERN AMERICAN CORPORATION LAW (Garland Publ'g 1993); WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 144-75 (Princeton Univ. Press 1997).

II. HISTORIES

A. *The Evolution of Corporation Law, 1880-1920*

The laws examined in this Article lay at the tail end of a forty-year process of legal reform.[42] The nineteenth century had seen the rise of "general incorporation," in which the early nineteenth-century requirement that each corporation receive a special charter from the legislature was replaced by a regime in which the state chartered any corporation that met fixed statutory requirements.[43] Yet, the general incorporation rules did not provide incorporators with broad freedom to organize their enterprises in any way they pleased. Before the 1890s, freedom of incorporation "meant only freedom to incorporate on rigidly restrictive provisions, not . . . freedom from restrictions in incorporation."[44] While general incorporation had made it easier to incorporate, corporations were still hemmed in by the laws that granted them their corporate status, and incorporators were not free to vary their corporation's organization significantly from the model supplied by the state.

In Massachusetts, to take one example, a corporation chartered before the turn of the twentieth century was limited in many ways. It corporation could not have legal capital of more than $1,000,000, or less than $5,000.[45] Its capital had to be fully paid-in, and it had attest to that to the Secretary of the Commonwealth.[46] Limited liability was limited; stockholders were personally liable for employees' unpaid wages, and further "liable to creditors where debts were contracted before the stockholder had fully paid for his stock, where capital was reduced and repaid to stockholders, [or] where special stock had been created and had not been redeemed."[47] The

42. *See* LAWRENCE FRIEDMAN, A HISTORY OF AMERICAN LAW 131-35, 390-400 (Simon & Schuster 3d ed. 2005) (summarizing changes in state corporation law in the nineteenth century); WILLIAM J. NOVAK, THE PEOPLE'S WELFARE: LAW AND REGULATION IN NINETEENTH-CENTURY AMERICA 105-11 (Univ. of N.C. Press 1996) (discussing the constitutional cases that marked the liberalization of the corporation).

43. *See generally* Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 45 AM. U. L. REV. 1, 100-01 (1989) (discussing the shift to statutory requirements for incorporating firms).

44. Rutledge, *supra* note 11, at 306-07; *see also* HURST, *supra* note 12, at 76 ("The acts of the 1880s . . . retained traces of earlier distrust of the [corporate] device by continuing to insist that incorporators accept significant limitations of corporate structure.").

45. Dodd, *supra* note 11, at 32 (citing 15 MASS. PUB. STAT. ch. 106, § 7 (1882)). The law here applied to "mechanical, mining, and manufacturing business." *Id.* Although Dodd explored the limits in Massachusetts's statute, they were similar to restrictions that bound corporations in other states. *See generally* WILLIAM W. COOK, A TREATISE ON STOCK AND STOCKHOLDERS AND GENERAL CORPORATION LAW (Chicago, Callaghan & Co. 2d ed. 1889) (surveying state laws from the 1880s).

46. Dodd, *supra* note 11, at 32.

47. *Id.*

corporation had to have a single, specific purpose set out in its charter,[48] and the law generally held corporate actions unconnected to that purpose void.[49] Only unanimous shareholder consent could change a corporation's purpose, which points to a second distinctive feature of nineteenth century corporation law: not only did it constrain the corporation's activities, but it also gave meaningful control to shareholders. The Board's power over the corporation was, in theory, limited to managing its day-to-day affairs.[50] Directors could not, for instance, absent shareholder approval, enter into a conveyance, mortgage, or long-term lease of real estate,[51] authorize the issuance of new stock, or sell newly issued stock to whomever they wished, as the corporation had to first offer any new stock to existing shareholders in proportion to their current holdings.[52] The limit on stock issuance also served as a brake on any effort by managers to expand the corporation. Nor could directors and officers sidestep shareholder supervision by receiving voting proxies from them, as the laws also limited the number of proxies a director or officer could vote at a shareholders' meeting.[53]

Massachusetts's laws were typical of the late nineteenth century's "set pattern incorporation acts."[54] But, while these acts may have been adequate for a time when most corporations were comparatively small, they raised problems toward the end of the century when technological and organizational developments gave birth to giant industrial enterprises.[55] The new enterprises were often created by the combination of several once-independent companies, producing a pressing need to coordinate the operations of these companies through some centralized authority.[56] At that time, however, corporation law did not allow most corporations to hold

48. The fundamental organizing document of a corporation is called either the charter or the articles of incorporation, depending on the state of incorporation. This Article uses the term "charter."

49. Dodd, *supra* note 11, at 33. This is the *ultra vires* doctrine, which Part IV.E *infra* discusses in greater detail.

50. As a treatise of the time explained:

> The general authority of the directors of a corporation extends merely to the supervision and management of the company's regular business. A board of directors has no implied authority to make a material and permanent alteration of the business or constitution of a corporation, even though the alteration be within the company's chartered powers.

VICTOR MORAWETZ, 1 A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 512, at 479 (Boston, Little Brown & Co. 2d ed. 1886).

51. Dodd, *supra* note 11, at 33.

52. *Id.* Part IV.D, *infra*, discusses preemptive rights.

53. Dodd, *supra* note 11, at 33.

54. HURST, *supra* note 12, at 76.

55. *See generally* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (Harv. Univ. Press 1977) (setting out the now-standard story of the growth of large-scale enterprise in the United States).

56. *See id.* at 323-32 (tracing the formation of six pioneering trusts in the 1880s).

stock in other corporations,[57] and other arrangements that would have provided for centralized control, such as use of a "trust" as a holding entity, were open to legal challenge.[58] As such, the new corporations strained at the limits of the laws' set patterns.

In 1889, New Jersey offered a way out for these new enterprises when it passed a new corporation law that explicitly permitted corporations to own shares of other corporations, and so instituted the modern era in corporation law.[59] According to traditional accounts, this step was a move to lure corporations—or rather their incorporation business and accompanying fees—to New Jersey, and the gist of that account probably is correct.[60] Recently, Charles Yablon has painted a more nuanced picture of the development and pointed out that, even before it changed its laws to accommodate holding companies, New Jersey modified other parts of its corporation law to provide an attractive legal home to out-of-state corporations. As early as 1875, New Jersey amended its laws to allow corporations incorporated there to hold directors' meetings out-of-state; a few years later, its courts adopted a rule particularly protective of directors who authorized the issuance of corporation stock in exchange for property, such as would occur in a corporation's exchange of stock for another corporation's assets in a merger.[61] New Jersey soon became the preferred state of incorporation for large corporations, a development that profited

57. *Id.* at 323.

58. Challenges to corporations that participated in trusts were often based on a limiting feature of corporation law: a corporation typically could not participate in a trust if its charter did not explicitly grant that power. *See* Yablon, *supra* note 38, at 338-39 (discussing the legal challenges to trusts and the relevant role of corporation law).

59. Some challenge this date as the start of the modern era, and indeed, the best historian on the development of New Jersey's laws has emphasized the degree to which the 1889 legal reforms merely continued New Jersey's pro-corporation legal policy. *Id.* Notwithstanding, the opening of New Jersey to holding companies marks a departure from nineteenth century conceptions of corporation law.

60. The claim that New Jersey adopted liberalized corporation laws to attract out-of-state firms to incorporate, and thus pay the state fees, became a staple of Progressive attacks on corporations. *See* Lincoln Steffens, *New Jersey: A Traitor State*, MCCLURE'S MAG., Apr. 1905, at 649 (arguing that New Jersey passed incorporation acts that other states would not pass, simply to raise revenue); *see also* RON CHERNOW, TITAN: THE LIFE OF JOHN D. ROCKEFELLER, SR. 332 (Random House 1998) (explaining that Standard Oil executives noticed New Jersey's law). *See generally* MITCHELL, *supra* note 39, at 34-42 (providing a more general background on New Jersey's long history of favoring business interests).

61. Yablon, *supra* note 38, at 334. As Yablon observes, New Jersey became popular for incorporations not only because it legitimized the holding company, but also because its combined legal provisions "added flexibility to any firm or promoter engaged in negotiating the complex mergers and consolidations that were becoming increasingly popular in the 1890s." *Id.* at 343; *see* Jonathan Chausovsky, *State Regulation of Corporations in the Late Nineteenth Century: A Critique of the New Jersey Thesis*, 21 STUD. AM. POL. DEV. 30, 37 (2007) (arguing that New Jersey "did not start the 'race to the bottom;' rather, the state won a race already underway").

the state greatly, as the inrush of corporation taxes and franchise fees allowed it to eliminate its state property tax.[62] Thus, New Jersey won the first competition for charters.

Revisions that New Jersey made to its laws in 1896 give us a window into what large corporations found most attractive in corporation law.[63] Out of a welter of specific provisions, two themes stand out: the new law removed many limits formerly imposed on corporations, and vastly increased incorporators' and directors' powers relative to shareholders to craft the internal organization of a corporation. The 1896 act provided that a corporate charter could include "any provision for the regulation of the business and the conduct of the affairs of the corporation."[64] Two years later, the legislature further amended the act to allow provisions "creating, defining, limiting and regulating the power of the corporation."[65]

The new statutes also lessened shareholder power by removing unanimity requirements for major corporate transactions. New Jersey's revisions gave incorporators greater power to amend the corporate charter and issue new kinds of securities, with approval of only a set majority of shareholders.[66] This was one example of a larger shift during this era; corporation law—beginning with New Jersey's and Delaware's—replaced the requirement for unanimous shareholder approval of mergers with one that provided for mere majority approval, and instead gave dissenting shareholders the right to demand an appraisal and purchase of their shares.[67] As Yale's Bayless Manning noted half a century ago, while the replacement of unanimity with an appraisal right was sold as a protection for minority shareholders, it also had the effect of "giving greater mobility of action to the majority—that is, to corporate management speaking in the name of the majority."[68]

62. *See* GRANDY, *supra* note 41, at 45, 49-50, tbls. 3.4-3.5 (tracing the rise in New Jersey corporation receipts). New Jersey Governor Leon Abbett, in his 1893 message to the legislature, gave revenue from corporations "credit for dispensing with the state property tax. He attributed this solely to liberal corporation policy of the state." *Id.* at 45; *see also* MITCHELL, *supra* note 39, at 38-42 (describing how New Jersey hit on the incorporation business as a way to earn money).

63. Yablon, *supra* note 38, at 349-53; *see also* GRANDY, *supra* note 41, at 43-45 (noting that the new laws liberalized merger and stockholding authority).

64. Yablon, *supra* note 38, at 352 (citing 1896 N.J. LAWS 280).

65. *Id.* (citing 1896 N.J. LAWS 408).

66. *Id.* New Jersey's revision here responded to a similar provision in New York law. *Id.*

67. *See* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 221, 226 (1962) (noting the appraisal remedy as a statutory remedy across all states). *See generally* Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 82 GEO. L.J. 1, 11-20 (1995) (discussing the shareholders' remedy).

68. Manning, *supra* note 67, at 227.

As other states moved to compete with New Jersey, a slow process was set into motion that would replace the restrictive set-pattern acts of the 1880s with the liberal and flexible "enabling" corporation statutes that characterized the twentieth century.[69] Delaware, Maine, South Dakota, and West Virginia all soon altered their corporation laws to attract out-of-state incorporators, and even entered into agreements with corporation services companies to advertise nationally the easy virtues of their corporation statutes.[70] In response, other states such as Massachusetts and New York liberalized their own corporation laws, not to attract out-of-state incorporators, but simply to discourage firms already based in-state from incorporating elsewhere.[71] Of the states that competed with New Jersey, Delaware proved the most successful, and after the turn of the century it also began to attract significant incorporation business.[72] Its eventual preeminence was guaranteed when, in 1913, New Jersey's new reformist governor, Woodrow Wilson, persuaded the state legislature to adopt the so-called "Seven Sisters" provisions to its corporation act, which tightened state limits on corporations and helped destroy New Jersey's image as a safe location for incorporations.[73]

By the beginning of the 1920s, the legal landscape of corporation law had been transformed by the competition for corporate charters. A rough division can be drawn between the few states with corporation laws highly favorable to corporations, preeminently Delaware, and many others with laws that were perceived as at best adequate.[74] Although many of these

69. Justice Brandeis's dissent in Liggett Co. v. Lee, 288 U.S. 519, 542-43 (1933), famously summarizes this process. As Yablon points out, the competition was broad-based and involved not just a liberalized corporation law, but cutting taxes and incorporation fees. Yablon, *supra* note 38, at 359. Delaware eventually reversed this trend; today, its corporate law product is so desirable that corporations pay a premium to incorporate there.

70. *See* MITCHELL, *supra* note 39, at 40-42 (providing an entertaining account of New Jersey's collaboration with the Corporation Trust Company); *see also* Yablon, *supra* note 38, at 347-49 (discussing the organization of the Corporation Trust Company of New Jersey).

71. Yablon, *supra* note 38, at 358-59. New York, for instance, repealed its requirement for an annual report and lowered its incorporation fees, in a successful attempt to persuade many corporations with operations in that state to incorporate there. *Id.* at 364.

72. *Id.* at 361.

73. Yablon points out that Delaware's victory was a slow one; most New Jersey corporations did not immediately reincorporate in Delaware, and Delaware emerged as the favored home for large corporations only over time. *Id.* at 325 n.10; *see also* Mark, *supra* note 12, at 625-27 (summarizing Delaware's eventual dominance of the incorporation market and explaining why it proved attractive to many corporations). One promoter wrote in 1922 that over 40% of the capital that business corporations in the United States employed came from corporations organized in Delaware, New Jersey, New York, or Pennsylvania. JOHN S. PARKER, WHERE AND HOW: A CORPORATION HAND BOOK vii (Broun-Green Co. 6th ed. 1922).

74. *See infra* Part IV (discussing changes in the modernized laws).

states had certainly amended their corporation laws since the late nineteenth century, laws that had not been thoroughly updated for decades still helped make these states less attractive as a legal home for corporations.[75] These conditions, as well as changes in business and the corporate economy that the next section discusses, created fertile ground for legal reform efforts that began in the subsequent decade.

B. Corporations in the 1920s

During the 1920s, many states moved to update their corporation laws in response not only to the challenges posed by Delaware and other "chartermongering" states, but also to pressures generated by national developments in economics and finance. Indeed, the changes in the laws, and the pressures that gave rise to them, cannot be understood apart from larger developments that characterized the decade.

In retrospect, the 1920s appeared an economic golden age. After the sharp but brief recession of 1920-1921, the American economy entered seven years of sustained economic growth and almost doubled industrial production.[76] A series of new technologies, and the rapid and visible spread of the automobile, telephone, electrical, and radio industries convinced many that the United States had entered a "new era" of sustained economic growth.[77] As the economy heated up, older debates cooled; after decades of battle over the role of corporations in society, most Americans appeared to accept, or at least acquiesce to, the dominant role that giant corporations played in the economy.[78]

Not only did most Americans accept corporations' new role, many also took on new roles themselves as investors in those corporations. For the first time, significant numbers of ordinary, or at least non-wealthy, investors entered the stock market. Contrary to popular accounts, not everyone plunged into Wall Street; even at the end of the decade, probably no more than two million Americans actively invested in the stock market,

---

75. *Id.*

76. WILLIAM E. LEUCHTENBERG, THE PERILS OF PROSPERITY, 1914-1932 179 (Univ. of Chi. Press 1993).

77. MORTON KELLER, REGULATING A NEW ECONOMY: PUBLIC POLICY AND ECONOMIC CHANGE IN AMERICA, 1900-1933 76-85 (Harv. Univ. Press 1990).

