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Delaware Beware

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DELAWARE BEWARE

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ABSTRACT

This article conducts an in-depth exploration of the dynamic competition among states to attract businesses and determine the legal framework governing corporations. It adopts an innovative market-centric viewpoint, treating corporate law as a product within the broader context of charter competition among U.S. states. While the scholarly spotlight has predominantly shone on publicly traded giants, this article daringly delves into uncharted territory, unraveling the intricate incorporation and governance decisions of privately held "unicorns"—those elusive venture capital-backed behemoths that silently shape the economic landscape.

By unraveling the decision-making processes of where these economic powerhouses incorporate, the article challenges prevailing assumptions on horizontal and vertical competitive federalism, introducing the concept of "long-term private giant" companies. This distinctive perspective provides insights into the relocation options and incorporation choices of both large private and public firms, illuminating how these entities navigate and influence the intricate landscape of organizational structure and governance choices within the corporate domain.

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[*] I would like to convey my appreciation to Marcel Kahan for sparking my interest in the field of state competition in corporate law and for shaping my perspective on the subject. I would also like to express my gratitude to Reece Disney, John Livingstone and Sharon Miller for their invaluable assistance. For their helpful comments, I extend my gratitude to Ian Ayres, Michal Barzuza, Lucian Bebchuk, Brian Broughman, Eric Chaffee, Stephen Choi, Alma Cohen, Jesse Fried, Jonathan Adler, Yifat Aran, Marcel Kahan, Sharona Hoffman, Ehud Kamar, Charles Korsmo, Juliet Kostritzky, Edward Rock, Cassandra Robertson, Roberta Romano, and Elizabeth Pollman.

INTRODUCTION

"*Never incorporate your company in the state of Delaware*."
– Elon Musk[1]

During Thanksgving weekend of 2023, a notable debate unfolded featuring former Attorney General William Barr,[2] attorney Jonathan Berry, and Delaware

[1] Elon Musk (@elonmusk), X (formerly Twitter) (Jan. 30, 2024, 5:14 PM), https://twitter.com/elonmusk/status/1752455348106166598.

[2] William P. Barr & Jonathan Berry, *Delaware Is Trying Hard to Drive Away Corporations,* WALL ST. J. (Nov. 24, 2023), https://www.wsj.com/articles/delaware-is-trying-hard-to-drive-away-corporations-business-environmental-social-governance-investing-780f812a. At the core of Barr's argument is the concern that Delaware faces the risk of aligning itself with "many blue states" that

Vice Chancellor Travis Laster.[3] The discussion centered around the question of whether Delaware is at risk of alienating corporations due to its involvement with environmental, social, and governance ("ESG") investment principles.[4] Delving into the historical context of New Jersey's policy failures that led to a significant migration of corporations to Delaware over a century ago, the multifaceted debate explored both contemporary and historical dimensions, sparking discussions on the potential repercussions for Delaware's standing as a corporate hub and its appeal to businesses.[5]

These issues, however, seem to represent just the tip of the iceberg, signifying a broader and more intricate discourse on the intersection of corporate governance, jurisdictional choices, and evolving societal expectations.[6] On January 30th, 2024, in a 201-page opinion, *Tornetta v. Musk*,[7] Chancellor Kathaleen St. J. McCormick of the Delaware Court of Chancery invalidated Elon Musk's unprecedented $55.8 billion compensation package granted by Tesla, Inc., an American multinational automotive and clean energy company headquartered in Austin, Texas.

In response, Musk commented on X Corp. (formerly Twitter), an American social media company based in San Francisco, California, advising against

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utilize Environmental, Social, and Governance (ESG) principles to integrate progressive political agendas, particularly related to climate, race, and other societal issues, into corporate governance. Barr suggests that such an incorporation of political ideologies into corporate decision-making may have consequences for Delaware's traditional business-friendly reputation. Additionally, Barr notes that "red states" are actively developing alternatives that may be perceived as more attractive for corporations seeking a different political and regulatory environment.

[3] J. Travis Laster, Hon., *Attorney General Barr Could Use Some Help on Delaware Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 2, 2023), https://corpgov.law.harvard.edu/2023/12/06/attorney-general-barr-could-use-some-help-on-delaware-law/. Vice Chancellor Laster appears to hold the upper hand in the doctrinal debate on this matter. Formally, Delaware law does not exhibit a preference for "progressive" governance over "conservative" governance, regardless of how one defines these terms.

[4] Delaware recently dismantled one of its longstanding safeguards against accusations of political bias: the stipulation that the Court of Chancery and the Delaware Supreme Court must maintain a balance between Republicans and Democrats. This change marks a significant shift in the state's judicial landscape, as the requirement for a partisan split has been a historical cornerstone in Delaware's legal framework. On January 30, a federal court sanctioned a consent judgment between Delaware's Democratic Governor John Carney and a former Democrat turned independent plaintiff, affirming that the constitutional "major political party" mandate violates the First Amendment. This alteration raises pertinent questions about the potential implications for perceptions of Delaware's judicial impartiality and the broader influence on corporate governance discussions involving political considerations. *See* Adams v. Carney, No. 20-1680-MN, Document 72 (D. Del. 2022).

[5] *See infra* Section IV.

[6] *See* Clara Hudson, *Delaware Judge Faces New Era of Politically Charged ESG Cases*, BLOOMBERG LAW (December 19, 2023), https://news.bloomberglaw.com/esg/delaware-judge-faces-new-era-of-politically-charged-esg-cases (Judge Will is "pioneering how judges navigate a growing cache of politically-charged corporate disputes tied to environmental, social and governance, or ESG, issues."); *See* Jody Godoy, *Chancellor says ex-Trump official got Delaware's ESG stance wrong*, REUTERS (November 27, 2023), https://www.reuters.com/legal/government/chancellor-says-ex-trump-official-got-delawares-esg-stance-wrong-2023-11-27/ ("Delaware Chancellor Kathaleen McCormick, who leads the top U.S. business court, said on Monday that a former Trump official got it wrong when he wrote the state is trying to "drive away corporations" by embracing environmental, social and governance issues").

[7] Tornetta v. Musk, C.A. No. 2018-0408-KSJM (Del. Ch. Jan. 30, 2024).

incorporating companies in Delaware and suggesting Nevada or Texas as alternatives, particularly if shareholders should have a say in the matter.[8] Ironically, Tesla's own shareholders were the plaintiffs in the *Tornetta* case. Musk's tweets have brought more attention to the dynamics of jurisdictional competition. By pushing to move Tesla and holding a stockholder vote on reincorporating in Texas, Musk has ignited discussions about the factors that influence corporations' decisions on their legal domicile.

The spotlight on jurisdictional competition underscores the significance of state policies, political climates, and other considerations that can impact a company's choice of location. Moreover, a closer examination of the *Tornetta* ruling offers valuable insights into Delaware law and the competition among states to attract corporations for chartering (incorporation). These examples illustrate that the influence of politics on corporate law has experienced a notable surge. This trend reflects an increased recognition of the impact that political and societal factors can have on corporate decision-making and legal frameworks.

There is a shift among "red" states to distinguish themselves from, rather than emulate, the Delaware Court of Chancery.[9] This departure from imitation suggests a growing acknowledgment that states are reevaluating their legal landscapes to better cater to evolving corporate needs and preferences, signaling a broader transformation in the competitive dynamics among jurisdictions for corporate incorporation.[10] The evolving landscape highlights an era where political considerations are shaping the direction of corporate law and influencing the choices of businesses regarding their legal homes.

The competition among states is a longstanding American tradition.[11] This system is commonly referred to as "competitive federalism," a concept embodying the idea of horizontal competition,[12] in which various government entities—specifically states within a federal system—have the power to regulate local entities and business activity, by engaging in competition to entice businesses to charter within their borders.[13]

Elon Musk's comments about leaving Delaware shouldn't be surprising to corporate scholars following his legal entanglements with the Delaware Court of Chancery, which have resulted in publicized losses. In fact, Musk already took several steps to leave and incorporate outside of Delaware in March 2023. News outlets reported that three new corporations linked to Elon Musk opted for

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[8] Elon Musk (@elonmusk), X (formerly Twitter) (Feb. 1, 2024, 12:09 AM), https://twitter.com/elonmusk/status/1752922071229722990.

[9] *See infra* Section IV.

[10] *See infra* Section IV.

[11] Melissa C. Wyatt, *Professor Saw Elon Musk and TripAdvisor Move to Nevada Coming — 11 Years Ago: Why Some Firms Are Leaving Delaware for Nevada, a Legal Wild West*, UVA LAW (June 12, 2023), https://www.law.virginia.edu/news/202306/professor-saw-elon-musk-and-tripadvisor-move-nevada-coming-11-years-ago.

[12] The Constitution delineates sovereign authority between governmental entities in two key ways: a vertical plane, which establishes hierarchy and delineates boundaries between federal and state powers, and a horizontal plane, which aims to coordinate fifty coequal states for peaceful coexistence. Both vertical and horizontal federalism are essential aspects of the U.S. government. *See* Allan Erbsen, *Horizontal Federalism*, 93 MINN. L. REV. 493 (2008).

[13] *See infra* Section II.

incorporation in Nevada, stirring curiosity about this unconventional choice.[14]

The subsequent reveal identified these companies as X.AI. Corp., an artificial intelligence startup, and X Holdings, the parent company of X Corp. (formerly Twitter), adding layers to the intrigue.[15] Elon Musk's departure from the typical choice of incorporating in Delaware reignited the ongoing debate among corporate law scholars on state charter competition.[16] This move and his efforts to relocate Tesla challenge the conventional wisdom that Delaware had unconditionally secured its position as the go-to jurisdiction for charter business, particularly in the context of publicly traded firms.[17] Can Elon Musk relocate Tesla, a publicly traded company, from Delaware and avoid judicial scrutiny?