78. *See id.* at 89 ("It was in the 1920s that the modern corporate economy, dominated by large, publicly financed companies servicing a massive consumer market, came of age."). "Most" does not mean "all"; some Americans continue to challenge the large corporation's role. *See, e.g.*, Liggett v. Lee, 288 U.S. 519, 541-43 (1933) (Brandeis, J., dissenting) (expressing wariness towards the growing size and power of modern corporations); Robert C. Schragger, *The Anti-Chain Store Movement, Localist Ideology, and the Remnants of the Progressive Constitution, 1920-1940*, 90 IOWA L. REV. 1011, 1022-28 (2005) (discussing the anti-chain store movement).

and probably "75 percent of the dollar value of all outstanding securities were held by not much more than half a million people."[79] Even this, however, was many more investors than before World War I, when stocks of all kinds had been perceived as highly speculative investments.

The War itself was one reason for the change, as it produced a sophisticated sales campaign that persuaded millions of Americans to place their savings in government-sponsored "Liberty Bonds."[80] From wartime Liberty Bonds, it was only a small step for postwar investors to begin purchasing corporate bonds, preferred shares, and even comparatively risky common stocks, a step aided by popular economics writers and businessmen who contended that purchasing stocks was no longer a risky "speculation" but instead a prudent "investment."[81]

As the number of securities buyers increased, so did the mix of securities that they bought. In 1922, the first year of the boom, securities issuances were overwhelmingly bonds; that year $2,329,000,000 in bonds were issued, compared to $333,000,000 in preferred shares and only $288,000,000 in common stock.[82] Seven years later, the numbers reflected the change in securities markets. In 1929, $2,620,000,000 in bonds were issued, but so were $1,565,000,000 in preferred shares, and an astonishing $5,062,000,000 in common stock.[83] Moreover, as investors bought more securities, they also bought new kinds of securities. According to one practitioner, the post-war years saw the sudden "development of such novel instruments of finance as non-par stock, non-voting and management stock, participating preferred stock, stock purchase warrants and convertible bonds, bankers' control, and holding and subsidiary corporations."[84] The proliferation of these new products offered investors new opportunities, but also untested choices. For example, investors who wished to keep their main investments in comparatively safe securities, but did not want to miss

79. STEVEN FRASER, EVERY MAN A SPECULATOR: A HISTORY OF WALL STREET IN AMERICAN LIFE 391 (Harper Collins 2005). When "passive holders of securities in pension funds, corporate stock ownership plans, and so on" are included, however, as many as fourteen million could be numbered as Wall Street investors. *Id.*

80. *Id.* at 350-51.

81. *See* VINCENT CAROSSO, INVESTMENT BANKING IN AMERICA: A HISTORY 285 (Harv. Univ. Press 1970) (discussing the campaigns to encourage investment in common stocks).

82. 3 HISTORICAL STATISTICS OF THE UNITED STATES: FROM EARLIEST TIMES TO THE PRESENT MILLENNIAL EDITION 3-766, tbl. Cj831-837 (Cambridge Univ. Press 2006).

83. *Id.*

84. Joseph V. Kline, *Studies in the Law of Corporation Finance*, 42 HARV. L. REV. 714, 714 (1928) (reviewing A. A. BERLE, STUDIES IN THE LAW OF CORPORATION FINANCE (1928)). Kline may have exaggerated the novelty of some of these innovations—for instance, railroad financing used convertible bonds in the mid-nineteenth century. ARTHUR STONE DEWING, THE FINANCIAL POLICY OF CORPORATIONS 117 (Ronald Press Co. 3d ed. 1934). But, Kline's comment points out the spectacular growth and spread of these instruments in the 1920s.

out on the potential upside offered by common stock, could purchase bonds or preferred shares convertible into common stock, or which came with attached option warrants that allowed later purchase of common shares at a preset price.[85] Investors who wished to purchase common stocks directly still had to select among different classes of common stock with different financial and voting rights.[86]

For some, the influx of neophyte investors and the general growth of bafflingly complex securities and capital structures signaled a more fundamental development: the growing separation of ownership and control in large corporations. Although many scholars date the discovery of the "separation of ownership and control" to A. A. Berle and Gardner Means's seminal 1932 work, *The Modern Corporation and Private Property*, others circulated similar ideas in the 1920s.[87] As early as 1914, the journalist Walter Lippmann wrote that "[t]he real news about business is that it is being administered by men who are not profiteers. The managers are on salary, divorced from ownership and from bargaining."[88]

Harvard economist William Z. Ripley lodged the idea in the public consciousness in 1926 when he published his best-selling critique of corporate finance and law, *Main Street and Wall Street*.[89] Although Ripley directed much of his ire at the proliferation of non-voting common stock, a device which really did free managers from shareholders' control, his central claim was more generally that developments in corporate law had given managers the ability to manipulate a corporation free of shareholder involvement.[90] His complaint had at least two important prongs: that the rising number and dispersion of shareholders, particularly retail investors, made it more difficult for them to govern or supervise the corporation,[91]

---

85. Isador Grossman, *Some Modern Trends in Industrial Corporation Financing*, 15 A.B.A. J. 127, 130 (1929).

86. *See id.*; *see also* Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 694 (1986) (noting two examples of leading corporations that provided common stock); W. H. S. Stevens, *Stockholders' Voting Rights and the Centralization of Voting Control*, 40 Q. J. EC. 353 (1926) (providing a quantitative measure of changing securities offerings in the 1920s).

87. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (MacMillan Co. 1932).

88. WALTER LIPPMANN, DRIFT AND MASTERY (Univ. of Wis. Press 1914) (quoted in THOMAS MCCRAW, PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, ALFRED M. KAHN 141 (Belknap Press 1983)).

89. WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET (Kessinger Publ'g 1926).

90. *See* Seligman, *supra* note 86, at 693-99 (explaining that Ripley waged a dramatic war on non-voting common stock, which the New York Stock Exchange prohibited in 1927).

91. Ripley did not wish for shareholders to directly engage in management; as he put it, "expectation of a general active participation by the whole body of shareholders is bound to go wrong from the crossing of the wire." RIPLEY, *supra* note 89, at 129. Rather, Ripley sought some mechanism to attain "the desired end of a reasonable check and balance upon

and that recent changes to corporation law similarly stripped shareholders of controls they once wielded within the corporation.[92] His charges were at times scattershot; *Main Street and Wall Street* leaves the reader with the impression that corporation law largely is a plot against the shareholder. But, Ripley's basic complaint is clear: that the legal and ownership changes of the 1920s created a situation in which "ownership and control had parted company, each going its own way as ships that pass in the night[.]"[93] Shadowing many of the specific legal developments that this Article discusses, then, was a growing sense that shareholders, the legal owners of corporations, were losing out to those who were supposed to manage the corporation on their behalf.

III. CHANGING CORPORATION LAW

Beginning in the mid-1920s, a series of states, including those that dominated the nation's industrial heartland, either substantially revised or completely replaced their existing corporation laws. While states often adjusted their corporation laws throughout the previous two decades,[94] observers at the time identified the wave of changes that began in the mid-1920s as a new phenomenon, a true movement to produce a coherent set of corporation codes to replace fragmented and outmoded frameworks for regulating corporations. Wiley Rutledge, later a Supreme Court Justice but then still a corporate law scholar, identified "[t]he climax of the movement . . . in the comparatively recent adoption of so-called 'modern' or 'liberal' incorporation laws in such old-time 'conservative' states as California, Illinois, Indiana, Idaho, Louisiana, Michigan, Minnesota, Ohio, Pennsylvania, and Washington."[95] These states, he predicted, were "merely the vanguard of a procession which will grow longer and longer until perhaps the entire country will be included."[96] This Article focuses

management." *Id.* at 130.

92. Ripley actually hated a host of corporation law reforms, some discussed *infra* Part IV. *See id.* at 29-54 (surveying the state-by-state reforms).

93. *Id.* at 117.

94. *See* Henry Winthrop Ballantine, *Recent Legislation: Legislative Developments in Corporation Law*, 15 CAL. L. REV. 421, 422 (1927) (clarifying that not all states stood still before this; in the early and mid-1920s, for instance, New York, New Jersey, Maryland, and Michigan rewrote their corporation acts). None of these changes, however, yielded thoroughgoing "modern" incorporation acts of the kind produced later that decade.

95. Rutledge, *supra* note 11, at 309; *see also* Ballantine, *supra* note 94, at 422 (discussing the modernized laws of several states, especially Ohio); Garrett, *supra* note 11, at 412 (noting the development of corporation laws); Floyd A. Wright & Victor Baughman, *Past and Present Trends in Corporation Law: Is Florida in Step?*, 11 MIAMI L.Q. 69, 98 (1947) (speaking of a "new era of modernized codification [that] got underway in the late twenties").

96. Rutledge, *supra* note 11, at 309.

on these changes, as they constitute a sustained response to both the economic and social developments just sketched out and the previous decades' competition for corporation charters. This Part of the Article discusses states' motives and methods to modernize corporation laws, while the next Part focuses on several of the most important provisions of the acts themselves.

A. The Challenge of Competition and Motives for Innovation

While each state had its own reasons for a new corporation statute, one reason was advanced across the board: the threat of Delaware and other "chartermongering" states.[97] Specifically, chartermongering states threatened to lure corporations to incorporate in them, rather than in the states where they were located. The modernizing states' goal, in contrast, was not to attract the incorporations of corporations located elsewhere, but simply to persuade corporations based in-state to incorporate there as well. A drafter of Ohio's new corporation act explained that one reason for his state's new law was that previously "many, if not most, of the large industrial corporations of Ohio [were] organized under the laws of other states."[98] Minnesota's reasons were similar; before the adoption of a new act in 1933, "many attorneys . . . felt compelled to use the laws of other states for purposes of incorporation."[99] When Illinois introduced its new corporation law to the legislature in 1931, its sponsor justified the law by noting that under the old law "[m]embers of the bar too often have found it necessary to advise their clients to incorporate under the laws of other states, to avoid inadequate and burdensome provisions."[100]

California particularly illustrates why states wished to retain in-state incorporations. Henry Ballantine, the father of California's new act, asserted that the law's main purpose was to "obviate the need to resort to other states for the incorporation of California enterprises."[101] The legislature also presented this claim to California's voters in 1929 when it asked them to approve a constitutional change to give corporations limited liability as part of California's corporation reforms. "Thousands of

97. "Chartermongering" appeared to be the preferred pejorative for states that aimed to attract out-of-state incorporators. *See, e.g.*, RIPLEY, *supra* note 89, at 30 ("The little state of Delaware has always been forward in this chartermongering business.").

98. Elwyn G. Davies, *Reflections of the Amateur Draftsmen of the Ohio General Corporation Act*, 12 WISC. L. REV. 487, 487 (1937).

99. P. L. Solether & Edward G. Jennings, *The Minnesota Business Corporation Act*, 12 WISC. L. REV. 419, 419 (1937).

100. Arthur Evans, *Offers Revised Illinois Law on Corporations*, CHI. TRIB., Apr. 24, 1931, at 7 (quoting State Sen. A.B. Huebsch).

101. Henry W. Ballantine, *Questions of Policy in Drafting a Modern Corporation Law*, 19 CAL. L. REV. 465, 466 (1931).

corporations, organized by California citizens to transact business in California," read the ballot statement that accompanied the amendment proposal, "incorporate under the laws of other states, because they can not obtain reasonable corporate facilities at home."[102] Certainly, both economic and political reasons abounded for keeping corporations incorporated "at home"; income from franchise and corporate taxes was one, the desire to maintain some control over local corporations another. Yet, less pecuniary reasons also propelled the new laws; Ballantine spoke at one point of the "humiliation" of California-based corporations resorting to Nevada and Delaware for incorporation.[103]

These were the stated motives for the new acts, but were they also the real ones? At least one scholar who examined the development of California's law voiced skepticism, noted that there was no upsurge in California incorporations after it passed the new law, which one would expect if the drafters really designed the law to lure back incorporations.[104] His evidence also shows, however, that among the backers of the changes to California's laws were several large law firms, which had been compelled in the 1920s to recommend that some large corporate clients reincorporate in Delaware. This supports the hypothesis that competition with Delaware was a major motive for reform.[105]

A remarkable study that Wisconsin commissioned as part of its statutory revision process further supports the conclusions that the new statutes were attempts to retain the incorporations of in-state firms, and not attempts to enter into the national competition for charters. In 1933, a University of Wisconsin Law School doctoral fellow, John Shiels, wrote a thesis examining Wisconsin-based firms that chose to incorporate elsewhere and produced a comprehensive study to identify exactly why many large Wisconsin firms preferred other states' legal regimes.[106] Shiels

102. *Argument Printed on the Ballot in Support of C.A. Const. art. XII, amend.*, *reprinted in* HENRY WINTHROP BALLANTINE, CALIFORNIA CORPORATION LAWS 2 (Parker, Stone & Baird Co. 1932).

103. Henry W. Ballantine, *Recent Legislation: Changes in the California Corporation Laws*, 17 CAL. L. REV. 529, 530 (1929) (explaining California's humiliation as it helplessly observed other states provide their citizens with the resources to invest capital and organize business).

104. Mark I. Weinstein, *Limited Liability in California, 1928-1931: It's the Lawyers*, 7 AM. L. & EC. REV. 439, 457 (2001) (suggesting that the robust nature of California's economy best explains the increase in incorporations within that state).

105. *See id.* at 475 (noting that, in the 1920s, Gibson, Dunn & Crutcher recommended to certain clients that they reincorporate in Delaware); *id.* at 478 (maintaining that some backers of the new law were attracted to the idea of having an up-to-date law, while for others, "modernity *per se* was an issue"). This parallels Macey and Miller's account of the Delaware bar's role in making that state attractive to corporations. Macey & Miller, *supra* note 9, at 471-74.

106. John Hofstatter Shiels summarizes this study in *Why do Wisconsin Concerns*

reviewed these corporations' charters to determine which aspects of the incorporating state's laws the charters specifically included, and were thus presumably important to the corporation.[107]

Shiels concluded that no single element of Delaware's law made it preferable to Wisconsin's; rather, a host of provisions attracted the firms.[108] Apart from the fact that Delaware had lower incorporation fees than Wisconsin,[109] Shiels identified a number of attractive provisions, including that Delaware law allowed a corporation to gain limited liability upon incorporation, while Wisconsin required a corporation to show a certain amount of paid-in capital first;[110] Delaware's statute expressly provided for mergers and consolidations, where Wisconsin's was silent;[111] and Delaware law allowed boards of directors to delegate functions to committees.[112] A particularly noticeable difference was that Delaware gave directors far greater powers to amend a corporation's charter and by-laws than did Wisconsin.[113] The report noted that, unlike in Wisconsin, the Board of a Delaware corporation could, with majority shareholder concurrence, make "fundamental alterations in the purposes and objects of a corporation," and could, with appropriate shareholder approval, alter "the relative preferences, participations, limitations, and rights" of classes of stock, something impossible under Wisconsin law.[114] In sum, the study revealed the concrete ways in which Delaware law was more flexible than

Incorporate in Other States?, 11 WISC. L. REV. 457 (1936) (examining a list of 163 "foreign corporations" doing business in Wisconsin, and concluding that 120 qualified under his criteria as "Wisconsin concerns organized under the laws of other states"). *See also* John Hofstatter Shiels, A Factual and Legal Study of the Foreign Incorporation of Wisconsin Concerns (1934) (unpublished S.J.D. thesis, University of Wisconsin) (on file with author).

107. *See* Shiels, *Why do Wisconsin Concerns Incorporate in Other States?*, *supra* note 106, at 458 (revealing that out of the 120 corporations incorporated elsewhere, eighty-four incorporated in Delaware, eleven in Minnesota, ten in Illinois, four in Michigan, and the remainder scattered among nine other states). As far as the size of corporations, Shiels found that larger firms—defined as those worth more than $1 million—tended to incorporate out-of-state, while a much lower percentage of small firms did so. *Id.* at 459-60. The comparatively high number of Illinois and Minnesota incorporations suggests limited competition for corporate charters between these states, perhaps because in an era of less rapid transport it was more convenient for some Wisconsin firms to incorporate in Springfield or St. Paul, rather than Wilmington.

108. Shiels examined the charters of the Wisconsin-based, Delaware-chartered firms to see which provisions of Delaware's law they adopted (many of Delaware's provisions were elective). This examination, however, failed to capture other reasons why corporations preferred Delaware, most notably a preference for Delaware's allegedly pro-management courts.

109. *Id.* at 461.

110. *Id.* at 465.

111. *Id.*

112. *Id.* at 466.

113. *Id.* at 468-69.

114. *Id.* at 468.

Wisconsin's, and showed that other states' need to compete with Delaware provided a major impetus for legal change.[115]

Ascribing these changes solely to the need to compete with Delaware misses, however, another important element of the new state laws: the degree to which drafters explicitly designed them *not* to duplicate those of Delaware. In broad outline, these acts often followed and even borrowed provisions from Delaware's acts, which, as just noted, provided incorporators great leeway to frame the corporation as they wished, and acknowledged the need for greater managerial autonomy and less shareholder involvement in the day-to-day workings of the corporation.[116] Yet, the new laws' drafters clearly did not wish them to duplicate those of the chartermongering states. According to Ballantine, the California act's main purpose was to make it unnecessary for "California enterprises" to incorporate elsewhere.[117] Ohio's new law aimed only to check "the migration of corporate enterprises from that state," and did not seek to place Ohio "among the states that make a specialty of issuing charters to enterprises doing business elsewhere."[118] Other states were even blunter: "Minnesota has no desire to become a chartermongering state."[119] The purpose of Illinois's act, according to its sponsor, was not "merely to increase the revenue of the state"—perhaps an implied rebuke to Delaware.[120]

Drafters of the new acts claimed that their acts would differ sharply from those of the competitive states by providing substantial protections to shareholders. California's law, for instance, aimed to be:

> [L]iberal enough to facilitate business transactions without undue formalities of checks and balances, of votes and consents of shareholders, and applications to courts, and at the same time not so lax that the management or the majority may manipulate the machinery to the prejudice of creditors or investors or the

115. This is not a comprehensive list of all the ways that Delaware corporation law was more attractive than Wisconsin's. *See generally id.* (providing a more comprehensive analysis).

116. In 1933, a professor of law at the University of Illinois, discussing the new corporation statutes, wrote that the "models of these laws have, in general, been the Delaware law, which in a general way, is the model for the new law of Illinois." Sveinbjorn Johnson, *Recent Judicial and Legislative Trends in Corporation Law*, 19 A.B.A. J. 631, 633 (1933). He was to some extent correct; many of these laws borrowed provisions from Delaware. *See* Garrett, *supra* note 11, at 418-19 (noting that many states modernized their acts based in part on the Delaware model). Although Johnson may have meant that the broad outlines of the corporation acts and their liberalizing tendencies followed Delaware's, the laws did not follow Delaware's in every important respect.

117. Ballantine, *supra* note 101, at 466.

118. Paul J. Bickel, *Ohio's New Corporation Law*, 15 GEO. L.J. 409, 424-25 (1927).

119. Solether & Jennings, *supra* note 99, at 423.

120. Evans, *supra* note 100, at 7.

oppression of minority shareholders.[121]

Illinois's law promised to protect shareholders from ongoing abuses and to simplify the state's complex corporation code.[122] Even discounting such statements as self-serving, they indicate that the new acts marked out shareholder protection as a particularly important difference between the enacting state's laws and Delaware's. A few years later, Harvard's Merrick Dodd reviewed developments of the past decades and noted that, while the long-term trend in corporation law was to "grant extremely broad powers to the management or to the management when supported by vote of the majority of the shareholders[,]" some of the more recent corporate acts provided restrictions "definitely designed for the protection of investors or creditors."[123]

The new laws, then, were the product of complex and not always harmonious motives. Their drafters clearly did not want simply to copy statutes from Delaware and other chartermongering states, as they believed those corporate codes insufficiently protected shareholders and creditors. Nevertheless, the need to retain corporations and to provide managers with flexibility pushed the acts towards Delaware's model. After all, if the new laws were too shareholder-friendly or insufficiently flexible, they would not be able to persuade local corporations to incorporate in-state. As Ballantine wrote, "[i]t is perfectly useless to impose drastic limitations and requirements that will simply have the effect of driving corporations from their home states to more hospitable shores."[124]

121. Ballantine, *supra* note 101, at 465.

122. Thomas Furlong, *Illinois Plans Better Law on Corporations: New Act Proposed to Protect Investor*, CHI. TRIB., May 14, 1933, at A9; *New Corporate Act to Reform Illinois Code: Clarifies Law, Safeguards Investor*, CHI. TRIB. June 9, 1933, at 29.

123. E. Merrick Dodd, *American Business Association Law a Hundred Years Ago and Today*, *in* 3 LAW: A CENTURY OF PROGRESS 254, 275-76 (Alison Reppy ed., 1937).

124. Ballantine, *supra* note 101, at 465. At least one other record reveals that drafters were aware that an overly-restrictive statute would drive corporations to reincorporate out of state. The 1924 meeting of the NCCUSL considered the ninth draft of the Uniform Incorporation Act. One commissioner, Ryall of Michigan, noted the popularity of Delaware and New Jersey, and then objected to a provision on the grounds that its inclusion in the Act would allow "two or three [states to] capitalize on the strictness of this act and deliberately pass a more liberal one and undo just exactly the situation we are trying to accomplish." HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 230 (1924).

B. *Networks of Reform*

These new acts were more than the work of state-level interest groups. Previous accounts have typically identified in-state interest groups as the main movers behind such corporation law reforms, particularly state bar associations whose members stood to benefit most directly from reforms.[125] Certainly, such groups were necessary for corporation law reform. The account presented in this Article, however, broadens these accounts of corporation lawmaking by identifying two other sources for the era's reforms.

First, it points to the growth of a network to reform state corporation laws that slowly developed in the late 1920s and 1930s.[126] This network can be traced to the lawyers in the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), who developed the proposed Uniform Business Corporation Act ("UBCA") in the 1920s, at times in conjunction with a few corporate law critics of the period, notably the then-law professor A. A. Berle.[127] As states began to revise their corporation laws, they drew on the UBCA and other states' reformist acts, which fostered a network that shared reform ideas and model statutory provisions. For instance, the NCCUSL drafted the UBCA in the mid-1920s, and the revisers of Ohio's corporation act (aided by Berle) relied upon a draft version of it in 1927. States following after could then draw on both the UBCA and Ohio's example, and so on.[128] State-level legal reforms were therefore a product of more than state-level influences, and the consequent movement for corporation law reform truly was a national one.

Second, this Article shows how in-state legal change was more than just the product of an undifferentiated "state bar." While state bar associations were prime movers in many corporate law reform efforts, in order to win support for proposed legal reforms they had to engage in extensive coalition-building to secure support for the new laws, carefully

125. *See supra* Part I (discussing the origins of corporate law reform).

126. The national dimension is important because depicting the revised laws as chiefly the product of particular state-level pressures misunderstands their genesis and import. This is the one flaw to an otherwise excellent account, for instance, of California's corporation law reform in 1931. *See* Weinstein, *supra* note 104, at 439 (discussing the state-level pressures and their impact on the modernization of California's law).

127. The account in this Article thus points forward to later reform efforts that attempted to sway state-level corporation reform through national organizations, such as the development of the Model Business Corporation Act beginning in the 1940s, or the American Law Institute's development of its Principles of Corporate Governance in the 1990s.

128. The influences were highly eclectic and not uniform; for instance, while some states relied heavily on the UBCA as a model, not all did.

developing laws that would attract support from both big-city and small-town lawyers, and to vet the new laws with accounting and other professional groups to ensure broad support. In sum, this section sets out a richer account of the development of corporation law than previously offered.

Movements to reform corporation law have a long history. National law reform, including proposals for a single federal corporation law, appeared on the agenda by the end of the nineteenth century.[129] Supporters had long floated proposals to revise state corporation laws; at the turn of the twentieth century, two New York corporation lawyers proposed a (never enacted) Model Business Corporation act.[130] In the late 1920s, the American Law Institute produced a tentative *Restatement of the Law of Business Associations*.[131]

The most influential of these reform projects began in 1903 when the NCCUSL began work on what eventually became the UBCA, a project that later won support from the American Bar Association.[132] The NCCUSL was born out of the first push for uniform commercial acts in the late nineteenth century, and it spent much of the early twentieth century producing model acts to cover commercial areas from bills of lading to warehouse receipts.[133] Despite its early start, consensus eluded the project to produce a uniform corporation act, and the NCCUSL did not finally promulgate a version until its tenth draft was accepted in 1928.[134]

The NCCUSL clearly designed the UBCA as an alternative to the

129. *See* KELLER, *supra* note 77, at 88-89 (examining proponents of a national corporation law).

130. *Id.* at 88.

131. RESTATEMENT OF THE LAW OF BUSINESS ASSOCIATIONS (A.L.I., Tentative Draft No. 1 1928) (reflecting the American Law Institute's concern with uniform business laws in 1928); *see* HANDBOOK OF NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAW (1928) (reflecting the National Conference of Commissioners' concern with corporation law); *Uniform Business Corporation Act and the Uniform Stock Transfer Act*, 5 WASH. L. REV. 170, 170 (1931) (explaining that "a uniform business corporation act . . . was approved and recommended for adoption at the meeting of the [1928 National Conference of Commissioners on Uniform State Law]"); Melvin A. Eisenberg, *An Overview of the Principles of Corporate Governance*, 48 BUS. LAW. 1271, 1272 (1993) (summarizing the history of reform projects).

132. At least one state cited ABA support as important in its eventual reliance on the UBCA. *See* Chicago Bar Association, Corporation Law Committee, *Memorandum re A Bill for an Act to Revise the Law Relating to Corporations for Pecuniary Profit, to be known as the "Business Corporation Act"* 44, 72 (1933). Previous accounts downplay the influence of the UBCA, but this account suggests that the UBCA's influence was greater than might be detected from a list of states that adopted it.

133. KELLER, *supra* note 77, at 95-96.

134. HANDBOOK OF NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE THIRTY-EIGHTH ANNUAL MEETING 78 (1928); Robert S. Stevens, *Stock Issues Under the Uniform Business Corporation Act*, 13 CORNELL L.Q. 399, 399 (1927).

corporation laws offered by chartermongering states.[135] The NCCUSL's drafting committee introduced its tentative Uniform Incorporation Act (as it was then called) in 1924 by identifying three approaches to corporation statutes: those "that seem to regard corporations principally as a source of revenue to the state," those that "regard the corporation somewhat suspiciously as something to be dealt with in an extraordinary regulatory manner," and those "where the corporation seems to be neither feared . . . nor specially encouraged for purposes of revenue . . . but where incorporation is permitted to be effected as an ordinary incident of business, allowing generous latitude in such organization and imposing no specially drastic regulations."[136] Though the drafting committee claimed that its proposed Act harmonized these three views, there can be little doubt that the committee saw itself as rejecting the extremes of rigid regulation and chartermongering, and aimed to take the middle position.

Although the NCCUSL produced a "tentative" UBCA in 1924, it was Ohio's adoption of a new corporation act in 1926 that marked the beginning of a trend toward such laws,[137] and the process of Ohio's revisions shows how in-state and out-of-state influences could produce a new corporation act. Ohio's legislature last rewrote its law thoroughly in 1851, and the law showed its age by the 1920s. Until 1927, for instance, Ohio limited its corporations to a single corporate purpose, a provision long abandoned in most jurisdictions.[138] The main supporter of the new law was the interest group that stood to benefit most directly from a law that would persuade local corporations to incorporate in-state—the Ohio Bar Association—which began to push for a new corporation law in 1925.[139] Although a revised act seemed uncontroversial, the Bar Association still campaigned carefully to enlist support and defuse any opposition that other interest groups in the state could generate. It held open meetings concerning the possible reforms in major Ohio cities, consulted "public officials, lawyers, accountants, and business men" as to their views of corporation law, and circulated five successive drafts of the proposed law

135. Interestingly, the Committee's seven members hailed from Michigan, Alabama, Texas, New Jersey, Pennsylvania, Arkansas, and Missouri. Only one member came from a state that could be accused of competing for charters—New Jersey—and none from Delaware. HANDBOOK, *supra* note 124, at 10.

136. *Id.* at 542.

137. Though some commentators noted that Florida adopted a modernized code in 1925, later, most commentators pointed to Ohio as the innovator. *See* Note, *The New Ohio Corporation Act*, 40 HARV. L. REV. 1143, 1144 (1927) (citing OHIO GEN. CORP. ACT §§ 8623-1 to 8623-138 (1927)).

138. Davies, *supra* note 98, at 487. Ohio's 1851 law passed in an era when corporation law sought to rein in corporations; at the 1851 Constitutional Convention one delegate complained that without tighter restrictions, "the whole state [would] become shingled over with corporations." *Id.*

139. *Id.*

before submitting it to the legislature.[140]

In preparing the law, the Bar Association not only built in-state coalitions, but drew on out-of-state expertise.[141] The law itself was based on the 1924 draft of the NCCUSL's Uniform Act. The Bar Association also sought "expert and scholarly guidance" from two of the nation's leading corporation law scholars, A. A. Berle of Columbia, a leading critic of recent innovations in corporation law, and Cornell's Robert S. Stevens, drafter of the UBCA.[142] Berle in particular had harshly criticized elements of Delaware's corporation law, and his presence as a consultant suggested that Ohio desired to do more than mimic Delaware's approach.

As campaigns for revised corporation laws appeared in other states, those states too saw in-state coalition building and interstate consultation. In Minnesota, for example, the State Bar Association planned a revised corporation code in the late 1920s.[143] At that time, Minnesota's constitution did not provide limited liability for all corporations, which meant that part of the campaign required a popular vote to amend the constitution.[144] An initial attempt to amend the constitution failed to gain enough votes in 1928, perhaps signaling to the Bar Association that it had not built enough of a coalition behind the new reforms.[145] In 1931, the Bar Association began another effort at revision and organized a drafting committee whose members it carefully chose to represent both large and small communities, with one member from the University of Minnesota Law School. "The drafting division, thus composed, could not be accused of representing any special interest group. The University connection increased the confidence of the Bar and of the public in the committee."[146] To craft the new Minnesota law, the drafters drew elements from the newly finalized UBCA, as well as California's, Delaware's, and Ohio's recently revised corporation acts, and presented the bill for further revisions and

140. *Id.* at 488; *see also* Bickel, *supra* note 118, at 409 ("The drafts of the Bar Association's work were submitted to lawyers throughout the state as they were produced, with the result that the experience of many lawyers is embodied in the final draft.").