Maybe the Eagles said it best in their ubiquitous hit: "You can check out any time you like, but you can never leave."[18] Elon Musk's relocating Tesla from Delaware to Texas highlights broader legal implications observed in recent cases. This move signifies a departure that may not be as straightforward as Henley's 1977 *Hotel California*. Tesla's move raises questions about fiduciary duties, conflicts of interest, and the impact on corporate governance, mirroring recent cases like TripAdvisor's proposed move from Delaware to Nevada.

This Article builds on this discussion and shifts it to privately held companies, shedding new light on the dynamics of state competition in the corporate landscape.[19] Notably, there is no uniform corporate law applicable across

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[14] According to filings with the Nevada Secretary of State, Elon Musk is listed as a director for both X Holdings Corp. and X Corp. These companies are registered with a Carson City address. The third company, X.AI Corp., is registered with a Las Vegas address and has Jared Birchall listed as its secretary. The *Wall Street Journal* has reported that Jared Birchall is the individual who manages Musk's family office. Sean Hemmersmeier, *Elon Musk Forms 3 Companies in Nevada, Filings Show*, LAS VEGAS REVIEW-JOURNAL (Apr. 17, 2023), https://www.reviewjournal.com/business/entrepreneurs/elon-musk-forms-3-companies-in-nevada-filings-show-2763280/.

[15] Connor Smith, *Twitter Inc. No Longer Exists. Elon Musk Says 'Stay Tuned' on X Holdings*, BARRON's (Apr. 12, 2023), https://www.barrons.com/articles/twitter-nevada-musk-x-super-app-1f998f30.

[16] Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684 (2002) ("the very notion that states compete for incorporations is a myth. Other than Delaware, no state is engaged in significant efforts to attract incorporations of public companies."). *See also* Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Re- considering the Competition over Corporate Charters*, 112 YALE L.J. 553, 563–64 (2002) (arguing that Delaware's dominant position imposes insurmountable barriers to entry); Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1790 (2011) ("Some recent evidence, however, suggests that the basic premise of both stories (i.e., that states compete actively for corporate charters) is wrong."); Mark J. Roe, *Delaware's Shrinking Half-Life*, 62 STAN. L. REV. 125, 125 (2009) ("A revisionist consensus among corporate law academics has begun to coalesce that, after a century of academic thinking to the contrary, states do not compete head-to-head on an ongoing basis for chartering revenues, leaving Delaware alone in the ongoing interstate charter market."); *id.* at 127 (quoting Ronald Gilson as saying that "'Kahan and Kamar ha[ve] demonstrated [that] there is no[] competition for corporate charters in the U.S. [and] no competition among states for the revenue from incorporation'").

[17] *See infra* Section III.

[18] EAGLES, *Hotel California*, *on* HOTEL CALIFORNIA (Asylum Records 1976).

[19] It should be noted that a "close corporation" is a specific type of "privately held" corporation with a more limited ownership structure and typically more flexible governance, which caters to a close group of individuals. Privately held corporations are not publicly traded, and their

all states.[20] Instead, individual states, rather than the national government, play a decisive role in determining the legal structure and governance of corporations through the process of state chartering.[21]

Competitive federalism in corporate law allows states to customize their laws. For example, Nevada incorporated both Delaware statutory and common law principles into its corporate regulations, but despite this alignment, Nevada hasn't significantly challenged Delaware's dominant position in the chartering business.[22] The possibility of more private companies following Elon Musk's lead and flocking to Nevada in the future remains.

While Nevada has not proven to be a significant competitor to Delaware, Elon Musk's consideration of Texas for Tesla, his publicly traded company, becomes more understandable. The challenge lies in persuading a board of directors of a public company to relocate to Nevada, particularly given the waived duty of loyalty. It becomes even more complex against the backdrop of Texas's current efforts to establish a specialized business court, signaling a potential competitive stance against Delaware in corporate chartering matters. This Article will delve into the corporate chartering landscape, examining whether Texas could emerge triumphant in a possible battle against Delaware.

However, Delaware's sustained dominance is rooted in its unmatched commitment to providing highly appealing corporate laws for managers. This

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characteristics can vary based on various factors including ownership structure and governance preferences.

[20] States' competition for incorporations of public companies has long been a dominant paradigm in corporate legal scholarship. Early treatments of the state competition for incorporations date to the nineteenth century. *See* WILLIAM W. COOK, A TREATISE ON STOCK AND STOCKHOLDERS 1604-05 (3d ed. 1894) (noting that federalism in corporate law in the United States is driving some states to liberalize their corporate statutes); Edward Q. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 201-02 (1899) (same). Contemporary scholars claim that states still vie for incorporations today. *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961, 961 (2001) (arguing that states compete for corporate charters); Jonathan R. Macey, *Smith v. Van Gorkom: Insights About C.E.O.s, Corporate Law Rules, and the Jurisdictional Competition for Corporate Charters*, 96 NW. U.L. REV. 607, 625 (2002) (same). *See* Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205 (2001); Kahan & Kamar, *supra* note 16; Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998).

[21] *See, e.g.*, Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Takeover Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 14461-70 (1992); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1512-13 (1989); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U.L. REV. 913 (1982); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 256 (1977); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 666 (1974). ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993). Kahan & Kamar, *supra* note 16.

[22] *See infra* Section IV.

assurance holds immense value for firms, considering the substantial costs associated with changing corporate domiciles.[23] Delaware's historical dominance is underpinned by its cost-effectiveness and business-friendly laws, making it the preferred choice for publicly traded companies.[24] Factors such as the specialized Delaware Court of Chancery and a consistent application of laws contribute to its attractiveness. These elements solidify Delaware's role as a top jurisdiction for corporate governance.[25]

This Article explores the intricate dynamics of state competition in corporate law, with a particular focus on venture-backed privately held firms, often referred to as "unicorns."[26] It is essential to clarify that a unicorn is a distinct category of a very large or gigantic venture-backed startup that surpass a valuation of $1 billion. This Article adds another feature to the common definition of a unicorn, which is that a unicorn is characterized by its preference to stay private for extended periods, resisting the traditional exit strategies, such as an initial public offering ("IPO"). The analysis delves into the nuanced landscape of state competition within this specific subset of gigantic privately held startup companies.

Existing research on state competition predominantly focuses on publicly traded firms, leaving a significant gap in understanding how the market for corporate law shapes the organizational structure and governance of large privately held firms, specifically unicorns.[27] Unraveling the incorporation decisions of these entities provides a unique perspective, as they navigate a distinct path from other large privately held firms or publicly traded counterparts.[28] As public firms face a decline in numbers, large private companies, including unicorns, are thriving and reshaping the corporate landscape.[29]

The Article addresses a significant gap in the literature and aims to scrutinize two widely accepted beliefs: (1) the common assumption that privately held firms in the United States predominantly incorporate in the state where their headquarters are located, and (2) the contention that there is a race to the bottom in terms of regulatory standards pre-initial public offering ("pre-IPO"). The Article will present arguments that question these commonly held assertions.

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[23] The costs associated with changing a corporate domicile involves not only search costs for more favorable corporation codes but also substantial transaction costs. (This is based on Oliver Williamson's theory of contractual precommitment, i.e., hostage-taking. *See* Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519 (1983). Consequently, managers seek the assurance that Delaware's corporate laws will consistently meet their needs, eliminating the need for a future change in their firms' domicile. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 470 (1986).

[24] *See infra* Section III.

[25] *See infra* Section IV.

[26] The term "unicorn" was coined in 2013 by venture capitalist Aileen Lee. The term describes a phenomenon where a startup is capable of raising substantial capital without the necessity of going public initially. *See* Aileen Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013), https://techcrunch.com/2013/11/02/welcome-to- the-unicorn-club/ [https://perma.cc/7WQP-NG6S].

[27] *See infra* Section II.

[28] *See infra* Section III.

[29] *See infra* Section IV.

Examining a notable shift within the technology sector, where certain tech giants, exemplified by figures like Elon Musk, no longer pursue public status, this new phenomenon is both intriguing and challenges our conventional understanding of how privately held firms operate. It specifically focuses on the operational dynamics of long-term privately held venture-capital backed startup companies. The Article introduces the innovative concept of recognizing a new classification - the "long-term private giant" company,[30] citing examples such as Elon Musk's corporations. This idea initiates an interesting analysis of how different states compete to attract these companies, marking a departure from viewing unicorns merely as a transitional phase before going public. It suggests a more enduring or long-term state for these entities. These challenges are primarily tied to the impact of federal securities laws on our state corporate laws.

Contrary to the notion that private companies primarily incorporate in their home state, this is not true for unicorn firms.[31] This research challenges these conventional notions and examines motivations for choosing to incorporate in Delaware rather than home states. The Article further contributes to the broader debate on state charter competition, questioning whether it fosters a "race to the top" or "race to the bottom."[32] It also addresses the longstanding question of whether states adopt corporate laws favoring managers over shareholders, offering new perspectives and groundbreaking insights into the dynamics of unicorn incorporation choices.[33]

The adoption of standardized documents, endorsed by industry experts, adds an extra layer of familiarity and consistency for both investors and companies during transactions. Furthermore, Delaware's appeal may extend to its ability to attract out-of-state investors.[34] Unicorns, being high-profile entities with diverse investor bases, may find Delaware's legal landscape conducive to accommodating investors from various geographical locations. This aligns with the theory that these companies leverage Delaware's reputation and legal framework to attract a broader pool of investors, further solidifying its status as the preferred jurisdiction for unicorn incorporation.