141. *See generally* Ohio State Bar Association, *Working Notes of Special Committee to Draft Revision of Ohio Corporation Laws* (1926).

142. Davies, *supra* note 98, at 487; *see also* Bickel, *supra* note 118, at 409 (discussing changes in terminology in the new Ohio Corporation Law).

143. *See generally Current Legislation, Stockholders' Liability*, 14 MINN. L. REV. 64, 67 (1929) (proposing an amendment to stockholder liability that allowed the legislature "to regulate the limit of liability from time to time"); Harvey Hoshauer, *The Minnesota Business Corporation Act*, 18 MINN. L. REV. 1, 1-12 (1933) (analyzing key provisions of Minnesota's new act); Solether & Jennings, *supra* note 99, at 419 (stating "the Minnesota State Bar Association, in 1929, determined to take the initiative to correct [its corporation code]").

144. Minnesota's constitution of 1872 restricted the provision of limited liability to certain corporations. *See Current Legislation*, *supra* note 143, at 67 nn.12 & 13.

145. *See* Solether & Jennings, *supra* note 99, at 419 n.4.

146. *Id*. at 420.

comments to the annual convention of the State Bar.[147] Even after this process, Minnesota's legislature held up the revisions, less, it appears, because of any specific objections to the law than out of a generalized suspicion of any revisions to the corporate code; the Act only passed at the tail end of the legislative session.[148] This suggests another hurdle that proponents of the new laws faced: a lingering distrust of corporations, perhaps exacerbated by the worsening Depression, and which made *any* loosening in once-restrictive laws problematic.[149]

This basic pattern, in which states drew on out-of-state expertise and models, and built in-state coalitions for reform, repeated itself elsewhere. Indiana adopted its new General Corporation Act in 1929 only after it exhaustively studied the corporation laws of other states, and decided to model the new act on the UBCA.[150] Drafters widely circulated drafts of the new Indiana act to Indiana attorneys and out-of-state experts.[151] Wisconsin's approach was similar, though perhaps affected by the unusual trust the state placed in its university. In 1933, when changes to the corporation law were first mooted (it being suggested the existing law was "defective and antiquated"), the state tasked a law research fellow to identify the defects in Wisconsin laws that led Wisconsin-based firms to incorporate elsewhere.[152] The next year, the State Bar Association appointed a special committee to revise the corporation law in conjunction with the Law School. The committee, in drafting, at least claimed to be "building upon the admirable work done by the draftsmen of the recent corporation acts in Illinois, California, Minnesota, and Ohio; the Uniform Business Corporation Act; and the 'Model Business Corporation Act' drafted by George S. Hills of New York" and published in the Harvard Law Review.[153] Again, the committee reached across state lines to have Berle serve as a consultant.[154] After the committee produced the initial

147. *Id.* at 421-23.

148. *Id.* at 422-23.

149. Hostility toward corporations, especially in areas such as the Midwest where the Populist movement flourished, dated at least to the late nineteenth century, and probably to the early days of the Republic. CHARLES POSTEL, THE POPULIST VISION 5 (Oxford Univ. Press 2007).

150. George O. Dix, *The Indiana General Corporation Act*, 5 IND. L.J. 107, 107-08 (1929).

151. *See id.* at 108 (describing the committee's thorough review and improvement process).

152. Lloyd K. Garrison, *Proposed Redraft of the Wisconsin Corporation Laws*, 12 WISC. L. REV. 417, 417 (1937). The study appeared in Shiels, *Why do Wisconsin Concerns Incorporate in Other States?*, *supra* note 106. *See also* Shiels, Thesis, *supra* note 106.

153. Garrison, *supra* note 152, at 417. Hills was an expert on corporation finance and a freelance consultant on corporation law reform. George S. Hills, *Model Corporation Act*, 48 HARV. L. REV. 1334 (1935).

154. JORDAN SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICA ERA

draft, lawyers from "smaller towns as well as the larger cities" and a special committee of the Wisconsin Society of Certified Public Accountants further vetted the law.[155]

In part, the proponents of revision did only what any wise reformer would do: they sought consensus and tried to identify and defang potential opposition to the proposed changes. But their careful coalition-building also revealed that, even at the end of the 1920s, liberalized laws that promised to unshackle corporations could stir opposition. Such opposition certainly materialized in Minnesota, and even more strikingly in Illinois.

Corporate law revision in Illinois began in 1930, spurred by "[m]embers of the Chicago bar specializing in corporate practice."[156] Illinois previously modified its corporation law in 1919, but had not fundamentally revised it since 1872.[157] In its initial reform efforts, Chicago's Bar Association reached out to the state bar, but also asked for contributions and suggestions from a miscellany of organizations that ranged from the state's three law schools, to the "Illinois State Federation of Labor, Illinois Agricultural Association . . . and Chicago Real Estate Board."[158] It then formed a research committee to study other state statutes, a drafting committee began work thereafter, and the committee circulated the proposed drafts to individuals and associations throughout the state.[159] Despite all these efforts, when drafters presented the proposed act to the state legislature in 1931, it "met violent and uncritical hostility and efforts to pass it failed."[160] The source of the hostility is difficult to identify at this remove—was it a specific provision that angered legislators, or a general mistrust of corporations, perhaps spurred by the Depression? One commentator later attributed legislative hostility to the provision that allowed a corporation an unlimited life.[161] Only in 1933, after the

54 (Free Press 1987).

155. Garrison, *supra* note 152, at 418. Perhaps this rigorous review held up the Act as it was still under consideration in 1938.

156. Wilbur G. Katz, *The Illinois Business Corporation Act*, 12 WISC. L. REV. 473, 473 (1937).

157. *See* Henry Winthrop Ballantine, *A Critical Survey of the Illinois Business Corporation Act*, 1 U. CHI. L. REV. 357, 357 (1934) (noting 1919 Act).

158. Katz, *supra* note 156, at 483-84.

159. *See id.* at 484 ("As the drafts of various sections were completed, copies were mailed to all members of the general and special committees . . . with requests for suggestions and criticisms.").

160. *Id.* at 485.

161. Ballantine, *A Critical Survey of the Illinois Business Corporation Act*, *supra* note 157, at 389. There are only spotty records of deliberations in Illinois's legislature from this era, and the search for more detailed reasons for the law's rejection in 1931 is unavailing. One odd factor is that at least one of the state's major newspapers simply ignored the 1931 rejection of the act. In 1931, the *Chicago Tribune* ran a laudatory account of the act's introduction, highlighting the degree to which the Chicago and Illinois bar associations, the state's law schools, and the state's accountants and labor federation supported the act.

government appointed a commission to review the law, did the state adopt a new corporation act, and even that faced opposition in the legislature; indeed, the governor refused to sign the resulting bill and it became law only through a provision that allowed the state to adopt statutes without a governor's signature.[162] Illinois's difficulties in passing its law indicated that 1930s corporations and the laws that governed them still could stir passions.

Separate note should be made of California's reform efforts.[163] Initially, California's reform trajectory was not so different from that of other states. By the 1920s, its corporation statutes were antiquated. Initial support for a revised corporation statute and a related state constitutional amendment came from attorneys in Los Angeles and San Francisco, who gained a powerful ally in Henry W. Ballantine, a corporate law scholar at the University of California at Berkeley who was active in national corporation law reform efforts and eventually drafted the new act.[164] After the usual rounds of drafting and consensus-building, aided by public meetings throughout the state, the bar produced a corporation code that the state legislature adopted in 1929, and also persuaded voters to adopt a constitutional amendment that supported certain changes in the law.[165] What distinguished California's reform effort from that of other states was a central provision in the new law, one that required constitutional amendment: it gave California corporations limited liability. Before 1929, California's law did not provide corporate shareholders with a shield from the liabilities of their corporation.[166] For this reason, unlike in other states, California's campaign for reform did not focus on the outmoded law as a whole, but rather on the state's problems as the only state without limited liability for shareholders.

By the early 1930s, a movement to reform state corporation laws clearly was underway.[167] It was equally clear why states sought new laws.

Evans, *supra* note 100, at 7. Yet, this bill later failed. When reintroduced in 1933, the *Chicago Tribune* again provided laudatory coverage—with no discussion of the bill's rejection in the previous term, or the passions it engendered. Furlong, *supra* note 122; *New Corporate Act*, *supra* note 122.

162. Katz, *supra* note 156, at 485.

163. Weinstein, *supra* note 104, at 439, provides an excellent account of California's developments.

164. *Id.* at 449-50; *see also* Thomas W. Dahlquist, *Henry W. Ballantine*, 37 CAL. L. REV. 171, 171 (1949) (describing Ballantine as "the architect and chief builder of our modern California corporation laws").

165. *See* Weinstein, *supra* note 104, at 448 (noting that voters approved Senate Constitutional Amendment 5 at the November 1928 general election).

166. *See id.* at 446 ("The 1879 California constitution . . . required a system of pro rata unlimited liability for shareholders.").

167. *See, e.g.*, Hills, *supra* note 153, at 1334 ("The promulgation of new or revised corporation laws during the past few years has stimulated an interest in better organic and

To keep locally based corporations incorporated in-state, states felt compelled to offer a corporation law that was more flexible and accommodating than the nineteenth century set pattern acts. At the same time, drafters avoided the perceived excesses of the laws of the chartermongering states, which they believed lacked important protections for shareholders. The reform effort was both a local and national task; local, in that state bar associations constructed coalitions to push the required changes through the legislature and, in a couple of instances, to amend state constitutions; national, in that the drafters relied on the UBCA, other states' modernized acts, and nationally prominent corporation law experts to prepare the acts. The resulting movement did not produce a set of identical state laws. Rather, the new laws shared important family resemblances, as they drew on similar models, arose from similar motives, and attempted to resolve similar problems. The next Part of this Article examines some of the new acts' most notable provisions and asks whether they actually provided shareholders greater protections than the laws of Delaware.

IV. HOW THE LAW CHANGED

The provisions of the modernized acts testify both to their drafters' ambitions to craft more shareholder-protective laws than Delaware's law and to the ways that large corporations, and their threats to reincorporate in Delaware if faced with overly restrictive laws, curbed those ambitions. The new laws were clearly less rigid than their predecessors, as they were the end-product of a decades-long evolution of views about the corporation. They embodied the notion that the corporation essentially was the private creation of its members, and the contractual agreement of its shareholders—not the mandate of the state—dictated its structure and operations.[168]

regulatory legislation for corporations.").

168. *See, e.g.*, Rutledge, *supra* note 11, at 312 (noting growth in a belief that incorporation was a "natural right" rather than special privilege). Others have also recognized these changes. *See, e.g.*, HURST, *supra* note 12, at 70-73 (delineating the changes in the corporate structure of contractual rights). At times, supporters invoked the contractual analogy quite explicitly. *See, e.g.*, Davies, *supra* note 98, at 488 (noting that the committee of lawyers who drafted the Ohio Act "accepted and used as a basis the contract theory, though aware that when applied to a corporation with any considerable number of shareholders this theory has its limitations and there is no contract in the sense in which the term is commonly understood"). During this period, corporation law retained some rigidity, which particularly impeded the development of separate legal rules for the close corporation. *See* Harwell Wells, *The Rise of the Close Corporation and the Making of Corporation Law*, 5 BERKELEY BUS. L.J. 263 (2008) (examining the common law development of corporate law for close corporations to show that the corporate law that publicly-held corporations use often poorly fits the close corporation).

To critics at the time reduction in state oversight and the shift of power to management were the laws' most notable features, and scholars often characterize the broader changes in corporation law during this era as a move from stricter "set-pattern" acts, to "enabling" acts that "empowered businessmen to create whatever arrangements they found most serviceable."[169] But not all enabling acts were alike, and they did not simply license any given arrangement. A concern for shareholders and an unwillingness to give managers unlimited power leavened many of the acts. The question for this part of the Article is the degree to which concerns about shareholder protections and managerial limitations found concrete expression in specific provisions of the acts. The answer is mixed.

The most significant features of the acts are not always visible, particularly to today's readers.[170] Many of the changes enacted then, and discussed below, were in technical areas of the law that now appear largely mechanical (e.g., legal capital rules), or that have become footnotes in contemporary law (e.g., the *ultra vires* doctrine).[171] Yet, these changes marked fundamental shifts in power within the corporation. This Part does not address every change in corporation law, but rather surveys several significant shifts that together illustrate larger contours of the new laws.[172]

A. Capital Structure and Legal Capital

Some of the most fundamental changes in corporation laws concerned changes in the apparently arcane requirements of legal capital. Understanding the import of these changes, however, is almost impossible without understanding ongoing changes in corporations' capital structures.

Before the 1920s, corporations' capital structures were comparatively rigid.[173] A corporation's charter recorded the number of shares authorized to be issued and their attributes (e.g., preferences or voting rights). After the initial issuance of shares, further issues could be made, but existing shareholders had preemptive rights, meaning that the corporation first had to issue the shares to them in proportion to their current ownership.[174]

169. HURST, *supra* note 12, at 70.

170. Although today's observers may not easily understand the differences, they are still significant; one observer at the time, for instance, declared the new laws were "radically different from their predecessors in pattern and content." Hills, *supra* note 152, at 1334.

171. *See id.* (tracing the changes in corporate law).

172. Thus, for example, this Article does not attempt to deal with restriction of investor informational rights or the issue of non-voting stock.

173. Adolf Berle, *Corporate Devices for Diluting Stock Participations*, 31 COLUM. L. REV. 1239, 1239 (1931).

174. There were exceptions to this general right of preemption. *See infra* Part IV.B (explaining that preemptive rights declined incrementally due to changing economic and capital structure conditions).

Shareholders' rights were fixed; a corporation could change the shares' attributes only with unanimous consent from the shareholders, which suggests that such changes rarely occurred.[175] Furthermore, while a corporation could issue different kinds of securities—it easily could have outstanding common and preferred shares, as well as many different bond issues—a corporation tended to have outstanding only a single class of common stock.[176] While opportunities for managerial malfeasance and theft no doubt abounded in this time as in any other, attention most often focused on the problems of "watered" stock, meaning stock that was issued and purchased for less than its stated value.[177]

By the 1920s, several developments conspired to change this situation. First was the influx of new investors into the stock market; second was the fact that corporations began to issue new kinds of securities.[178] Most important, however, was the spread of no-par stock and the changes it worked on the concept of legal capital.[179]

Legal capital rarely attracts attention today; Bayless Manning, who wrote the still-definitive treatise *Legal Capital*, once insisted that the subject, while very complex, was neither "very real [nor] very important."[180] Even in the 1920s, when legal capital did matter, one scholar spoke of the "unspeakable confusion among lawyers and accountants over the law relating to 'capital.'"[181] Yet, legal capital rules

175. *See* Rutledge, *supra* note 11, at 324-26 (describing the process of amending articles); *see also* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay in the Judicial Role*, 89 COLUM. L. REV. 1618, 1633-34 (1989) (describing the "vested rights" doctrine, which forbids certain fundamental changes to a corporate charter without unanimous shareholder approval).

176. *See* DEWING, *supra* note 84, at 43 (discussing the appearance of Class A common stock after 1923).

177. *See generally* DAVID L. DODD, STOCK WATERING: THE JUDICIAL VALUATION OF PROPERTY FOR STOCK-ISSUE PURPOSES (Colum. Univ. Press 1930) (discussing stock watering); *see also* MITCHELL, *supra* note 39, at 59-88 (analyzing the incentives for, practices in, and consequences of corporate overvaluation, i.e. watering down stock).

178. *See supra* Part II.A (outlining the process by which competition between states replaced the restrictive set-pattern acts of the 1880s with more liberal and flexible "enabling" corporation statutes).

179. *See* HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 217, 685-96 (Callaghan & Co. 1927) (discussing issuance of nonpar stocks). *See generally* Henry W. Ballantine & George S. Hills, *Corporate Capital and Restrictions on Dividends Under Modern Corporate Laws*, 23 CAL. L. REV. 229 (1935) (describing the development of corporate law prior to 1930s).

180. BAYLESS MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL viii (Found. Press 1977); *see also* JONATHAN BASKIN & PAUL MIRANTI, A HISTORY OF CORPORATE FINANCE 179-82 (Cambridge Univ. Press 1997) (stating that the par values were an initial attempt to provide investors with a rough, if possibly flawed, estimate of a corporation's value); Coffee, Jr., *supra* note 175, at 1633 n.35 (describing the legal capital rules as a "vestigial remnant").

181. Ballantine, *supra* note 101, at 477.

are important here because they were perceived in the 1920s as a bulwark of creditor and shareholder protection, and statutory changes in the rules could change the balance of power between shareholders and managers.

Understanding the debate over legal capital requires a quick review of the evolution of legal capital and par value. In the nineteenth century, the legal capital rules developed to protect shareholders and eventually creditors. At that time, each corporation's charter authorized at inception a certain number of shares and assigned each a par value. The rules required subscribing shareholders to pay par value for each share, and the sum received constituted the firm's legal capital. Therefore, a corporation that sold 100 shares each with a par value of $100 had a legal capital of $10,000.[182]

Although par value and legal capital requirements first developed to assure initial shareholders that all other shareholders had paid a fixed amount for their shares,[183] they soon evolved into a protection for creditors. In other words, legal capital became less a protection for shareholders (assuring that other shareholders had paid the corporation equal amounts for shares), than for creditors (assuring that the corporation had the stated amount of legal capital available in case of insolvency).[184] Legal capital became a limit on the amount of assets that a corporation could distribute to shareholders, and the rules prevented a corporation from distributing funds or assets to the extent that it impaired its legal capital. Although the rules were incredibly complex, the underlying principles were clear: a corporation could not sell shares for less than par[185] and always had to

182. At first, commentators simply used the term "capital" for this amount, but to distinguish it from the very different accounting notion of capital, they eventually began to use the term "legal capital." Moreover, the par value requirement applied only to the corporation issuing shares; it required a corporation that sold a share with $100 par value to sell the share for $100 (and required the shareholder to pay that amount), but a shareholder could later sell those shares for any amount.

183. MANNING, *supra* note 180, at 18-19.

184. This was the genesis of the now-defunct "trust fund doctrine," under which a corporation held legal capital for the benefit of creditors. *See* Wood v. Dummer, 3 Mason 308, 30 F.Cas. 435 (C.C.Me. 1824) (Story, J.) (assuming legal capital is held for the benefit of creditors); *see also* Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1331-36 (2007) (describing the trust fund doctrine in detail). Some also asserted that legal capital was a sum that shareholders set aside in exchange for the privilege of limited liability. *See* Ballantine & Hills, *supra* note 179, at 230 (arguing that shareholders hold legal capital for limited liability).

185. The sale of shares for less than par, often through a stock-for-asset swap, produced "watered" stock and "overcapitalization," or the illusion that a company had more capital than it actually did. A shareholder might want par value stock on the cheap for obvious reasons; the reasons why a corporation might want to appear overcapitalized are more complex. *See* MITCHELL, *supra* note 39, at 57-89 (recounting the factors that drive incentives for corporate overvaluation).

retain a sum at least equal to its legal capital for the benefit of creditors.[186] In contrast, any amount above legal capital—surplus—was available for distribution to shareholders.

These rules could create significant problems for corporations. Until judicial exceptions developed in the 1890s, for example, corporations could not sell shares at below par value, even if the market price for shares dropped below par.[187] A corporation could change the par value of its shares only if it amended its charter, which was a burdensome process. Although clever lawyers devised ways to slip around some of the legal capital rules, none of these expedients seemed satisfactorily to solve the underlying problems with par value.[188]

The answer seemed obvious when it appeared: allow corporations to issue shares with no par value—a solution that New York first tried in 1912 and that most states adopted within the next two decades.[189] Yet, the elimination of par value raised a series of difficult questions about the relationships between managers, creditors, and shareholders. Without par value, what protections would be left for creditors or shareholders?[190]

186. This was a minimal amount; legal rules that governed capital might well require a corporation to retain more. For instance, a corporation with outstanding bonds would have to retain both its legal capital and an amount sufficient to pay the principal on the bonds. Note that the rules did not consider this amount a dedicated fund separate from the rest of the corporation's accounts; it rather marked a limit beyond which a distribution could not occur.

187. *See* MANNING, *supra* note 180, at 23 (showing that the presumption that all purchasers paid the par value for stock kept any purchaser from acquiring stock for less). Technically, the problem was one not for the corporation but for the purchaser of the shares, who would have been legally obligated to the corporation for the shares' full par value; but this effectively deterred anyone from buying newly-issued shares from a corporation at below par. *See* Handley v. Stutz, 139 U.S. 417, 430-31 (1891) (crafting an exception to the rule that allowed a corporation in financial distress to sell shares to the highest bidder, even if at a price below par, without making the buyer liable for their full par value).

188. For instance, a company could issue shares to an incorporator for full value, then purchase the shares back and hold them as "treasury shares"; because the resale of such shares from the treasury was not an issuance of shares, they did not have to be at par value. BERLE, *supra* note 84, at 82.

189. *See generally* Cornelius W. Wickersham, *The Progress of the Law on No Par Value Stock*, 37 HARV. L. REV. 464 (1924) (outlining the development of no-par stock law).

190. To be sure, par value had already lost some of its protective role. While nineteenth century investors looked to a corporation's legal capital to estimate its value and ability to repay debts, they recognized by the early twentieth century that a corporation's value was tied not to its legal capital—which was, after all, a legal fiction that merely recorded initial sums paid for stock—but to its assets and ongoing earnings. *See, e.g.*, BASKIN & MIRANTI, *supra* note 180, at 182-83 (explaining that better financial reporting led to the declining importance of par value in valuing corporations); Adolf A. Berle, *The Organization of the Law of Corporation Finance*, 9 TENN. L. REV. 125, 136 (1931) (arguing that a share's primary attribute is its earning power rather than its book value); James C. Bonbright, *The Dangers of Shares Without Par Value*, 24 COLUM. L. REV. 449, 454-55 (1924) (discussing the weaknesses of arguments to do away with par values).

Scholars expressed these worries chiefly as concerns for creditors. The elimination of par value seemed to threaten the elimination of legal capital as well, and if legal capital were eliminated, so too would be the cushion of assets upon which creditors depended.[191] Yet, the debate also implicated shareholder protection; indeed A. A. Berle, writing in the 1920s, claimed that the invention of no-par stock probably was "the greatest single step in transferring control of property rights from stockholders to corporate managements."[192]

Berle probably exaggerated, but changes in the legal capital rules did offer managers new powers over shareholders, and potentially the ability to favor some shareholders at others' expense. One threat posed was that managers could issue no-par shares at low prices to new purchasers and thus give those purchasers a claim on the corporation's assets without exacting a fair contribution from them.[193] The elimination of preemptive rights—discussed below—compounded this problem, as current shareholders no longer had guaranteed participation in a new issue.[194] A second worrisome scenario essentially involved the reverse of the above transaction, one that would transfer assets from new shareholders to old shareholders. The elimination of par value might make it possible to sell shares to a group of new shareholders, and then distribute immediately all funds from the sale to the shareholders as a group, as consideration for the shares would not necessarily be included in legal capital.[195] Berle and Means outlined such a scenario in *The Modern Corporation and Public Property*, and claimed that this "real danger" appeared in corporations with more than one class of shareholders, a structure increasingly popular in the 1920s.[196] A corporation with class A and class B shares could, they hypothesized, sell additional class A shares for, say, $100, attribute most of the price to "surplus" available for immediate distribution, and commence "to pay dividends at once to both class A and class B out of the earned surplus item contributed by purchasers of class A. In a word, a part of the

191. *See* Bonbright, *supra* note 190, at 461 (noting confusion as to whether proceeds of sale of non-par stock constitute addition to capital).

192. BERLE, *supra* note 84, at 64. Proponents of no-par stock also sold the idea as a benefit to investors, as it would disabuse them of any notion that a share was worth a stated amount merely because that was its par value. Wickersham, *supra* note 189, at 464.

193. *See* Bonbright, *supra* note 190, at 459-62 (stating that the removal of par values could lead corporations to set their stated capital at far below their real capital). Furthermore, many states, most notably Delaware, essentially gave absolute discretion to a Board of Directors to value any property exchanged for shares; as one critic noted, this meant a purchaser "may even receive ten thousand shares of stock for a yellow dog and a dead cat without being subject to a further assessment." *Id.* at 460.

194. *See infra* Part IV.B (discussing the erosion of preemptive rights).

195. *See*, BERLE & MEANS, *supra* note 87, at 162-72 (describing the shift of assets among groups within the corporation).

196. *Id.* at 168.

asset value behind the class A shares is at once distributed to the class B as 'dividends.'"[197] One can understand why two of the leading experts on legal capital concluded that "the function of legal or stated capital is threefold: (1) the protection of the creditors against the shareholder; (2) the protection of senior shareholders against junior shareholders; and (3) the protection of all shareholders against mismanagement and the impairment of their investment and its earning power."[198]

Following the adoption of no-par stock, the law could have abandoned the notion of legal capital and left shareholders and creditors to find other means to monitor and protect their interests in a corporation. No state appears to have gone this far, though the approach taken by Delaware and most other states was close; they adopted legal capital rules that allowed a corporation to decide how much of any payment received for no-par shares it would count as legal capital, and how much it would count as surplus.[199] In other words, directors of a Delaware corporation could declare that all monies received for sale of no-par shares was surplus available for immediate distribution.

Despite their claim to provide greater protection to shareholders, several of the earliest of the reforming state laws took a similar tack, which suggests that legal capital did not always top their drafters' agendas. For example, Ohio's 1927 act did not mandate that a corporation declare consideration received for no-par shares as capital rather than surplus (which would make the consideration unavailable for distribution); the act required only that a corporation include consideration received for no-par shares in the firm's "stated capital" unless otherwise specified at the time of issuance.[200] Ohio's act did, however, erect other protections around legal capital; for instance, it mandated accounting procedures to calculate stated capital, thus confounding any attempts to make excess distributions

197. *Id.*

198. Ballantine & Hills, *supra* note 179, at 233.

199. As Bonbright explains:

> It would seem, then, that under the Delaware law a company issuing shares without par value is entirely free to credit to capital account as large or as small a part of its assets as it sees fit. If this is so, a company may issue stock for fifty dollars a share and simply by crediting all but five dollars to its surplus rather than to capital may leave itself free to pay back to its shareholders forty-five dollars a share.

Bonbright, *supra* note 190, at 461; *see also id*. at 458 (noting most states followed the Delaware model) *accord* Ballantine & Hills, *supra* note 179, at 237, 240 (noting that a number of states, including Delaware, allowed consideration for no-par shares to be classified as surplus).

200. *See* Note *supra* note 137, at 1146 (citing OHIO GEN. CODE §§ 8623-23, 8623-37). As to the new term "stated capital," reformers of the legal capital rules also happily revised the terminology, hence the proliferation of terms to replace "legal capital." *See, e.g.*, Ballantine & Hills, *supra* note 179, at 235 (discussing various changes in terminology).

through manipulations.[201] The point was to create "as public, as easy to ascertain by all concerned, and as important a measuring rod to determine shareholders' obligations, the right to declare dividends, directors' liability, etc., as 'capital stock,' . . . used to be in days before no par stock."[202]

Later corporation acts provided more stringent rules concerning legal capital, perhaps most significantly California's 1929 corporate law. Henry Ballantine, an expert on legal capital, drafted that law, which implemented a three-tier measure for legal capital and surplus, marking out separate categories for "stated capital," "paid-in surplus," and "surplus."[203] Whereas in other jurisdictions consideration paid for no-par stock was typically split between capital and surplus at the directors' discretion, in California it was to be split between "stated capital" and the new category of "paid-in surplus." Paid-in surplus was hedged about with limits on distribution; corporations could not, for instance, immediately distribute it to shareholders. Tellingly, one justification for the new category of paid-in surplus was to protect preferred shareholders from corporate management, who had evidently victimized such shareholders in the past when they sold them preferred shares and immediately used the proceeds to pay a dividend on common shares.[204] As Ballantine and Hills later explained:

> Under such a lax provision such as that of the acts of Delaware, New York and some other states much of the consideration contributed by one class of shares . . . may be distributed to the holders of junior classes of shares in the form of dividends or purchase price of shares. The more carefully drawn modern acts have, accordingly, distinguished between earned surplus and paid-in surplus, and earned surplus is made the basis or source of dividends upon common shares.[205]

201. *See* Austin Tappan Wright, *The New Ohio General Corporation Act*, 75 U. PA. L. REV. 753, 753-54 (1927) (describing the safeguards that the new Ohio act put in place).

202. *Id.* at 753.

203. This is not the first appearance of "paid-in surplus"—the concept apparently arose with the adoption of no-par stock and the rule that a corporation could allot some consideration for it to surplus. Initially, however, most states' rules treated paid-in surplus the same as any other kind of surplus; "it was left available for dividends and share purchases in the manner as if it had resulted from business earnings." Hills, *supra* note 153, at 1336. Only later did the laws begin to treat paid-in surplus as a separate category of surplus with its own distributional limitations.

204. *Id.*; BALLANTINE, *supra* note 102, at 122-24 (reprinting CAL. BUS. CORP. ACT §§ 87-89). The exact limits are complex, but one provision, for example, forbade the use of paid-in surplus to pay dividends on common stocks, but allowed it to make payments on dividends of preferred stock. *See* Katz, *supra* note 156, at 475-76 ("The danger of deception from the payment of dividends from sources other than earnings is minimized by the provision that the source of the dividend must be disclosed to the shareholders receiving it."). The provisions for distributions and use of the various kinds of surplus were quite elaborate; this discussion essays only their broad contours.

205. Ballantine & Hills, *supra* note 179, at 243.

The provision was clearly intended to protect creditors and some shareholders; "[s]uch restrictions on the use of paid-in surplus in effect treat it as a reserve or margin of value for the protection of preferred shareholders and those having claims against the corporation, although it is not formally capitalized."[206] Other states also adopted similar provisions concerning paid-in surplus, including Illinois and Minnesota in their 1933 revised corporation acts.[207]

These more stringent legal capital rules reflect both the reformers' desire to curb management power and their sometimes limited ability to do so. In states like California, Illinois, and Minnesota, limits were placed on distributions not just to protect creditors but also shareholders. These revisions were not minor, and did provide new safeguards. Yet, as will be discussed below, they still occurred against a backdrop of developments that eroded the power of and protections for shareholders overall, and limited the reformers' goals.