Another significant variable is that these unicorn companies are often deeply integrated into networks involving repeat players in the venture capital and startup ecosystem. The prevalence of repeat players, such as serial entrepreneurs as founders, and other experienced repeat players, including venture capitalists, legal advisors, and corporate governance experts who are familiar with Delaware's corporate laws, may influence this decision-making process. The established precedents and case law in Delaware provide a level of predictability and familiarity that benefits these repeat players. The variables are explained in greater detail below and contribute to the adoption of Delaware as the state of choice for

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[30] Most scholars refer to technology companies backed by venture capital as private entities that aspire to attain public status. The examples and quotations utilized in previous empirical works appear to pertain more to other different categories of private companies, which may not directly align with the technology sector under discussion in this piece.

[31] *See infra* Section II.

[32] *Id*.

[33] *Id*.

[34] *See* Klausner, *supra* note 21.

unicorn firms.[35]

This Article analyzes these factors as they relate to high-valuation startups in the context of the renewed debate surrounding competitive federalism. In essence, Delaware's corporate legal structure and the incorporation essentials it offers align seamlessly with the distinctive requirements of unicorns.

The Article is structured as follows and contributes to a comprehensive exploration of corporate charter competition and relocation considerations. Section II, *Horizontal Federal Competition for Charters,* delves into traditional theories on charter competition and organizational choices in the United States, addressing the significance and implications of the incorporation process. The exploration navigates the longstanding debate in literature, emphasizing the unexplored dimension of private entities in corporate chartering discourse. The market significance of privately held firms is unveiled, and distinctive traits in private firm charters amidst state charter competition are examined.

Section III, *Delaware - A Small Yet Mighty State Emerges Victorious*, describes Delaware's unique legal landscape. This section explores the role of Delaware's Court of Chancery and the evolution of Delaware corporate law, focusing on a paradigm shift of public and private firms towards corporate charter standardization. The Musk case study is then presented, unraveling corporate drama in the context of the Twitter acquisition saga, Twitter's relocation puzzle, and Tesla's proposed move, along with their implications and considerations.

Section IV, *Who Will Be the Next Contender - Nevada, Texas, Wyoming, or the Federal Government?*, explores lessons from other states that competed with Delaware. It sheds light on New Jersey's historical significance, examines changes to the duty of loyalty in Nevada, prospects for digital asset corporations in Wyoming, and evaluates the potential in Texas amidst the establishment of its business courts, along with challenges and criticisms surrounding these efforts to compete. The potential for future competitive vertical federalism is also assessed, considering legislative acts proposed by Senators Warren and Sanders, and their colleagues, and the evolution of the federalization of corporate governance.

Section V, *Navigating the Complex Landscape of Corporate Relocations*, explains the challenges associated with corporate relocations for private and public firms. It presents case studies on attempted relocations, including TripAdvisor's to Nevada, in terms of legal considerations in the context of a publicly traded firm and Harris FRC Corp.'s relocation to New Jersey in the context of private firms. It concludes with a summary, unpacking key insights on corporate charter competition and relocation considerations.

Section VI concludes. This final section synthesizes the findings and insights from the preceding sections, offering a comprehensive conclusion to the exploration of corporate charter competition and relocation dynamics.

[35] *See infra* Section III.

I. HORIZONTAL FEDERAL COMPETITION FOR CHARTERS

> "*[C]lose corporations generally incorporate in the states in which their principal places of business are located, the state competition debate has naturally focused on publicly traded companies.*"
> – Lucian Arye Bebchuk[36]

There is a gap in the literature in understanding the ways in which the market for corporate law shapes the organizational structure and governance of large privately held corporations. No research has been conducted specifically on the incorporation decisions made by the largest privately held firms in our economy - unicorns.

This Article's contribution fills the void in existing literature, presenting a novel viewpoint that offers fresh insights and groundbreaking discoveries. The ensuing narrative delves into the conventional discourse.

A. Corporate Law as a Market Product: Traditional Theory on Charter Competition and Organizational Choices in the United States

One of the most extensively debated subjects in American corporate law literature is corporate charter competition.[37] This body of literature is fueled, to a significant extent, by differing opinions regarding the normative desirability of companies having the ability to choose among various corporate laws.[38]

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[36] Bebchuk, *supra* note 21, at 1442 (citations omitted).

[37] *See* COOK, *supra* note 20, at 1604-05 (noting that federalism in corporate law in the United States is driving some states to liberalize their corporate statutes); Keasbey, *supra* note 20, at 201-02 (same). Contemporary scholars claim that states still vie for incorporations today. *See, e.g.*, Choi & Guzman, *supra* note 20, at 961 (arguing that states compete for corporate charters); Macey, *supra* note 20, at 625 (same). *See* Kahan & Kamar, *supra* note 20, Kahan & Kamar, *supra* note 8; Kamar, *supra* note 20.

See, e.g., Bebchuk & Ferrell, *supra* note 13; Klausner, *supra* note 13; Bebchuk, *supra* note 13, at 1461-70; EASTERBROOK & FISCHEL, *supra* note 13; Eisenberg, *supra* note 13 at 1512-13; Romano, *supra* note 13; Fischel, *supra* note 13; Winter, Jr., *supra* note 13; Cary, *supra* note 13, at 66. ROMANO, *supra* note 13. Kahan & Kamar, *supra* note 8. *See also* William J. Moon, *Global Corporate Charter Competition*, *in* A RESEARCH AGENDA FOR CORPORATE LAW 231-50 (Christopher M. Bruner & Marc Moore eds., 2023); Marcel Kahan, *The State of State Competition for Incorporations Revisited* (NYU Sch. of L., Pub. L. Rsch. Paper, forthcoming; European Corp. Governance Inst. – L. Working Paper No. 724, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4495588; Jens Dammann, *State Competition for Corporate Headquarters and Corporate Law: An Empirical Anaylsis*, 80 MD. L. REV. 214 (2021).

[38] *See* COOK, *supra* note 20, at 1604-05 (noting that federalism in corporate law in the United States is driving some states to liberalize their corporate statutes); Keasbey, *supra* note 20, at 201-02 (same). Contemporary scholars claim that states still vie for incorporations today. *See, e.g.*, Choi & Guzman, *supra* note 12, at 961 (arguing that states compete for corporate charters); Macey, *supra* note 12, at 625 (same). *See* Kahan & Kamar, *supra* note 12; Kahan & Kamar, *supra* note 8; Kamar, *supra* note 12.

See, e.g., Bebchuk & Ferrell, *supra* note 21, Klausner, *supra* note 21; Bebchuk, *supra* note 21, at 1461-70; EASTERBROOK & FISCHEL, *supra* note 21; Eisenberg, *supra* note 21, at 1512-13; Romano, *supra* note 21; Fischel, *supra* note 21; Winter, Jr., *supra* note 21; Cary, *supra* note 21, at

The prevailing discourse surrounding state competition in corporate law primarily focuses on publicly traded firms while overlooking privately held entities.[39] The fundamental argument posits that the decision-making processes of privately held firms differ significantly from those of their publicly traded counterparts, warranting a distinct analytical approach.[40]

States engage in competition over charters, essentially competing to attract companies to incorporate within a particular state.[41] Viewing corporate law as a product involves recognizing that the legal frameworks and services provided to businesses as essential components contribute to the overall function of the business environment.[42] Let's first understand the services involved in the process of registering and incorporating a business entity.

The following is an analysis of the ways in which the process of incorporation affects corporate personhood and the unique significance of the certificate of incorporation to venture capital backed companies.

1. Decoding the Incorporation Process: Significance and Implications

Let's start with the basics. A corporation comes into existence when it is registered with the state to do business. The process of registering and establishing a legal entity for a business that is distinct from its shareholders is called "incorporation." Only after the certificate of incorporation is filed does the business become a separate legal entity - a legal person is born, with its own rights and responsibilities. [43]

The legal fiction of the corporate form with its "shield" of limited liability for its investors, i.e., shareholders, is the single most important invention and innovation of modern times. The corporate form allows an investor to invest in a vehicle that is regarded as a separate entity, which means that the investor cannot be sued for more than they invested in the vehicle. It allows wealthy investors to diversify their investment portfolio and entrepreneurs who possess the ideas but not cash with the ability to raise funds for their businesses.[44]

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66. ROMANO, *supra* note 21. Kahan & Kamar, *supra* note 8. *See also* Moon, *supra* note 37; Kahan, *supra* note 37; Damman, *supra* note 37.

[39] There now exists a well-developed body of empirical research exploring the incorporation choices of publicly traded corporations in the United States. *See, e.g.*, Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 421 (2003) (analyzing the incorporation choices of IPO firms and providing evidence that states adopting a greater number of antitakeover statutes tend to attract more corporations); Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 363 (2006) (analyzing the incorporation choices of IPO firms and finding that the flexibility of a state's corporate law regime is positively correlated with success in the charter market).

[40] Bebchuk & Ferrell, *supra* note 13; Klausner, *supra* note 13; Bebchuk, *supra* note 13, at 1461-70; EASTERBROOK & FISCHEL, *supra* note 13; Eisenberg, *supra* note 13 at 1512-13; Romano, *supra* note 13; Fischel, *supra* note 13; Winter, Jr., *supra* note 13; Cary, *supra* note 13, at 66.

[41] *Id*.

[42] Romano, *supra* note 21.

[43] Delaware Department of Corporations, https://corp.delaware.gov/howtoform/.

[44] *Id*.

The important aspect of incorporation is the limited liability it provides to the shareholders. The personal assets of shareholders are separated from the business assets. In the event of legal claims or financial obligations, the liability of shareholders is restricted to their investment in the corporation. In order to exist as a separate legal entity, the corporation enters into an agreement with the state called a "charter."

To illustrate the importance of this legal document that brings to "life" the limited liability corporation, which is a legal person, note that in 1911, President Nicholas Murray of Columbia University made the following statement:

> "I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times . . . . Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."[45]

The corporate form serves as a crucial tool for shareholders, enabling them to safeguard their personal assets from being utilized to settle corporate debts. According to state law, the act of filing the certificate grants state courts general jurisdiction over the corporation. The charter as a legal document not only establishes the corporation's existence but also delineates the scope of its accountability within the jurisdiction where it is registered.

Sometimes a charter is also referred to simply as a "piece of paper." The U.S. Supreme Court recently rendered a decision in *Mallory v. Norfolk Southern Railway Co.*, where Justice Gorsuch stated that (emphasis added):

> [A] company is subject to suit on any claim in a forum State ***only*** because of its decision ***to file a piece of paper*** there (a certificate of incorporation). The firm is amenable to suit even if all of its operations are located elsewhere and even if its ***certificate only sits collecting dust on an office shelf for years thereafter***.[46]

To be fair, the Court in *Mallory* asserted that a Pennsylvania statute mandating an out-of-state corporation to "consent" to legal proceedings in Pennsylvania courts as a condition for registering to conduct business in the state does not infringe upon the Due Process Clause of the U.S. Constitution.[47]

Until *Mallory*, state courts generally concluded that they could exercise general personal jurisdiction over out-of-state corporate defendants ***only*** if the corporation had its principal place of business or was incorporated in the forum state. The *Mallory* decision marks a significant departure for corporate defendants, introducing the potential for heightened complexity in future challenges to personal

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[45] Quoted in William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 UNIV. PITT. L. REV. 837, 841 (1982).

[46] Mallory v. Norfolk S. Ry. Co., No. 21-1168, slip op. at 22 (U.S. June 27, 2023).

[47] *Mallory*, *id*.

jurisdiction.[48] This is especially true if other states adopt similar registration requirements. This is an important legal development, which could have significant implications for corporate legal matters, as it may influence where companies choose to register and operate in the future, but is outside the scope of this Article.[49]

This development bears importance because of a corporate law doctrine called "the internal affairs doctrine," which dictates that issues concerning corporate governance are subject to the laws of the state where the corporation is incorporated, irrespective of its business operations in other states.[50] The internal affairs doctrine emphasizes that the laws of the state of incorporation, not the location of the corporate headquarters, govern the corporation and any subsequent disputes arising from its internal affairs. [51]

Past Supreme Court decisions under the commerce clause have reinforced the foundation of state chartering.[52] These rulings have also restricted states from prohibiting foreign (out-of-state) corporations from conducting business activities within their borders.[53] Collectively, these principles have established a market for incorporation in the United States.

2. Navigating State Charter Competition: Unraveling the Longstanding Debate in Literature

Delaware earns profit margins of several thousand percent on its incorporation venture. This looks like a great line of business to get into.

– Marcel Kahan[54]

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[48] *Mallory* is an important development because it appears to recognize a consent-based test for personal jurisdiction separate and apart from the contacts-based general and specific jurisdictional analysis that has predominated since *International Shoe Co. v. Washington*. Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945). *See Mallory v. Norfolk Southern Railway Co.: A New 'Third Rail' for Litigation Tourism or a Short-Lived Detour from the At Home Rule?*, GREENBERGTRAURIG (June 30, 2023), https://www.gtlaw.com/en/insights/2023/6/mallory-v-norfolk-southern-railway-co-a-new-third-rail-for-litigation-tourism-or-a-short-lived-detour-from-the-at-home-rule.

[49] The Supreme Court held that the Pennsylvania statute requiring out-of-state companies to consent to suit in Pennsylvania courts in order to do business in Pennsylvania does not violate the Due Process Clause. Moreover, it held that such "consent" broadly confers personal jurisdiction in Pennsylvania to seek redress against a non-resident corporation for conduct that occurred elsewhere.

[50] *See generally* Dammann, *supra* note 37; *see also* Ann Lipton, *Inside Out (or, One State to Rule them All): New Challenges to the Internal Affairs Doctrine*, 58 WAKE FOREST L. REV. 321 (2023).

[51] *See generally* Dammann, *supra* note 37; *see also* Lipton, *supra* note 50.

[52] *Id*.

[53] Int'l Shoe v. Washington, 326 U.S. 310 (1945). *International Shoe Co. v. Washington* marked a series of legal cases centered around the concept of personal jurisdiction, specifically addressing whether an entity or individual possesses sufficient "contact" with a state to be subject to legal action in the state. Over the past seventy-eight years, this line of cases has evolved. However, the recent ruling by the Supreme Court in *Mallory v. Norfolk Southern Railway Co.* appears to have "disrupted" or "altered" this well-established body of law, potentially providing states with the opportunity to broaden personal jurisdiction and authority over entities or individuals from out of state. Mallory v. Norfolk S. Ry. Co., No. 21-1168, slip op. (U.S. June 27, 2023).

[54] Marcel Kahan, *Delaware's Peril*, 80 MD. L. REV. 59, 61 (2021).

The dual function of corporate law as a product in our economy involves both rationalizing economic behavior and continuously adapting to changes in technological and innovation dynamism.[55] This dynamic nature reflects the evolving needs and challenges faced by corporations, emphasizing the significance of corporate law in providing a framework that accommodates these changes while influencing organizational structures and governance models.[56]

Chartering decisions have a significant impact on a company's norms and corporate governance structures. The ongoing debate surrounding state charter competition centers on whether states are adopting corporate laws that prioritize managers over shareholders, prompting extensive empirical research (on publicly held corporations).[57] The core of this debate revolves around the question of whether state chartering competition aligns more with a "race to the bottom"[58] or a "race to the top"[59] theory of corporate law.

In the "race-to-the-top" perspective, firms choose to charter with Delaware because its laws are perceived to maximize firm value for shareholders.[60] Conversely, the "race-to-the-bottom" viewpoint suggests that firms opt for Delaware due to its favor of firm insiders at the expense of others.[61]

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[55] *See generally* Christopher Grandy, The Economics of Multiple Governments: New Jersey Corporate Chartermongering, 1875-1929 (1987) (Ph.D. dissertation, University of California, Berkeley), https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=4ff463d5b93028b14e32f5ec22cd5fc02221f80c; *see also* ALFRED D. CHANDLER, JR., STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF AMERICAN INDUSTRIAL ENTERPRISE (1962). (Chandler documented the large representation of New Jersey in incorporation of large industrial enterprises at the turn of the century, during the merger wave between 1895 and 1904.)

[56] *See generally* Grandy, *supra* note 55; *see also* CHANDLER, JR., *supra* note 55.

[57] For surveys of this work, see Sanjai Bhagat & Roberta Romano, *Event Studies and the Law: Part II: Empirical Studies of Corporate Law*, 4 AM. L. & ECON. REV. 380 (2002); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387 (2001); Romano, *supra* note 21; Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001); Lucian Bebchuk, Alma Cohen, & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775 (2002). For a formal model demonstrating this point, see Oren Bar-Gill, Michal Barzuza & Lucian Bebchuk, *The Market for Corporate Law* (Harvard L. Sch., Discussion Paper No. 377, 2002), www.papers.ssrn.com/abstractp275452. This paper models a race-to-the-bottom equilibrium in which (1) states are induced to provide rules that give managers excessive private benefits and (2) incorporation in the dominant state is associated with a higher shareholder value because of the institutional advantages and network benefits offered by that state. *See* Bebchuk & Cohen, *supra* note 39; Robert Daines, *Does Delaware Law Improve Firm Value?* (New York Univ.,Working Paper CLB-99-011, 1999), …the majority of firms incorporate either in their home state or in Delaware. In contemporaneous work, Daines presents evidence that firms display home preference in their incorporation decisions when they first go public. The results of Daines's study, which is based on data on the dates of initial public offerings (IPOs), complement and reinforce these findings, which are based on Compustat data on the stock of all firms existing at the end of 1999. *See* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559 (2002) [hereinafter Daines, *The Incorporation Choices of IPO Firms*].

[58] *Id*.

[59] *Id*.

[60] *See* Winter, *supra* note 21, Romano, *supra* note 21.

[61] Cary, *supra* note 21; Bebchuk, *supra* note 21; Oren Bar-Gill, Michal Barzuza & Lucian

Other perspectives on why a firm might opt for Delaware shift away from the theory surrounding the intrinsic quality of its laws, focusing instead on the number of other companies incorporated in Delaware.[62] Drawing from the network-effects literature, Klausner contends that some firms must commit to a long-term domicile, specifically, firms that are going to do an IPO in the future, because they may not be able to easily change domicile after going public.[63] These firms may choose Delaware even if they do not consider corporate laws to be optimal. These pre-IPO firms may make decisions that are driven by the anticipation of a large number of other public firms being domiciled in Delaware in the future.[64] The extensive and sustained network of Delaware firms ensures that these firms will have access to a richer body of case law and superior legal services in the future compared to domiciling in its home state, where the firm network is comparatively smaller.[65]

Additionally, according to Kahan and Klausner, the persistence of contractual terms, found in loan agreements, charters, and similar documents, may not be solely due to their inherent quality but rather because of the learning advantages derived from their widespread use.[66] These benefits include drafting efficiencies and a reduction in uncertainty.[67] Their analysis proposes that a firm might opt for Delaware as its domicile not only for the state's attributes but also for the learning benefits generated by the historical choices of numerous other firms that have selected Delaware.[68]

Finally, the work of Broughman, Fried and Ibrahim builds on the works of Daines;[69] Klausner; and Kahan and Klausner. They assert that Delaware law can function as a common language, or "lingua franca," for investors across the United States, whether they are based in-state or out of state. This concept builds on the observation that, due to Delaware's prolonged dominance, business entities throughout the country—including investors and their legal representatives—are generally well-acquainted with Delaware law and the legal framework of their home states. Consequently, a firm aiming to attract investors from various parts of the country may opt for Delaware, aiming to provide a legal framework that is universally understood by all of its investors.[70]

Bebchuk, *The Market for Corporate Law*, 162 J. INSTITUTIONAL & THEORETICAL ECON. 134 (2006).