B. Preemptive Rights

Closely related to the transformation of corporate capital structures was the erosion of preemptive rights. A preemptive right was the equitable right of a shareholder in an existing corporation to purchase a pro rata share of any new share issuance.[208] For example, under the doctrine, a shareholder who owned ten shares of a company with 100 shares outstanding would have first claim on 10% of any additional issue of shares.[209] Dating back to the early nineteenth century, the right was part of the shareholder's property interest in the corporation. Some contended that the doctrine protected a shareholder's voting power and ensured that a corporation could not use new issues to reduce an existing shareholder's percentage vote; others depicted it as essentially an economic protection

206. *Id.*

207. The Illinois and Minnesota acts allowed limited payments of certain dividends out of paid-in surplus. *See* Ballantine & Hills, *supra* note 179, at 244 (discussing relevant sections of the Illinois and Minnesota acts).

208. Courts generally accepted the right as equitable; it was a judicial creation to protect shareholders, which dated back to *Gray v. Portland Bank*, 3 Mass. (2 Tyng) 364 (Mass. 1807). *See* Douglas M. Branson, *Recent Changes in the Model Business Corporation Act: Death Knell for Main Street Corporation Law*, 72 NEB. L. REV. 258, 264 (1993) (explaining preemptive rights doctrines and cumulative voting).

209. *See generally* BALLANTINE, *supra* note 179, § 135 (discussing existing stockholders' rights and remedies vis-à-vis new stock in the 1920s); Victor Morawetz, *The Preemptive Rights of Shareholders*, 42 HARV. L. REV. 186 (1928) (discussing preemption rights); Alexander Hamilton Frey, *Shareholders' Preemptive Rights*, 38 YALE L.J. 563 (1929) (discussing preemption rights). The right attached to additional issuances for cash, but not property—an important exception that the issuance of shares during an acquisition likely made necessary. BALLANTINE, *supra* note 179, § 135, at 423.

that preserved a shareholder's claim on a fixed percentage of corporate property.[210] Though the doctrine had notable exceptions—it did not, for example, apply when shares were exchanged for property—scholars into the 1920s viewed it as an important protection for shareholders who were concerned that managers would appropriate their claims to the corporation.[211]

The 1920s, however, saw the doctrine go into steep decline. Around 1919, corporate charters began to include provisions that claimed to eliminate preemptive rights,[212] and the modern corporation acts of the 1920s and 1930s transformed preemptive rights by changing them from mandatory to optional.[213] Ohio's 1927 Act, for example, limited preemptive rights to certain classes of shares and explicitly allowed a corporation to renounce such rights in its charter.[214] California's act went further, eliminated preemptive rights unless provided for in the charter.[215] Illinois's 1933 act similarly included provisions that allowed a corporation to limit or deny shareholders' preemptive rights.[216]

This development, as with so many others in this period, undercut the position of existing shareholders, especially because many issues under the preemptive doctrine were priced at slightly below market, which gave existing shareholders of a corporation both the right to preserve their pro

210. *See generally* BERLE & MEANS, *supra* note 87, at 176-80, 256-59 (discussing the emergence and history of preemptive rights in the nineteenth and early twentieth centuries); WILLIAM W. COOK, A TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK § 286, 946-62 (Baker, Voorhis & Co. 8th ed. 1923) (discussing preemptive rights). Unlike some of the doctrines discussed here, preemptive rights have not disappeared from corporation law, though all states now, at a minimum, allow corporate charters to eliminate them. JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 497 (Aspen Publishers 2d ed. 2003).

211. *See* RIPLEY, *supra* note 89, at 40 (noting that this "serious trespass" on shareholder rights originated with corporation lawyers).

212. On the use of corporate charters to restrict preemptive rights, *see* RIPLEY, *supra* note 89, at 38-40 (citing the charter provisions of corporations, including Great A&P Tea Co., General Baking Corp., and Standard Oil of California). It is not clear, however, whether these provisions were enforceable.

213. A few state laws offered the possibility to eliminate preemptive rights earlier; amendments to Massachusetts's corporation law in 1902 gave majority stockholders "the power to fix the terms and manner of disposition of the increased stock, thus enabling them to eliminate preemptive rights." Dodd, *supra* note 11, at 37. In general, however, new corporation acts decisively limited preemption rights. *See* Rutledge, *supra* note 11, at 330-31 ("Most of the statutes permit the articles to make any provision desired concerning [preemptive rights] . . . . Thus another of the shareholder's protections is on its way out.").

214. *See* Bickel, *supra* note 118, at 419-20 (reviewing old and new Ohio corporate statutes on preemptive rights); *see also* Wright, *supra* note 201, at 754-58 (highlighting negative aspects of the Ohio General Corporation Act with regard to preemptive rights).

215. BALLANTINE, *supra* note 102, at 140 (citing CAL. CORP. L. § 98).

216. *See* Dodd, *supra* note 11, at 45 (citing ILL. REV. STAT. ch. 32, § 47 (1935)).

rata ownership stake and a chance to buy new shares cheap.[217] Yet preemptive rights were probably doomed by larger economic developments. It is tempting to blame the death of preemptive rights on dispersed shareholding, under the reasoning that a corporation could not offer a new issue first to thousands of shareholders. Into the 1920s, however, it appears that some publicly held corporations did just that; American Telephone and Telegraph routinely offered shareholders a preemptive right to purchase newly issued shares, even though it was the most widely held corporation in the 1920s with over 400,000 shareholders.[218]

The problem with preemptive rights lay not in the number of shareholders, but in the new capital structures. By the 1920s, corporations often issued multiple classes of shares—often several different classes of preferred stock, each with its own voting rights and claims on corporate assets, and increasingly more than one class of common stock.[219] In such an intricate capital structure, asked one scholar, how could an "issue be apportioned as between the holders of prior preference shares, with limited participation in earnings and limited voting rights, holders of first preferred shares with full voting rights and no participation, and holders of class A and class B common shares?"[220] The difficulty of solving such apportionment problems—of figuring out who really had a claim on a new issue—led statutes' drafters to weaken preemptive rights. Even ardent reformers admitted that preemptive rights were no longer practicable. "[I]n a complex corporate structure the proper assignment of preemptive rights is simply insoluble," concluded Ballantine.[221] Berle also conceded that the preemptive right created too many problems; "where the classification of stock is carried to the extreme lengths now prevalent it becomes almost, if not wholly, impossible to work out a rule which will do justice to the situation."[222] This is not to say there were no objections. In *Main Street and Wall Street*, William Z. Ripley protested that the erosion of preemptive rights marked a "serious trespass upon the customary rights of shareholders."[223] Nevertheless, his complaints went unheeded, as almost all the new laws made preemptive rights optional and removed what had once been a bedrock protection for shareholders.

217. RIPLEY, *supra* note 89, at 38-39.

218. *See* Berle, *supra* note 173, at 1258 (noting AT&T has "scrupulously maintained" the preemptive rights of its shareholders).

219. A good example is given in Henry S. Drinker, Jr., *The Preemptive Right of Shareholders to Subscribe to New Shares*, 43 HARV. L. REV. 586, 610 (1930).

220. *Id.* at 611-12.

221. Ballantine, *supra* note 101, at 469; *see also* BALLANTINE, *supra* note 102, at 98-101 (citing § 73, Reasons for the Abrogation of Preemptive Rights).

222. Berle, *supra* note 173, at 1258.

223. RIPLEY, *supra* note 89, at 40.

C. *Blank Stock and Stock Options*

While the new statutes innovated in some important ways, at least as often, their task was to respond to and channel doctrines already adopted by more corporate-friendly states. Such was the case with "blank stock" and stock options, innovations that were notable not only because of the issues they raised, but also because they came with their own nemesis: A. A. Berle.[224]

Berle's involvement sheds more light on state lawmaking in the 1920s. This Article already discussed how states proceeded to adopt "modern" corporation statutes, through the deep involvement of state and local bar associations and recourse to an interstate network to support passage of the new laws.[225] Things worked differently in Delaware.[226] Berle knew this because he had been involved in the process of amending Delaware's corporation laws. In 1927, the Corporation Trust Company ("CTC"), a Delaware-based firm that assisted corporations reincorporating in Delaware, assembled a panel of New York corporate lawyers to redraft parts of Delaware's corporation law.[227] According to Berle, the CTC hired as its Wilmington counsel the secretary of the Delaware Bar Association, and thereby got its proposals quickly through the legislature.[228] While Berle served on the CTC's committee, he ultimately failed to persuade the majority to adopt the reforms he proposed.[229] Defeated there, he instead launched an attack on the changes to the Delaware act.[230]

The innovation he most detested was "blank stock." Blank stock originated as a solution to problems associated with the requirement that a corporate charter record all the attributes of authorized stock.[231] While this

224. *See* Adolf A. Berle, Jr., *Investors and the Revised Delaware Corporation Act*, 29 COLUM. L. REV. 563 (1929) (examining features of the 1929 amendments to the Delaware Corporation Act).

225. *See supra* Part III (discussing major changes to various state corporation laws that occurred since the mid-1920s).

226. The best contemporary account of Delaware corporation lawmaking is Hamermesh, *supra* note 17, at 1752-56.

227. *See* SCHWARZ, *supra* note 154, at 55 (noting Berle's participation in the CTC committee and his concern for the individual investor). For Berle's own more guarded account of this process, *see* Berle, *supra* note 224, at 563-64 (commenting on the history of the 1929 amendments to the Delaware Corporation Act and the theory behind the changes). CTC has had a long involvement in Delaware lawmaking; a CTC representative also sat on the committee that revised Delaware's corporation law in 1967. Cary, *supra* note 8, at 690.

228. SCHWARZ, *supra* note 154, at 55.

229. *Id.*

230. Some of Berle's criticisms found their way into THE MODERN CORPORATION AND PRIVATE PROPERTY, *supra* note 87, but his initial salvo was *Investors and the Revised Delaware Corporation Act, supra* note 224, at 563 *passim*.

231. This paragraph draws on Berle, *supra* note 224, at 566-67, and BERLE & MEANS, *supra* note 87, at 185-87.

posed little problems for common stock, it created difficulties with the issuance of preferred stock after incorporation. Preferred stock's value was tied to its dividend rate, generally expressed as a percentage of its par value (e.g., 8% preferred with par value $100 returned $8 a year).[232] But, interest rates fluctuated over time and a share with a fixed dividend could well be unmarketable, at least at par value, at the time a corporation needed to issue it. Corporate charters thus began to give "management the power to change the provisions of authorized but unissued preferred stock to fit market conditions."[233] Hence, blank stock.

Berle's problem with blank stock was not its limited use to set a dividend for preferred stock, but the possibility that its untrammeled use could further tilt the balance of power between managers and shareholders.[234] Delaware's revised law allowed a corporation to have authorized but unissued stock with "voting powers, designations, preferences and relative, participating optional or other rights if any" to be determined by the Board at the time the stock was issued.[235] In Berle's eyes, this empowered the Board to set a dividend rate and "issue stock in such a way as to vary the pro rata share of all outstanding stock; to vary their dividend participations; to vary their relative strength; in short, to do pretty much as they will with the existing shareholders."[236] Blank stock, according to Berle, was a license to print stock with any qualities the Board wished.

Almost as provoking as blank stock was the stock purchase warrant or "stock option."[237] While corporation finance occasionally used stock options—securities that give the holder the right to purchase stock at a fixed price at a later date— since at least the 1870s, stock options lacked explicit statutory authorization before Delaware revised its corporation law in 1929.[238] This modification was a straightforward attempt to accommodate changes in the financial markets. While common stock gained a much better reputation in the 1920s, many purchasers still saw bonds or preferred stock as safer investments. Those instruments, however,

232. Because preferred stock had a liquidation preference—i.e., in case of liquidation, preferred stock with $100 par value received $100—it often still had a par value, and corporations were unwilling to sell it below par.

233. Berle, *supra* note 224, at 566.

234. Writing to a friend about the new innovations, Berle stated that "compared to this, the non-voting stock provisions of a few years ago are child's play." SCHWARZ, *supra* note 154, at 55.

235. Berle, *supra* note 224, at 566-67 n.5 (quoting DEL. REV. CODE ch. 65, § 13 (1929)).

236. BERLE & MEANS, *supra* note 87, at 186.

237. *See id.* at 180-85 (describing stock options, or "stock purchase warrants").

238. *Id.* at 181 n.48. *Accord Grimes v. Alteon*, 804 A.2d 256, 263-64 (Del. 2002) (describing the 1929 statute as "the first statute in the nation expressly to authorize the issuance of stock options").

lacked access to the upside potential available with common stock.[239] In the 1920s, then, corporations began to attach a stock warrant "kicker" to some bonds and preferred shares to give buyers access to the appreciation of a firm's common stock. Many of these warrants were permanently attached to the securities they accompanied, but some were not and could be split off and traded independently.

Delaware's 1929 corporation law revisions specifically authorized stock options.[240] Two aspects of the change incensed Berle: that the option could be eternal, and that a corporation's Board could issue the options by a mere resolution.[241] The combination of broad power to issue options, and the secrecy that could surround them, appeared to offer a Board unlimited power to transfer wealth from existing stockholders to options-holders. The result, Berle believed, made it possible "for the board of directors, by simple resolution, to authorize options on all or any part of a company's capital stock at any price deemed fit, and such options may run forever."[242] This was not a theoretical concern; organizers of the utilities holding companies that characterized in the 1920s sometimes granted themselves significant options in the firms, effectively giving themselves a disproportionate claim on future earnings.[243]

Despite Berle's objections, both blank stock and stock options became common tools of corporate finance. Blank stock did not, it appears, become a serious problem. Several years after his jeremiad against blank stock, Berle admitted that he "ha[d] come across no certificate [of incorporation] which has not, to some extent, limited the power of directors . . . ; either because the power was not realized, or, because its existence seemed too drastic even for the corporate organizers of today."[244]

Stock options present an even more interesting case because they not only survived in Delaware law, but were authorized by some of the new, shareholder-protective modern corporation acts. Ohio's revised act authorized stock options as early as 1927, an inclusion that did not earn Berle's wrath, perhaps because he was focused on Delaware as the legal home of giant corporations.[245] Yet, California's corporation code, adopted

239. *See* Russell D. Garner & Alfred S. Forsythe, *Stock Purchase Warrants and "Rights,"* 4 S. CAL. L. REV. 269, 269 (1930) (describing the post-war shift in investment preferences from preferred stock to common stock); Grossman, *supra* note 85, at 130.

240. *See* Berle, *supra* note 224, at 570 n.9 (citing DEL. REV. CODE ch. 65, § 14 (1929)). The use of the options before 1929 suggests that many authorities believed they were legal; the revision of the Delaware code merely ratified the arrangement.

241. Berle, *supra note* 224, at 570.

242. *Id.*

243. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 36 (Aspen Publishers 3d ed. 2003) (discussing the United Corp.).