[62] Klausner, *supra* note 21.

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997).

[67] *Id.*

[68] *Id.*

[69] Daines states that, "Focusing on one national standard allows [corporate lawyers] to economize on the need to keep up to date with developments in multiple jurisdictions. Delaware is thus much like a common language, and such lawyers are 'bi-lingual,' speaking Delaware law plus the local dialect." Daines, *The Incorporation Choices of IPO Firms*, *supra* note 49, at 1581.

[70] Brian Broughman, Jesse M. Fried & Darian Ibrahim, *Delaware Law as Lingua Franca: Theory and Evidence*, 57 J.L. & ECON. 865, 872 (2014).

B. Overlooking Private Entities: The Unexplored Dimension in Corporate Chartering Discourse

The fact that privately held firms have been largely overlooked by scholars is perhaps expected. Only in the last eleven years has there been a noteworthy shift in the market, with private firms surpassing and outperforming public firms.[71] To put it in perspective, if public firms were likened to a species, one might say they are currently moving towards extinction.[72]

1. Unveiling the Market Significance of Privately Held Firms: A Comprehensive Exploration

Public firms are dwindling in number, raising less capital from public markets, and experiencing faster dissolution than ever before.[73] This trend, spanning several decades, reveals a substantial decline in the count of publicly traded U.S. companies. In 1996, the United States boasted a peak of 8,090 listed companies, but as of the first quarter of 2023, this number had plummeted to 4,572, representing a staggering 43% decrease.[74]

Private companies, on the other hand, are experiencing significant growth, securing substantial capital from private markets and opting to remain private for extended durations.[75] Only in the past eleven years have we seen a growth in unicorn firms, which aim to prolong their status as privately held entities for as long as feasible. Unicorns, as a unique category of high-valuation startups, possess distinct characteristics that set them apart from other startups or close large privately held corporations or public ones.

Originally coined to underscore the exceptional success and rarity of such companies in the competitive business landscape, the term "unicorn" highlights the scarcity of achieving such a high valuation of $1 billion before going public or being acquired.[76] However, the once-rare occurrence of unicorn firms has become more prevalent. As of January 1, 2024, the global count of unicorn companies was 1,354, signaling a remarkable surge in these privately held startups.[77]

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[71] *See* JAY RITTER, INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS (Feb. 2, 2024), https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf; *see* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445 (2017).

[72] Lynn Stout, *The Shareholder Value Myth*, Lecture at Rothman School of Management, *YouTube*, https://www.youtube.com/watch?v=ZzztBF9nprA.

[73] RENÉ M. STULZ, NAT'L BUREAU OF ECON. RSCH., THE SHRINKING UNIVERSE OF PUBLIC FIRMS: FACTS, CAUSES, AND CONSEQUENCES (2018), https://www.nber.org/reporter/2018number2/shrinking-universe-public-firms-facts-causes-and-consequences.

[74] *Why Has the Number of Public Companies Declined*, BLUETRUST (Sept. 13, 2023), https://www.bluetrust.com/blogs/why-has-the-number-of-public-companies-declined/.

[75] *See* Alon-Beck, *supra* note 122.

[76] *See* Lee, *supra* note 26.

[77] Jordan Rubio, *Unicorn Companies Tracker*, PITCHBOOK (Jan. 1, 2024), https://pitchbook.com/news/articles/unicorn-startups-list-trends.

We should add some elements to the definition of a "unicorn firm," so that it is clear that these companies aspire to stay private for an extended period and may not pursue an exit event is the near term. This reflects the trend of unicorns choosing to remain private for a more extended duration, possibly avoiding IPOs or other exit strategies commonly associated with private firms. Acknowledging the strategic choice of unicorns to stay private for an extended period can provide a more comprehensive understanding of the dynamics within the private sector. This choice may be driven by factors such as maintaining control, avoiding short-term pressures, or pursuing alternative financing models.[78]

These market developments explain the void in literature regarding the effect of the corporate law market for charters on the organizational structure and governance of large privately held corporations.

2. Distinctive Traits in Private Firm Charters Amidst State Charter Competition

The significance of the Certificate of Incorporation ("COI") lies in its role as a pivotal document in various aspects of businesses, especially for venture-backed businesses. The following illustrates that unicorn firms make incorporation decisions based on the quality of the "incorporation product" offered, according to Kahan's "directional debate."[79] This document not only formalizes the establishment of a company but also delineates essential details such as the company's structure, purpose, and key governing rules.[80]

A unicorn doesn't commence its journey as a large entity upon incorporation; instead, it originates as a startup. It is crucial therefore to distinguish between non-tech small firms and startups. While they might be similar in size, they often vary in their characteristics, growth trajectories, and approaches to corporate governance. Venture-backed startups, in particular, have the potential for rapid growth and scalability. Their primary focus is usually on capturing market share and securing funding for expansion. Consequently, their conflict of interest considerations will involve different contractual arrangements compared to other small or medium-sized companies, driven by these distinct goals. [81]

First, ownership in small firms is commonly concentrated among a few individuals or entities. Small firm shareholders typically have a longer-term perspective, seeking stability and consistent returns. Ownership in venture-backed firms is typically distributed among a larger number of investors, including equity

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[78] It is important to acknowledge that achieving a $1 billion valuation is considerably more challenging in the present economic climate than in the past. As an illustration, Aileen Lee, the co-founder of Cowboy Ventures, who initially coined the term "unicorn," now refers to them as "ZIRPicorns." This terminology shift reflects the growing difficulty faced by hundreds of startups in raising substantial capital due to the evolving economic landscape. See, https://www.theinformation.com/articles/so-long-unicorns-hello-zirpicorns. Note that the "unicorn" moniker has been traced to a *TechCrunch* article by Aileen Lee in 2013. *See* Aileen Lee & Allegra Simon, *Welcome back to the Unicorn Club, 10 Years Later*, TECHCRUNCH (Jan. 18, 2024), https://techcrunch.com/2024/01/18/welcome-back-to-the-unicorn-club-10-years-later/.

[79] Kahan, *supra* note 37, at 3.

[80] *Id*.

[81] *Id*.

granted to employees through stock options. Shareholders that invest in startups often have a higher risk tolerance and are willing to endure initial losses for the potential of significant returns.[82]

Second, we can expect different corporate governance arrangements. Corporate governance in small firms tends to be more straightforward, with centralized decision-making processes among a small group of leaders. Corporate governance in startups may evolve as the company grows, often becoming more formalized to meet the needs of an expanding organization. Startups typically establish more formal structures as they grow and seek more sophisticated investors or are gearing to go public. Their structures may include boards of directors and advisory boards, and implementation of additional governance practices to attract and retain external investors.[83]

To sum up, at the initial formation stages, while small firms and startups may both fall under the umbrella of "small businesses," their approaches to shareholders, investors, and corporate governance can significantly differ based on their growth trajectories, funding needs, and business models.[84]

Therefore, the COI plays a crucial role in the context of a venture capital portfolio investment. It defines the rights, privileges, and restrictions associated with different classes and series of the company's stock. It serves as a foundational legal instrument that provides clarity and structure to the corporation's operations and relationships.

Here's a breakdown of some of the elements included in COIs of venture-backed firms. The COI includes rights that represent the entitlements granted to shareholders of a particular class or series of stock. It includes provisions about voting rights,[85] dividend preferences,[86] or the right to receive assets in the event of liquidation.[87]

The COI will typically outline any privileges that are granted to specific stockholders, such as preferential treatment in receiving dividends or participating in corporate decisions. It will also specify any restrictions that are applicable to certain classes or series of stock, which may include limitations on voting power, transferability, or the issuance of additional shares. It specifies the voting power of each class in matters such as electing directors or approving major corporate actions.[88] These and other provisions in the COI are crucial for establishing a clear structure within the company, providing a framework for corporate governance and safeguarding the interests of various stakeholders.

The "competitive federalism" system creates an interesting dynamic here because states cannot discriminate and mostly allow foreign corporations, i.e.,

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[82] *Id*.

[83] *Id*.

[84] *Id*.

[85] The COI defines the voting rights associated with each class or series, specifying the voting power of each class in matters such as electing directors or approving major corporate actions.

[86] The COI outlines whether certain stockholders have priority in receiving dividends over others and the conditions under which dividends are distributed.

[87] The COI outlines the liquidation preferences of different classes or series, determining the order in which stockholders receive distributions during the winding down of the company.

[88] Kahan, *supra* note 37, at 3.

corporations that are chartered in other states, to conduct business within their borders. Corporations, therefore, are free to choose where to incorporate, regardless of where they are headquartered or conduct their business operations. This flexibility has led to a notion that corporate law is considered a product, where corporations, including venture-backed ones, "shop" for a state with favorable corporate laws and states compete with each other over this business.[89]

Now, let's delve into the next issue: once companies decide where to incorporate, can they relocate easily? In this Article, we will explore this question in both the public and private firm contexts, commencing with a case study on Elon Musk to illustrate the challenges associated with relocating a company.

II. DELAWARE: A SMALL YET MIGHTY STATE EMERGES VICTORIOUS

As revealed by the findings of my investigation, the state of Delaware not only maintains its position but has also emerged as the top preference for the incorporation of unicorn companies, as well as publicly traded firms, within the United States. How is a small state like Delaware able to successfully compete with large states over this business?