244. BERLE & MEANS, *supra* note 87, at 186.

245. *See, e.g.*, BALLANTINE, *supra* note 102, § 71, at 92 (claiming to follow "the

two years after Berle's attack, also authorized stock options despite the fact that the law's drafter agreed with much of Berle's critique. Stock options were, Ballantine admitted,

> subject to grave abuse. They may be utilized as a subtle contrivance to keep a string on all future corporate growth, prosperity and increment in value without expense or risk or adequate consideration. When exercised at less than the value of the shares, they dilute the value of outstanding shares and transfer an interest in the surplus from the investors who took the risk to the option holders.[246]

Discussing ways to limit the risk in his treatise, *California Corporation Laws*, Ballantine presented Berle's proposals to rein in stock options, which included making their issuance public, limiting the number issued to a percentage of the corporation's outstanding shares, and giving them an expiration date.[247] Yet, none of these protections made it into California's code. The drafting committee concluded that any statutory limits would be "unwise . . . because the matter of granting options may be sufficiently regulated by the courts and the commissioner of corporations and statutory regulations might unduly hamper business."[248] The need to attract incorporations limited reformers' options; California rejected even a measure to merely eliminate some possible abuses of stock options because of its potential to "unduly hamper business." The provisions' inclusion also illustrates how often reformers hewed to existing corporation law standards; even California's shareholder-friendly and "modern" corporation act incorporated provisions remarkably similar to Delaware's.

D. Amending the Charter

Central to power in a corporation is the power to amend its charter. Among the major trends in the 1920s were statutory changes that gave directors and majority shareholders new "powers of amendment of the articles with consequent restriction, if not elimination, of the fixed contractual and 'vested' rights of the shareholder."[249]

Delaware and Ohio Acts, under which the board of directors is authorized by resolution to give options to purchase or subscribe or convert or exchange securities for shares upon such terms as may be deemed expedient").

246. *Id.* at 93.

247. *Id.*

248. *Id.* at 94.

249. Rutledge, *supra* note 11, at 310. For a more theoretical account that addresses charter amendments, see Lucien Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989) (arguing for limits on opt-out charter amendments because of information and collective action problems in the charter amendment process).

The issue of when and how a corporation's charter could be altered long predated the 1920s. In the nineteenth century, a corporation's charter was conceived of as, among other things, a contract among the shareholders,[250] and under classic contract law a contract could be modified only with the agreement of all the parties.[251] Obviously, this gave minority shareholders power to block any proposal that the majority made to alter any feature of a charter. In response, doctrines slowly developed to allow a majority of shareholders to amend a charter so long as the amendment did not "fundamentally change the character of the corporation, or its objects, but which [was] merely in furtherance of the objects for which it was created, and for the purpose of enabling it the better to carry out those objects."[252] Although this was useful for corporate managers and majority shareholders who desired to alter some aspects of a corporation's operations, the doctrines still reflected nineteenth century views that the corporation was fundamentally a static enterprise with a set purpose and structure.

The move to greater flexibility in charter amendments traces back to the laws of mergers and consolidations. Under the old rule, any plan to merge a corporation into another or to accomplish the same end by selling its assets, required unanimous shareholder approval, which invited a holdup by an objecting shareholder. By the end of the nineteenth century, however, judges increasingly refused to give a minority such a veto.[253] So was born the appraisal remedy; it allowed a majority of shareholders to authorize a merger or sale of a corporation's assets while giving dissenting shareholders not a veto but the right receive an independently determined price for their shares.[254]

250. The charter also was a contract between the corporation and the state. The question of when the state could change the charter also loomed large in the nineteenth century, especially after the Supreme Court imposed limits on state alteration of a charter in the *Dartmouth College* case. *See* Dartmouth College v. Woodward, 17 U.S. (4 Wheat) 519, 605 (1819) (noting that the legislature cannot amend a private corporation's charter without the consent of the grantees). The question of when and how a legislature could change a corporate charter is separate from the question considered here: how shareholders could change the charter. A charter still is a contract among shareholders, however fictive the notion might appear.

251. *See* WILLIAM W. COOK, *supra* note 210, § 500 (characterizing such a change as a constitutional violation of stockholders' contract rights).

252. BALLANTINE, *supra* note 179, § 281, at 826. This broad statement disguises a huge body of case law in which courts wrestled with which changes to the charter were so fundamental as to require consent of all shareholders.

253. *See* Norman D. Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233, 233-35 (1931) (noting that courts would give the minority rights similar to the appraisal remedy before the passage of statutes that granted such appraisal rights).

254. *See supra* text accompanying notes 67-68. Legislatures passed the appraisal statutes mostly in the early twentieth century, though New Jersey and Delaware had

Similar doctrines soon arose concerning charter amendments. As noted above, the common law rule did not allow a mere majority of shareholders to work a "fundamental" change in a corporate charter, such as changing its purpose or capital structure. Yet, by the turn of the century (and probably sooner), such changes became increasingly necessary for corporations with dispersed stockholders that navigated a fluid commercial landscape. Corporations needed the freedom to enter new business fields or to issue new securities, even if these changes disadvantaged existing shareholders. New Jersey law made allowances early on for majorities that wished to fundamentally change their corporations' charters, and Delaware followed close behind.[255] Delaware's 1915 corporation act allowed a corporation to, by less than unanimous agreement:

> [A]mend its charter of incorporation, either by addition to its corporate powers and purposes, or diminution thereof, and by substitution of other powers and purposes in whole or in part, for those prescribed by its charter . . . or by making any other change or alteration in its Charter of incorporation that may be desired; provided only that such amendment, change, or alteration, shall contain only such provisions as it would be lawful and proper to insert in an original certificate of incorporation . . . .[256]

Minority shareholders who objected had little recourse, much less an appraisal remedy. While Delaware courts later stepped in to craft a few equitable protections for shareholders severely disadvantaged by such changes, minority shareholders still had relatively few protections from such changes.[257]

Unsurprisingly, most new corporation acts sought a middle ground. They tended to allow amendments even in the face of shareholder dissent,

appraisal statutes for mergers and acquisitions by the turn of the century. *See* Manning, *supra* note 67, at 246 n.38 (noting that New Jersey first passed an appraisal statute in 1878, while Delaware first passed such a statute in 1899).

255. The spread of this new stance, which allowed shareholders to fundamentally alter the corporate charter on a less-than-unanimous vote, was slow and uneven. In 1923, one of the standard treatises on corporation law could still assert that "a material and fundamental change in the charter by an amendment to that charter is an unconstitutional violation of the contract rights of any shareholder who does not assent to such an amendment." COOK, *supra* note 210, § 500, at 1313.

256. ROBERT PENNINGTON, A TREATISE ON DELAWARE CORPORATION LAW § 26, at 104 (1925) (quoting DEL. GEN. CORP. L. § 26).

257. Most notably, in 1923, a Delaware court held that a majority could not change a corporate charter to eliminate preferred shareholders' accrued dividends. Morris v. American Public Utilities Co., 122 A. 696, 703-06 (Del. Ch. 1923). A later decision, however, effectively bypassed this case when it allowed a merger to effect a similar result, so long as an appraisal remedy was provided. Federal United Corp. v. Havender, 11 A.2d 331, 344 (Del. Ch. 1940) (discussed in Manning, *supra* note 67, at 227-28); *see* Cary, *supra* note 8, at 677-78 (stating that all shareholders did not have to approve a merger so long as there was an appraisal remedy).

subject to Board approval, while sometimes providing stronger protections for dissenting minority shareholders.[258] The UBCA, for instance, allowed any amendment of the charter by "two-thirds of the voting power of all shareholders," unless the charter itself specified a different number.[259]

The new acts also addressed a particular danger posed by the confluence of more permissive rules concerning charter amendments and the increasing complexity of corporations' capital structures: the danger that majority shareholders could use charter amendments to strip rights away from minority shareholders. As discussed above, by the 1920s, large corporations increasingly had outstanding several different classes of preferred and common shares whose attributes were set out in the charter.[260] The interests of these different classes did not always align, and could at times be at odds. In particular, common and preferred shareholders often vied for limited sums available for distribution to shareholders; to the extent that preferred shareholders were guaranteed cumulated dividends, for instance, the amounts available for distribution to common shareholders were reduced. As the charter recorded the attributes and rights of all shares, the power to change the charter would, if not checked, allow a majority of shareholders to vote to change the preferences and rights of a class of minority shareholders.[261] This power particularly threatened preferred shareholders, as common shareholders typically outnumbered them. Under a regime that allowed a majority of shareholders to change charters, a majority composed of common shareholders could potentially take a host of actions to disfavor preferred shareholders, from reducing the preferred shareholders' fixed dividend, to issuing securities senior to the current preferred securities, thereby completely undermining the position of these minority shareholders.[262]

To protect minority shareholders, especially preferred shareholders, almost all the new corporation acts adopted class voting, which required a

258. On statutory changes concerning charter amendments, *see* Routledge, *supra* note 11, at 324-26. Surprisingly, even as late as 1930, stockholders had comparatively few shields against charter changes. One observer noted in that year that appraisal rights, for example, were limited to cases where a minority objected to a corporation's merger or consolidation. Irving J. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420, 422 (1930).

259. Unif. Bus. Corp. Act § 38 (1930).

260. *See supra* text accompanying notes 83–86.

261. The laws discussed below, and the occasional equitable interventions by the courts, have limited this theoretical power.

262. Merrick Dodd nicely captured the dangers that such an ability to change the charter, and thus shares' attributes, posed: "One who . . . buys seven per cent cumulative first preferred stock in a rubber factory does not expect his investment to be metamorphosed into five percent non-cumulative second preferred stock in an iron foundry." Merrick Dodd, *Amendment of the Corporate Articles Under the New Ohio General Corporation Act*, 4 U. CIN. L. REV. 129, 134 (1931).

charter amendment that disadvantaged a class of stock to be approved by the holders of that class. Somewhat surprisingly, Delaware adopted this approach early and required that a majority of each affected class approve any provision that:

> [W]ould alter or change the preferences given to any one or more classes of preferred stock, authorized by the certificate of incorporation, or would increase or decrease the amount of the authorized stock of such class or classes of preferred stock, or would increase or decrease the par value thereof.[263]

Many of the modern acts contained similar provisions, a number going beyond a mere majority class vote requirement. The UBCA required that two-thirds of a class approve any amendment that would "make any changes in the rights of the holders of shares of any class, or would authorize shares with preferences in any respect superior to those of outstanding shares of any class."[264] It also gave a dissenting shareholder the same right as a dissenting shareholder in a merger or consolidation: to appraisal resulting in payment of fair value for his shares.[265] Ohio's Act took a near-identical approach.[266] California, however, provided only more limited remedies; its act required a class vote, but rejected the appraisal remedy; "[t]he protection against the abuse of the power to amend is found in the votes required for the adoption of amendments and in the equitable remedies against fraud or abuse of power."[267] This set the general trajectory of reform; while most states adopted class voting to protect minority shareholders, relatively few states gave them the absolute out of an appraisal.[268]

263. PENNINGTON, *supra* note 256, at 105 (quoting DEL. GEN. CORP. L. § 26 (1925)).

264. Unif. Bus. Corp. Act § 38 (1930).

265. Unif. Bus. Corp. Act § 41 (1930).

266. *See* Dodd, *supra* note 262, at 141-43 (discussing sections 15 and 72 of the Ohio General Corporation Act).

267. BALLANTINE, *supra* note 102, § 347, at 417.

268. In 1958, Arthur Lattin found only nine states' corporation codes provided appraisal rights if a change in the charter materially affected a class of shares. Norman D. Lattin, *Minority and Dissenting Shareholders' Rights in Fundamental Changes*, 23 LAW & CONTEMP. PROBS. 307, 311 n.8 (1958).

E. Ultra Vires

The changes discussed here shifted power from shareholders to management, leaving shareholders less protected than they had been a generation before. Yet, while disempowering to shareholders, some of these changes made great sense. Such is the case with the elimination of the *ultra vires* doctrine.[269]

Ultra vires was the term for a transaction "foreign to [the corporation's] authorized business."[270] Born in an era when corporations had limited purposes, the *ultra vires* doctrine held that corporations could not perform actions outside their state-chartered authority.[271] The reasoning behind the doctrine was straightforward; the state created a corporation for specific purposes and the corporation lacked power to engage in any activity beyond those purposes. *Ultra vires* also protected shareholders; by banning *ultra vires* acts, the law blocked managers from using shareholders' property in ways to which the shareholders never agreed.[272] As the Supreme Court held in 1830, the "exercise of the corporate franchise . . . cannot be extended beyond the letter and spirit of the act of incorporation."[273]

As the doctrine developed over the nineteenth century, it accumulated complexities and contradictory holdings. A particular problem was that courts generally held that a corporation's *ultra vires* contracts were not merely voidable, but void; that is, if a corporation entered into a contract beyond its powers, the corporation could not be bound by the contract.[274] To mitigate this harsh result, other courts carved out exceptions by ruling that a corporation would be estopped from invoking *ultra vires* under some

269. On the doctrine, see generally BALLANTINE, *supra* note 179, §§ 67-86 (discussing the doctrine); HOVENKAMP *supra* note 37, at 59-64 (explaining the scope of the doctrine).

270. BALLANTINE, *supra* note 179, at 234.

271. HOVENKAMP, *supra* note 269, at 59. In a *quo warranto* proceeding, a state Attorney General could move to enjoin a corporate action as *ultra vires*; they used such actions in the late nineteenth century to challenge corporations' abilities to participate in trust arrangements. *See* CHERNOW, *supra* note 60, at 331 (noting such an action in 1889 by Ohio's attorney general against Standard Oil).

272. *See* Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1287, 1304 (2001) (noting the doctrine protected shareholders who invested based on the scope of the corporation's activities).

273. *Id.* at 1302 (quoting Beaty v. Lessee of Knowler, 29 U.S. (4 Pet.) 152, 167 (1830)).

274. Under *ultra vires*, the law charged individuals with constructive knowledge of a corporation charter's limits. In this sense, *ultra vires* rejected the doctrine of apparent authority, for even if a corporate officer reasonably appeared to have authority to bind the corporation, the corporation would be bound only if the corporation actually had such power to enter into the contract, as determined by its charter.

circumstances to avoid an executed contract.[275] As the century progressed and exceptions multiplied, *ultra vires* appeared less as a shareholder protection from managerial overreaching, and more as a tool occasionally available for corporations to avoid the obligations of their contracts.[276] One authority described it as "a doctrine of business immorality, if not legalized plunder."[277] According to one scholar, by the 1920s, there was "perhaps no part of the law concerning corporations in which we meet with so much difficulty, confusion, and conflict of opinion."[278]

Ultra vires also did not fit with changing understandings of the corporation. For most of the nineteenth century the corporation was seen as the creation of the state, possessing only the powers bestowed by the state.[279] Conceptually, under that view, a corporation was literally powerless to perform an *ultra vires* act. The twentieth century view was very different. As one contemporary commentator wrote:

> When a group of persons may agree together to form a corporation and decide upon the powers they shall provide for it-—and the state is helpless to prevent the formation of the corporation with such powers so long as those persons go through the formality of complying with certain statutory requirements—it seems a little inaccurate to describe the corporation as an entity created by the state and deriving its powers therefrom.[280]

The era's reformers therefore sought not to improve *ultra vires* but to bury it.[281] As with much else, each new corporation act took a slightly different approach. To overcome *ultra vires*, the UBCA drew a new distinction between a corporation's "capacity" and "authority."[282] A

275. *See Legislation—Statutory Modification of the Doctrine of Ultra Vires*, 44 HARV. L. REV. 280, 281 (1930-31) (noting that courts looked to theories of estoppel, illegality, and public policy to limit the effect of *ultra vires)*.