A. Navigating the Landscape of Delaware's Chancery Court

Small states, like Delaware, are able to successfully compete with large states over the charter business because, historically, they largely depended on the business of charter incorporation as their main source of income.[90] They have the ability to grant charters to large corporations while incentivizing them to operate beyond their borders.[91] This legal externality in return affects large states. The small states take precedence in governing large corporations that operate in the large states. [92]

Delaware has been very successful in maintaining its title as the prominent state of choice for public corporations. It is home to about eighty percent of the publicly traded firms and over two-thirds of the Fortune 500 companies.[93] Delaware is the state of choice for incorporation for many firms in the United States and around the world, ranging from large to small entities. Last year, 2022, was no exception, and Delaware continued to be the domicile of choice for members of the Fortune 500 companies. It also dominated the market for companies that decided to do an IPO and become public entities for the first time. To illustrate, note that approximately eighty-nine percent of all U.S. companies that did an initial public offering in 2019 chose to incorporate in Delaware.[94]

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[89] *See* Mallory, *supra* note 46.

[90] Grandy, *supra* note 55; *see also* Romano, *supra* note 21, at 225-67.

[91] *See* Romano, *supra* note 21, at 225-67; Roberta Romano, *Market for Corporate Law Redux*, *in* THE OXFORD HANDBOOK OF LAW AND ECONOMICS: VOLUME 2: PRIVATE AND COMMERCIAL LAW 358-98 (Francesco Parisi ed., 2017).

[92] *See* Grandy, *supra* note 55; *see also* Romano, *supra* note 21, at 225-67.

[93] Kahan & Kamar, *supra* note 20.

[94] DEL. DIV. OF CORPS., 2019 ANNUAL REPORT STATISTICS (2019), https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2019-Annual-Report.pdf.

There are many theories that attempt to explain Delaware's success, as explained in greater detail below. But, let's focus our attention on one of the primary reasons why many public companies choose to incorporate in the state of Delaware – the Delaware Court of Chancery. Delaware has established a specialized and highly regarded judiciary that is renowned for its expertise in corporate law. The Delaware Court of Chancery not only handles a significant number of corporate law cases quickly and efficiently, it also developed a body of case law that helps reduce transactions costs because it provides guidance and predictability for businesses.

This court holds significant importance for corporations due to its expertise in handling issues arising under Delaware corporate law. The judicial precedents that the Delaware courts establish create a stable and predictable legal environment for corporations, which reduces the cost of capital. Delaware's judiciary operates without a jury, which allows for expedited and efficient resolution of corporate litigation and disputes.

The Delaware Court of Chancery is unique in that it operates as a court of equity, where disputes related to corporate matters are addressed. The judges are chosen from the Delaware bar based on their exceptional knowledge and experience in corporate law. These judges are known for their impartiality and are considered among the most knowledgeable corporate law experts in the country.

The Delaware Court of Chancery has earned a reputation for being one of the best commercial courts, not only in the United States, but also in the world. Its opinions are highly regarded and often include exhaustive analysis with extensive footnotes. The judges possess a deep understanding of corporate law and finance, regularly citing relevant materials such as corporate law articles and financial literature.

The judges' knowledge of the market and transactional law enables them to provide comprehensive and informed rulings, ensuring that parties receive what they agreed upon in their contracts. The expertise and reputation of the Delaware Court of Chancery make it an attractive choice for companies seeking a fair and impartial forum to resolve corporate disputes. This, in turn, has led to a significant number of public companies incorporating in Delaware, benefiting from the court's exceptional knowledge and expertise in corporate law matters. Delaware's market dominance and the state competition over corporations have led to the notion that corporate law is a type of product, as is explained in detail below.

B. The Evolution of Delaware Corporate Law: A Paradigm Shift towards Standardization

1. Standarization for Private Firms

The following explanation provides a comprehensive theory to why Delaware emerges as the preferred choice for unicorn firms in the United States.

The National Venture Capital Association ("NVCA") is a trade association that represents the venture capital industry in the United States. One of the main initiatives undertaken by the NVCA involves the creation and dissemination of

standardized legal documents commonly used in venture capital transactions. These standardized venture documents aim to streamline and simplify the investment process, making it more efficient for both venture capitalists and entrepreneurs.

The venture financing documents provided by the NVCA have become an established industry benchmark for venture financings in the United States. The extensive acceptance of these documents has notably minimized obstacles in finalizing deals, leading to a more streamlined process.[95] As a result, numerous startups across America have been able to secure funding more expeditiously, facilitating their growth into successful companies.[96]

The NVCA is involved in collecting and recommending form documents for investments. The NVCA, in collaboration with legal professionals, namely lawyers, and industry experts, develops standardized form documents that can be used in venture capital transactions. These documents typically cover various aspects of the investment process, including term sheets, stock purchase agreements, and other legal agreements. For our purposes, one of the main documents is the Certificate of Incorporation.

As noted above, the COI is a key document for any company and is very important in the context of a venture capital portfolio investment. Venture capital investors always inspect the COI because it establishes the rights, preferences, privileges and restrictions of each class and series of the corporation's stock.

In 2015, the NVCA made a noteworthy decision by designating Delaware as the preferred forum selection in the COI for venture portfolio companies in their standardized documents. The NVCA's choice of Delaware in form documents, specifically the COI, establishes firm incorporation in Delaware as the best corporate practice and industry practice. The NVCA provided a set of recommended templates for COIs and other venture financing documents so that incorporating in Delaware will become the common ground for negotiations between venture capitalists and entrepreneurs. But, why?

The NVCA historically embarked on this standardized process of form documents in order to contribute to the efficiency of the investment process. These standard documents provide a starting point for negotiations, reducing the time and effort required to draft legal agreements from scratch. This consistency can benefit both investors and entrepreneurs by fostering a more transparent and predictable investment environment.

The NVCA also offers educational resources and guidance on the use of these form documents. This can include explanatory notes, webinars, and other materials to help parties understand the terms and implications of the standardized agreements. In 2015, the NVCA inserted several provisions with regards to its form COIs; for example, in section 12, it included language that shareholder disputes should be exclusively litigated in the Delaware Court of Chancery.[97]

The NVCA model legal documents are widely adopted by the industry.

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[95] NVCA Financing Documents, COOLEY GO, https://www.cooleygo.com/documents/nvca-financing-documents/ (last visited Jan. 25, 2024).

[96] *Id.*

[97] Scott R. Bieier & Jonathan D. Gworek, *The Evolution of the NVCA Documents*, MORSE (Dec. 29, 2015), https://www.morse.law/news/evolution-of-nvca-documents/.

While the use of standardized documents is not mandatory, many venture capital firms and startups choose to adopt them. The widespread adoption of these forms created a more harmonized and efficient venture capital ecosystem.

> Here is the language from the NVCA's form COI document*:*
>
> *Choice of Jurisdiction.*
>
> *This form is set up for a portfolio company incorporated in Delaware. Delaware is generally the preferred jurisdiction for incorporation of venture-backed companies for many reasons, including:*
>
> *1. The Delaware General Corporation Law ("DGCL") is a modern, current, and internationally recognized and copied corporation statute which is updated annually to take into account new business and court developments;*
>
> *2. Delaware offers a well-developed body of case law interpreting the DGCL, which facilitates certainty in business planning;*
>
> *3. The Delaware Court of Chancery is considered by many to be the nation's leading business court, where judges expert in business law matters deal with business issues in an impartial setting; and*
>
> *4. Delaware offers an efficient and user-friendly Secretary of State's office permitting, among other things, prompt certification of filings of corporate documents.*
>
> *Please note the following special considerations if the Corporation is located in California, even though incorporated in Delaware:*
>
> *Considerations for Corporation with California Shareholders and Operations.*
>
> *Section 2115 of the California Corporations Code provides that certain provisions of California corporate law are applicable to foreign corporations (e.g., one incorporated in Delaware), to the exclusion of the law of the state of incorporation, if more than half of the Corporation's shareholders and more than half its "business" (a defined formula based on property, payroll and sales) are located in California. As a result, some companies based in California may be subject to certain provisions of the California corporate law despite being incorporated in another state, such as Delaware (although, as noted below, it is not clear that courts will apply Section 2115 if the law of the jurisdiction of incorporation is*

> *inconsistent with the provisions of Section 2115). Section 2115 does not apply to public companies listed on the New York Stock Exchange, the NYSE MKT, the NASDAQ Global Market or the NASDAQ Capital Market.*[98]

It's noteworthy to mention that the utilization of these NVCA form documents by attorneys that represent unicorns is expected. There is research showing that a significant majority of unicorns, exceeding 60%, were established by serial entrepreneurs who have previously founded companies.[99] Strebulaev also found that among 521 U.S. unicorns and their 1,312 founders, 499 founders (39%) had previous experience in founding pre-unicorn startups, with more than 50% of these startups receiving venture capital backing.[100] Indeed, it's likely that these entrepreneurs have prior experience collaborating with startup attorneys.

My theory builds on a study conducted by Bartlett, which investigates the standardization of venture capital contracts following the introduction of the NVCA model charter in 2003.[101] Bartlett analyzed nearly 5,000 charters associated with a startup's Series A financing.[102] His research reveals a substantial increase in the model's adoption, rising from less than 3% of charters in 2004 to nearly 85% by 2022.[103] The prevalence of Delaware-oriented charters has also coincided with the escalating dominance of Delaware incorporation, expanding from 54% of sample charters in 2004 to 100% in 2022.[104] Bartlett further found a widespread adoption among the six most active law firms in the United States that are serving startups, and this largely accounts for the success of the NVCA's standardization initiative.[105]

These findings also align with Anderson's theory, which posits that a firm's

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[98] *See* Amended and Restated Certificate of Incorporation, NVCA (2020), https://www.google.com/search?q=nvcas+amended+and+restated+certificate+ofincorporation+2020&oq=nvcas+amended+and+restated+certificate+ofincorporation+2020&gs_lcrp=EgZjaHJvbWUyBggAEEUYOTIKCAEQABiABBiiBDIKCAIQABiABBiiBDIKCAMQABiABBiiBDIKCAQQABiABBiiBNIBCTExMTM2ajBqNKgCALACAA&sourceid=chrome&ie=UTF-8.