276. *See* Greenfield, *supra* note 272, at 1310 (stating that corporations "began to use the *ultra vires* doctrine as a defense to contract actions against them").

277. Chicago Bar Association, *supra* note 132, at 32.

278. BALLANTINE, *supra* note 179, § 67, at 234.

279. *See supra* text accompanying notes 42–58 (discussing the modernization of corporation law).

280. Charles E. Carpenter, *Should the Doctrine of Ultra Vires be Discarded?,* 33 YALE L.J. 49, 59 (1923).

281. *See id.* (stating that "the doctrine of special powers cannot stand"); *Modification of Ultra Vires*, *supra* note 275, at 281-82 (describing various approaches to limit the use of *ultra vires*); Henry Winthrop Ballantine, *Proposed Revision to the Ultra Vires Doctrine*, 12 CORNELL L.Q. 453, 455-57 (1927) (proposing to eliminate *ultra vires* and instead bind a corporation by the acts of its agents as against a party entitled to assume that the agents acted within the authority conferred on them); Robert S. Stevens, *A Proposal as to its Codification and Restatement of the Ultra Vires Doctrine*, 36 YALE L.J. 297, 299 (1927) (noting a legislature could simply destroy the premise of *ultra vires*).

282. Unif. Bus. Corp. Act § 11 (1930); *see also* Stevens, *supra* note 281, at 334-35

corporation had the capacity "to act possessed by natural persons," but the authority to perform "only such acts as are necessary or proper to accomplish its purposes and which are not repugnant to law."[283] By stating that a corporation had the same capacity to perform an act as did a natural person, the law eliminated the possibility that an act would not bind a corporation solely because the act was beyond the corporation's purposes, even though the act may have been unauthorized.[284] Concerned that this repudiation was too subtle, the drafters of Ohio's statute largely eliminated the possibility of asserting that a contract was void because it was *ultra vires*. The Act stated that "[n]o limitations on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person, except by or on behalf of the corporation against a director or officer or a person having actual knowledge of such limitation."[285] A corporation could invoke *ultra vires* only in a suit against an officer or director who authorized an *ultra vires* act, or against a third person who knew that a corporation lacked power to enter into a contract. California's revision also eliminated the doctrine, a change that Henry Ballantine described as "the most original contribution of the California Act."[286] Under the California Act "[n]o limitation upon the business, purposes or powers of the corporation or upon the powers of the shareholders, officers or directors . . . shall be asserted as between the corporation or any shareholder and any third person," and it provided that "[a]ny contract or conveyance made in the name of the corporation . . . [or] done within the scope of the authority, actual or apparent, given by the directors . . . shall bind the corporation."[287] By the early 1930s, similar legislative reforms became standard solutions to the "*ultra vires* problem."[288]

(discussing the elimination of the doctrine of limited capacity and the application of principles of agency, estoppel, and laches to *ultra vires*).

283. Unif. Bus. Corp. Act § 11 (1930).

284. *See* Unif. Bus. Corp. Act § 11 Commissioners' Notes (reflecting the UBCA's clear intent to bind a corporation by its agents' apparent authority, even though the agent's act was *ultra vires*—a departure from existing doctrine).

285. Ballantine, *supra* note 281, at 456.

286. Henry W. Ballantine, *Problems in Drafting a Modern Corporation Law*, 17 A.B.A. J. 579, 579 (1931).

287. BALLANTINE, *supra* note 102, at 330-31 (quoting CAL. CODE § 345). California's code protected third parties that dealt with a corporation from *ultra vires* claims, but still allowed shareholders and the state to "enjoin the doing or continuation of unauthorized business by the corporation and/or its officers." *Id.* at 330.

288. *See* ROBERT STEVENS, HANDBOOK ON THE LAW OF PRIVATE CORPORATIONS, 1019-28, app. "Statutory Provisions Relating to Ultra Vires Problems" (West 1949) (surveying the legislative reforms).

V. FEDERAL LAW, STATE LAW, AND THE 1930S

States continued to produce new corporation laws into the 1930s and beyond. Ohio's 1927 revision was followed by new corporation laws in such states as Idaho (1929), Indiana (1929), Louisiana (1928), California (1931), Michigan (1931), Pennsylvania (1931), Illinois (1933), Minnesota (1933), and Washington (1933).[289] In 1937, the same year Wiley Rutledge foresaw "a procession which will grow longer and longer until perhaps the entire country will be included,"[290] Wisconsin prepared to revise its corporation act.[291] In ordinary times, such a succession of reforms would be unsurprising. But, these were not ordinary times. The thread of corporation law revisions spanned years, during which the adoption of the Securities Act of 1933 and the Securities Exchange Act of 1934 fundamentally changed the federal system for regulating the issue and trading of securities.[292] What effect did these acts have on corporation law reform?

Not as much as might be expected. The Securities Acts, particularly the Securities Act of 1933, did not trigger a wholesale revision of state corporation law or eliminate the need for reform; and that was not their goal.[293] The core of the Securities Acts is disclosure; the Acts for the most part allow corporations to issue securities as they wish, so long as they give potential purchasers extensive information about the securities.[294] The Acts' disclosure requirements aimed to provide shareholders and would-be shareholders more information about issuers than previously available, information that no doubt increased purchasers' power generally and would have ended some corporations' abusive practices in the 1920s.[295] For example, the 1933 Act required an issuer to disclose, among other things, all options "outstanding or to be created in connection with the security to

289. *See* Garrett, *supra* note 11, at 416 (listing states).

290. Rutledge, *supra* note 11, at 309.

291. *See* Garrison, *supra* note 152, at 417-18 (noting that work on revising Wisconsin law began in 1935). Wisconsin took its time and did not finally adopt a revised act until 1951. Garrett, *supra* note 11, at 421.

292. *See* LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 162-67 (Yale Univ. Press 2002) (discussing the emergence of the Acts following the Depression).

293. *See, e.g.*, Dodd, *The Modern Corporation, Private Property, and Recent Federal Legislation*, 54 HARV. L. REV. 917, 933-35 (1941) (describing changes under the Securities Exchange Act of 1934); Mark, *supra* note 12, at 629-32 (noting that the Securities Acts sought to avoid encroaching on the equity jurisdiction of state courts).

294. The 1933 Act sets out a rigid schedule that issuers must follow before they issue securities, and the 1934 Act includes stringent anti-fraud requirements.

295. Arguably, the disclosure requirements were not novel, as many were already present in state Blue Sky laws and the listing requirements of the New York Stock Exchange; "[w]hat was new was that these requirements now had federal imprimatur." Mark, *supra* note 12, at 631.

be offered," together with the names of any person allotted more than ten percent of those options,[296] a requirement that would have made impossible the secret issuance of options that agitated Berle.[297] The 1934 Act's requirements for annual and quarterly reports from an issuer similarly would have helped shareholders, as would section 14 of the 1934 Act, which set rules for corporate voting. Section 14 was significant not only because it required greater disclosure to shareholders in the election of directors, but it also required that shareholders, when asked to vote on "such matters as changes in the rights of any class of security holders," be given "a description of the material differences which the proposed change would make and also a statement of the present financial condition of the corporation."[298] Yet these reforms did not target all corporate abuses; even while Congress was passing the Securities Acts, New Deal stalwarts Berle and William O. Douglas actively, though ultimately unsuccessfully, pushed for the adoption of a separate federal incorporation statute, which they believed necessary to work genuine change in corporate governance on a national scale.[299]

Two federal securities acts did work fundamental changes in corporation law, but these were not the 1933 and 1934 Acts, and they applied only to a limited set of corporations. The Public Utilities Holding Company Act of 1935 ("PUHCA") and the Investment Company Act of 1940 each imposed an array of requirements on their industries, to the point where the corporation law that governed them was substantially federalized.[300] Under PUHCA, for instance, the Securities and Exchange Commission took control over a range of issues related to public utilities holding companies, including "the issue of new securities, the acquisition of additional utility properties, proxy solicitations, dividend payments, intercompany contracts and loans, the modification of shareholders' rights, and the modification of bondholders' and other creditors' rights in cases of reorganization."[301] Similarly, the Investment Company Act fundamentally changed the laws that regulated what became mutual funds, and set out detailed requirements for those firms' capital structures and governance.[302]

296. Securities Act of 1933, 15 U.S.C. § 77aa (2000), sched. A(10).

297. SELIGMAN, *supra* note 243, at 70 ("[V]irtually every undisclosed aspect of the option warrants issued by J.P. Morgan in connection with the United Corporation would have been revealed by Schedule A.").

298. Dodd, *supra* note 293, at 934-35.

299. A. C. Prichard & Robert Thompson, *Securities Law and the New Deal Justices*, 11 (Univ. of Mich. Law Sch. John M. Olin Center for Law and Econ. Working Paper No. 08-014, 2008).

300. *See id.* at 2-3, 6 n.14 (discussing PUHCA and the Investment Company Act).

301. Dodd, *supra* note 293, at 938.

302. *See* Alfred Jaretzki, *The Investment Company Act of 1940*, 26 WASH. U. L.Q. 303 (1940) (detailing the factors that legislators considered when they drafted the Investment

The comprehensive regulations imposed on these two industries through these Acts only emphasize the degree to which the 1933 and 1934 Acts left vast reaches of corporation law unaffected. As Merrick Dodd wrote in 1940:

> [M]any of the evils to which we have referred have been left untouched by these new statutes except in the cases of two special types of corporations—public utility holding companies and their subsidiaries, and investment corporations. It is only with respect to these two types of corporations that Congress has legislated with a view to preventing unsound and over-complicated capital structures. It is only in the case of public utility holding companies that the revamping of these structures by means of charter amendments—a process too often utilized by management as a means of extorting concessions from preferred shareholders—has been subjected to administrative supervision.[303]

In sum, the Securities Acts provided some protection for shareholders, but neither protected them from many of the abuses scholars identified in the 1920s, nor did the Acts take the place of state corporation law.

The state-level reform efforts of the 1920s flowed in an unbroken stream through the 1930s and beyond. As late as 1951, one observer, referring to the wave of revised corporation acts dating to 1927, spoke of the "wave of modernization that is still in motion."[304] Yet, it was also in the postwar period that the loose movement for corporation law reform crested and successors emerged. Since the mid-1920s, state corporation law reformers had pushed state-by-state statutory revisions, drawing on models provided by the Uniform Act, other states' revised corporation codes, and the loose network for reform that slowly formed during the first wave of reform. In 1946, however, a new chapter began in reform efforts when the American Bar Association completed a successor to the Uniform Act, the Model Business Corporation Act.[305] In many ways, the Model Act sought to carry forward the goals of the previous generation of reformers. Like the Uniform Act and many "modern" corporation acts, the Model Act aimed to update corporation law to both serve business and protect shareholders; indeed, one stated goal of the new Model Act was to strengthen the rights of shareholders, which had "almost ceased to exist in some states."[306] Yet, the Model Act also tried to move beyond the Uniform

Company Act of 1940).

303. Dodd, *supra* note 293, at 946-47.

304. Garrett, *supra* note 11, at 412.

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

306. *Id.* at x.

Act and the earlier generation of modern corporation acts, which for all their virtues had often differed among themselves in matters large and small.[307] The Model Act's drafters hoped that it would signal a new era and result in a genuinely standard corporation law.[308] Its issuance marked a continuation of the movement to modernize corporation laws, but also the end of that movement's first era.

CONCLUSION

For over a century, observers have identified competition for corporation charters as the engine of change in corporation law. States, it has been argued or assumed, changed their corporation laws to attract incorporations, either to compete for incorporations on a national stage or at least keep local corporations from incorporating elsewhere. Modern corporation law, so the tale goes, is the inexorable result of this process, and the logic of competition is to be credited or blamed for the contours of that law.

This Article significantly complicates that story, presenting an account that emphasizes the mixed and sometimes inconsistent motives of corporation laws' drafters and their ambiguous legacies. To be sure, state competition was an important factor in the development of the "modern" corporation statutes of the 1920s and 1930s, but it was a particular kind of competition: the states discussed here—or, more accurately, influential groups within these states—did not always aim to produce laws that were more attractive to corporations than those of Delaware or other states; many aimed merely to produce laws that were sufficiently attractive that they would dissuade local corporations from reincorporating elsewhere. Furthermore, competition for incorporations was not the sole motive behind the reforms. The acts' drafters were, through the statutes, not merely responding to competition but attempting to address both widespread concerns about changes in American capitalism and the fear that corporate management would soon be in a position to overmaster shareholders. The acts were thus responses not only to immediate competitive pressures but also to larger currents in American society and American thought about giant corporations.

What does this tell us about the history and production of corporation law? It suggests, first, that earlier versions have presented a one-sided

307. Commentators criticized the Uniform Act, for instance, because few states adopted the law wholesale, although others borrowed some of its provisions. *See* Garrett, *supra* note 11, at 420 (detailing the extent to which certain states adopted the Model Business Code).

308. Though beyond the scope of this Article, observers have noted the great deal of uniformity existing in today's state corporation statutes. *See* William J. Carney, *The Production of Corporation Law*, 71 S. Cal. L. Rev. 715, 729 (1997).

account of the law's development by focusing almost completely on the power of competition to shape corporation law. Of course, as this Article itself shows, competition was important. But competition was not the only significant influence on the laws; so were the hopes and fears of reformers, who often sought in the laws to respond to what they perceived as deeper trends in American corporate governance and, indeed, social and economic life. Indeed, the movement to modernize corporation law can only be understood if we widen our focus to take into account not only state competition but all the diverse and competing influences that combined to produce the new laws.

More fundamentally, this Article suggests the need to adopt a new and broader understanding of the development of corporation law. Despite a few recent dissents,[309] the standard story of corporation law has presented its evolution over the past century as a remarkably mechanical process. The story goes roughly like this: corporate federalism created the possibility of competition for charters; states began to compete for charters, producing laws to attract incorporators; once competition began, states were compelled to continually update the laws simply to stay competitive; and the resulting dynamic drove states to adopt laws that either scaled the heights of economic efficiency or paved a downward path to managerial dominion and exploitation. It may have been a race to the top or to the bottom, but the race was unavoidable either way.

This Article provides an alternative way to think about corporation law's development. While acknowledging the importance of state competition, it unearths other influences that also shaped corporation law, and thereby attempts to present a more complex and nuanced account of the law's evolution. It depicts the development of corporation law not solely as the result of state competition, but as a contingent, conflicted, and fragmented historical process. It was contingent, in that it did not have to happen this way. Some states adopted new corporation laws early, others waited longer, and some did not change their laws at all, for reasons internal to the states and their peculiar circumstances. Conflicted, in that the laws arose out of, and eventually embodied, motives that did not always mesh easily. Their backers aimed to respond to both local economic demands and national concerns, which yielded laws that aspired to both please corporate managers and protect shareholders. Fragmented, in that the reform efforts, while connected, were not of a piece. Some states were out front in reform efforts while others lagged behind, and the laws eventually produced varied depending on the politics of the adopting state, and the judgment and concerns of their drafters. Corporation law, in sum,

309. *See, e.g.*, Robert Ahdieh, *Trapped in a Metaphor: The Limited Implications of Federalism for Corporate Governance*, 77 GEO. WASH. L. REV. (forthcoming 2009).

is the product of complex and competing influences, and only when we acknowledge this will we be able to provide satisfying accounts of its development.