[99] Ilya Strebulaev, *Unicorn Founders as Serial Entrepreneurs*, (@IlyaStrebulaev), X (formerly TWITTER) (Mar. 15, 2022, 11:39 AM), https://twitter.com/IlyaStrebulaev/status/1503757899515973632.

[100] *Id.*

[101] Robert P. Bartlett, *Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters* (Rock Ctr. for Corp. Governance at Stan. Univ., Working Paper No. 253, 2023; Stan. L. & Econ. Olin Working Paper No. 585, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4568695 ("Adoption of the Delaware-oriented charter has also been accompanied by the growing dominance of Delaware incorporation, with Delaware charters growing from 54% of sample charters in 2004 to 100% in 2022. High adoption rates among the six most active law firms servicing U.S. startups largely explain the success of the standardization project"); ("the NVCA model charter assumes Delaware incorporation, the charter has been periodically updated to reflect Delaware judicial decisions relating to the interpretation of preferred stock rights and preferences.")

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

choice of law firm can significantly influence jurisdiction selection, carrying broader implications.[106] Law firms may direct companies toward states that align with their own interests, irrespective of the quality of legal regulations or the specific needs of the client.[107]

Certainly, there are several other reasons why lawyers advising unicorn firms might recommend incorporating in Delaware. The state-centric approach to corporate laws and regulations in the United States was designed to grant individual states the authority to formulate and regulate corporate statutes independently. However, over time, Delaware has emerged as the preeminent state for publicly held companies to incorporate. As my research indicates. Delaware is now also the number one choice for unicorn firms. The following additional factors contribute to Delaware's prominence in this regard.

First, unicorns often require a flexible and sophisticated legal framework to accommodate their dynamic business models and growth trajectories. Delaware's well-established and evolved corporate laws offer a conducive environment for startups with complex ownership structures, intricate funding arrangements, and evolving governance needs.

Second, Delaware stands out from other states in providing a streamlined and efficient process for incorporation, addressing the unique needs of unicorns. The state's incorporation essentials, such as the ease of filing, accessibility of regulatory support, and a well-defined legal landscape, contribute to making the incorporation journey seamless for high-valuation startups.

Third, Delaware's legal framework is often perceived as shareholder-friendly, providing unicorns with the ability to design their corporate governance structures in a manner that aligns with the preferences and expectations of investors. Unicorns, often backed by venture capital, find that incorporating in Delaware enhances their credibility and attractiveness to potential investors.

Finally, Delaware has a rich history of legal precedents, particularly in corporate law matters. The expertise of Delaware's Court of Chancery in handling complex business disputes and interpreting corporate laws positions the state as a hub of legal excellence. Unicorns benefit from this wealth of experience and jurisprudential knowledge, assuring them of a reliable legal system.

As we can infer from the findings above, the question of firm choice is far more intricate than the simplified categorization of the "race to the top" or the "race to the bottom" suggest, as it involves considering the underlying factors that shape the managers' or their attorneys' decision-making process. Can we say that there is no more race? As noted in the introduction to this Article, Elon Musk just rekindled this very debate. Before we turn to the case study involving Musk and Twitter/X, let's also compare unicorns with public firms on this.

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[106] Robert Anderson IV, *The Delaware Trap: An Empirical Analysis of Incorporation Decisions*, 91 S. CAL. L. REV. 657, 710 (2018). When Delaware is frequently the chosen state, there are limited alternative jurisdictions that both shareholders and managers can mutually agree upon. Consequently, companies may unintentionally find themselves ensnared in a "governance trap" where relocating out of state becomes nearly impractical. This interpretation suggests that Delaware's strategic positioning in the charter market has effectively diminished meaningful competition among states in terms of the quality of corporate law.

[107] *Id.*

Unicorns differ significantly from public firms in their core objectives and dynamics. Unlike public companies, unicorns typically opt to remain private, thereby shaping their priorities around contractual rights enforcement rather than public market considerations. The shareholders of unicorns place a premium on the ability to enforce their contractual rights in the private domain, as opposed to the stringent fiduciary and disclosure obligations faced by public counterparts.

Moreover, the investor landscape for unicorns is distinct, with a focus on venture capitalists, and alternative venture capital, each carrying unique incentives and preferences. The provisions advocated for by these investors diverge from the norms observed in public markets, reflecting the specific demands and expectations of the private investment sphere. The nuanced characteristics of unicorns, driven by their private status and investor composition, contribute to a distinctive set of considerations in their legal and governance frameworks.

2. Standarization for Public Firms

> *Why do they go to Delaware? I don't believe it is a mystery to any lawyer who has given a bit of thought to the appropriate state of incorporation. You're concerned about flexibility, capital structure, and corporate purposes. The fact is that Delaware has more law and has answered more questions through its decisions. Whether you like them or not, it is easier to get an answer to a question under the Delaware Act than it is under say, the Illinois law, which has very few cases in the corporate area. There is also an absence of various specific restrictions that are more troublesome than beneficial to anyone.*
>
> – Ray Garrett, Jr., former Chairman of the Securities and Exchange Commission and first Chief Reporter for the American Law Institute's Principles of Corporate Governance project[108]

What contributes to Delaware's allure among public corporations? The answer to this question lies in a combination of factors rather than a single element. It encompasses all the factors discussed above.

As noted, there are multiple factors that contributed to this phenomenon. To illustrate, note that the Delaware General Corporation Law ("DGCL") has always been regarded as one of the most sophisticated and adaptable corporation statutes, not just nationally, but also internationally.

Delaware's appeal to public corporations extends to its distinguished courts, particularly the highly respected Court of Chancery, featuring judges with substantial experience and education in business law. These judges are appointed by the governor, adding a layer of expertise and specialized knowledge to the judicial system. The deliberate selection process ensures that individuals appointed

[108] Quoted in LEWIS S. BLACK, JR., DEL. DEP'T OF STATE, DIV. OF CORPS., WHY CORPORATIONS CHOOSE DELAWARE 8 (2017), https://www.belfint.com/wp-content/uploads/2013/05/Why-Corporations-Choose-Delaware.pdf.

to the Court of Chancery possess the necessary background and qualifications to navigate complex business-related matters, contributing to Delaware's reputation as a premier jurisdiction for corporate governance.

Furthermore, the judges appointed to the Delaware Court of Chancery receive lifetime appointments, ensuring stability and continuity in the application of business law. This tenure-based system contributes to the perception of the court as impartial and independent, as judges are not subject to regular reappointments or elections. Additionally, the court maintains a balanced political composition, further reinforcing its reputation for fairness and neutrality in adjudicating corporate matters.

The Delaware Court of Chancery operates without a jury, eliminating the unpredictability associated with jury trials. This absence of a jury trial adds a layer of certainty to corporate legal proceedings, as decisions are rendered by experienced judges with a deep understanding of business law and corporate matters.

Delaware's appeal is further enhanced by its efficient and expeditious processes. The state boasts quick turnaround times, both in the incorporation services it provides and in the progression of legal proceedings. The Secretary of State's Office adopts a business-oriented approach, resembling more of a corporation administrator than a bureaucratic government entity.

This efficiency is particularly notable in the Court of Chancery, where trials and decisions are expedited, contributing to a business-friendly environment that values time-sensitive corporate matters. Additionally, Delaware's legislature actively maintains and updates business laws, taking its role seriously.

Less tangible but influential aspects contribute to Delaware's attractiveness to corporations and other business entities. Being a small state with a generally pro-business populace, Delaware recognizes the significance of income from corporation franchise taxes for its budget. The state's law firms specializing in business law employ substantial numbers of people, garnering support from the citizenry for keeping business laws state-of-the-art.

The familiarity of lawyers across the country with Delaware corporation law, often learned in law school and extensively studied, provides a common language, *lingua franca*, for legal professionals, fostering instant credibility and facilitating business transactions.[109]

Network analysis further emphasizes the interconnected relationships within the legal landscape.[110] Delaware's historical context, coupled with the widespread study and acceptance of its corporation law, establishes a network effect. This effect extends beyond statutory provisions, influencing legal professionals and business transactions nationwide. The network effect reinforces Delaware's position as a hub for corporate governance, creating a cohesive and interconnected legal environment that adds to its appeal and credibility.

Public firms, in particular, heavily rely on this certainty offered by Delaware corporation law to meticulously plan and execute their strategies. The stringent fiduciary and disclosure obligations incumbent upon public companies make the

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[109] *See* Broughman, Fried & Ibrahim, *supra* note 70; *see also* BLACK, JR., *supra* note 108.
[110] *See* Klausner, *supra* note 21.

predictability and clarity provided by Delaware's well-established legal framework crucial. The comprehensive legal structure allows these firms to navigate their fiduciary duties with a heightened level of assurance, facilitating transparent and well-informed decision-making processes that align with regulatory requirements.

To illuminate the intricate considerations faced by managers of both public and private firms, as exemplified by Musk, in their choice of incorporation location, it is essential to analyze the economic, legal, and strategic implications intertwined with these options. The following case study provides valuable insights into the ever-changing landscape of corporate behavior, particularly within the realm of private and public firms. Examining the decision-making process in this context unveils the multifaceted nature of factors influencing managerial choices in the corporate domain, both for incorporation and relocation alternatives.

C. The Musk Case Study: Navigating Corporate Incorporation and Relocation

In March 2023, three new companies linked to billionaire Elon Musk were registered in Nevada, with specific details and purposes not disclosed to the public initially.[111] Subsequently, these three entities became unicorns. Among them is x.AI., an artificial intelligence startup incorporated as a benefit corporation.[112] xAI recently filed with the Securities and Exchange Commission ("SEC") to raise up to $1 billion through an equity offering, thereby swiftly joining the unicorn roster.[113] Additionally, there's X Holdings, the parent company of X Corp., previously known as Twitter.[114] All are now considered unicorn firms.

Opting for Nevada as the location for incorporation suggests that Musk saw unique advantages or aligned with particular preferences offered by the state, both for himself individually and for the involved companies. Let's examine the company X, formerly known as Twitter, as a case study of a unicorn that incorporated outside of Delaware. Following a lengthy and publicized acquisition by Musk, Twitter was restructured from a publicly traded company to a private entity. The restructuring involved a rebranding effort where the familiar blue bird

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[111] According to filings with the Nevada Secretary of State, Elon Musk is listed as a director for both X Holdings Corp. and X Corp. These companies are registered with a Carson City address. The third company, X.AI Corp., is registered with a Las Vegas address and has Jared Birchall listed as its secretary. The Wall Street Journal has reported that Jared Birchall is the individual who manages Musk's family office. Hemmersmeier, *supra* note 14.

[112] xAI is a benefit corporation. Becky Peterson, *Musk's xAI Follows Anthropic with Benefit Corporation Structure*, INFORMATION (Dec. 26, 2023), https://www.theinformation.com/briefings/musks-xai-follows-anthropic-with-benefit-corporation-structure.

[113] Hayden Field, *Elon Musk's AI Startup – X.AI –Files to Raise $1 Billion in Fresh Capital*, CNBC (Dec. 6, 2023), https://www.cnbc.com/2023/12/05/elon-musks-ai-startup-xai-files-to-raise-1-billion-.html; X.AI Corp., Form D (Dec. 5, 2023), https://www.sec.gov/Archives/edgar/data/2002695/000200269523000002/xslFormDX01/primary_doc.xml.

[114] According to filings with the Nevada Secretary of State, Elon Musk is listed as a director for both X Holdings Corp. and X Corp. These companies are registered with a Carson City address. The third company, X.AI Corp., is registered with a Las Vegas address and has Jared Birchall listed as its secretary. The Wall Street Journal has reported that Jared Birchall is the individual who manages Musk's family office. Hemmersmeier, *supra* note 14.

logo of Twitter was replaced with a more sinister "X." Alongside this, there was a change in the corporate structure through an outbound merger, relocating Twitter from Delaware to Nevada and making it a subsidiary of X Holdings. This strategic move could have been driven by various factors, including considerations related to corporate laws, tax implications, governance flexibility, and overall business strategy.

The following actions that resulted in restructuring undertaken by Elon Musk provides a tangible example of why a company might shift its corporate structure to move out of Delaware.[115]

1. The Twitter Acquisition Saga: Unraveling Corporate Drama in Social Media

X, formerly known as Twitter, is a social media platform for microblogging and social networking service. Prior to Elon Musk designating X Corp. as the successor to Twitter, the initial charter for Twitter was established in Delaware. Delaware, renowned for its robust corporate laws and the Court of Chancery's proficiency in managing business affairs, played a pivotal role in the original incorporation of Twitter under the leadership of Jack Dorsey.[116]

Before Elon Musk's involvement, Twitter followed the typical trajectory of privately held, venture-backed technology firms. It began as a privately held company, led by ambitious entrepreneurs, and eventually underwent an exit through an IPO in 2013 that successfully raised $1.8 billion, transforming into a publicly traded firm.[117]

In March 2006, Jack Dorsey, Noah Glass, Biz Stone, and Evan Williams founded Twitter, initially conceived as a side project stemming from the podcasting tool Odeo. During that same month, Dorsey posted the first tweet, which simply read, "just setting up my twttr."[118]

Fast forward to 2013, when Twitter transformed into a public company following a successful IPO. There are a variety of reasons for private companies, like Twitter, to want to complete an IPO.[119] First, an obvious reason is for capital formation reasons. An IPO offers access to various public, including retail,

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[115] *Id*.

[116] *See* Delaware Law & Court of Chancery.

[117] *See Twitter IPO*, CNBC, https://www.cnbc.com/twitter-ipo/ (last visited Jan. 25, 2024).

[118] Jonathan Vanian, *Twitter Is Now Owned by Elon Musk – Here's a Brief History from the App's Founding in 2006 to the Present*, CNBC (Oct. 30, 2022), https://www.cnbc.com/2022/10/29/a-brief-history-of-twitter-from-its-founding-in-2006-to-musk-takeover.html.

[119] *See* Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389 (2013); Robert B. Thompson & Thomas C. Langevoort, *Rewarding the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573 (2013); *see also* Paul Rose & Steven Davidoff Solomon, *Where Have All the IPOs Gone? The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83, 84 (2016); Usha Rodrigues, *The JOBS Act at Work*, CONGLOMERATE (Sept. 11, 2015), http://www.theconglomerate.org/jobs-act/ (criticizing the JOBS Act's unrealistic endeavors to boost IPOs). *See* Usha Rodrigues, *The Once and Future Irrelevancy of Section 12(g)*, 2015 U. ILL. L. REV. 1529, 1544-45 (2015) [hereinafter Rodrigues, *Section 12(g)*].]

investors.[120] Second, many Chief Executive Officers ("CEOs") believe that there is prestige associated with being a publicly traded company.[121] Finally, going public provides liquidity to employees and existing investors.[122]

Twitter's major alteration occurred in April 2022, when Tesla's CEO, Elon Musk, announced his intention to purchase Twitter. The drama concerning the Musk acquisition lasted for several months and got the world's attention.[123] Musk was an avid user of Twitter, even attracting negative attention from federal regulators for his use of the platform. He was accused of moving markets and of hurting his current public companies, especially Tesla.[124] Following months of blustering, posturing, and making public demands, Elon Musk officially announced the withdrawal of his bid to purchase Twitter.[125] In a filing with the SEC, Musk pulled out of the deal, citing alleged material breaches of multiple provisions of the merger agreement by Twitter.[126] Musk repeatedly called into question Twitter's claims regarding fake or spam accounts and used this as the basis for his claims of material breaches.[127]

The saga continued, as a legal battle unfolded in Delaware courts over the question of whether the deal was genuinely terminated. The battle revolved around the question of whether Elon Musk owed a substantial penalty to Twitter for backing out of the deal and the possibility of whether the company could compel Musk to proceed with the agreement despite his attempts to exit. Twitter sought to

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[120] Rodrigues, *Section 12(g)*, *supra* note 119, at 1544-45.

[121] *Id*. at 1554.

[122] *See* Anat Alon-Beck, *Unicorn Stock Options – Golden Goose or Trojan Horse?*, 2019 COLUM. BUS. L. REV. 107 (2019).

[123] The following are interviews that Professor Beck did for the media concerning the Musk Twitter Saga: Anat Alon-Beck, *The Beginning of a Musk Controlled Twitter Era,* FORBES (Oct. 27, 2022), https://www.forbes.com/sites/anatalonbeck/2022/10/27/the-beginning-of-a-musk-controlled-twitter-era/?sh=216e06233162; Anat Alon-Beck, *Twitter, Your Time Is Up,* FORBES (Oct. 21, 2022), https://www.forbes.com/sites/anatalonbeck/2022/10/21/twitter-your-time-is-up/?sh=7811b5219571; Anat Alon-Beck, *The 'Absurd' Ongoing Case of Elon Musk And Twitter*, FORBES (Aug. 26, 2022), https://www.forbes.com/sites/anatalonbeck/2022/08/26/the-absurd-ongoing-case-of-elon-musk-and-twitter/?sh=32d268c35e7b; Anat Alon-Beck, *Let the Games Begin!*, FORBES (July 9, 2022), https://www.forbes.com/sites/anatalonbeck/2022/07/09/let-the-games-begin/?sh=1494f729378d; Anat Alon-Beck, *Elon Musk's Plan To Buy Twitter Put On Hold - Or Is It?*, FORBES (May 13, 2022), https://www.forbes.com/sites/anatalonbeck/2022/05/13/elon-musks-plan-to-buy-twitter-put-on-hold-or-is-it/?sh=78e600964914; Anat Alon-Beck, *The Ongoing Saga of Musk's Twitter Gamble,* FORBES (May 5, 2022), https://finance.yahoo.com/news/judges-ruling-on-twitter-musk-timeline-offers-clues-on-how-case-will-play-out-185108296.html; Jesse Weber, *Twitter-Elon Musk Trial Expedited*, LAW & CRIME PODCAST.

[124] The impact of Elon Musk's behavior on the reputation of his public companies, such as Tesla and SpaceX, has been a subject of much discussion and debate. Musk is known for his active and sometimes controversial presence on Twitter/X. Some of his tweets and public statements have led to negative consequences for his companies, such as decrease in share price, controversies with advertiser, and more.

[125] Kate Conger & Lauren Hirsch, *Elon Musk Moves to End $44 Billion Deal to Buy Twitter*, N.Y. TIMES (July 8, 2022), https://www.nytimes.com/2022/07/08/technology/elon-musk-twitter.html.

[126] *See* Conger & Hirsh, *supra* note 125.

[127] *Id.*

enforce the deal.[128] Meanwhile Musk, expressing buyer's remorse, made efforts to extricate himself from the agreement. According to Musk's letter to the company, Twitter provided data and information on several aspects, primarily concerning "mDAUs" or monetizable daily account users.[129] These aspects included information on Twitter's processes for auditing the inclusion of spam and fake accounts in mDAU, identifying and suspending spam and fake accounts, daily measures of mDAU for the past eight quarters, board materials related to Twitter's mDAU calculations, and materials related to Twitter's financial condition.[130]

The culmination of the extended saga between Twitter and Musk holds particular intrigue. Musk not only relinquished his rights for additional examination of Twitter's financial records when entering the initial merger agreement but also cited the necessity to furnish information to his creditors to secure the debt financing required to finalize the deal. This development is noteworthy, especially considering Musk's previous public statements asserting that he had already secured the necessary financing for months.[131]

While Elon Musk deemed the deal already dead from his perspective, the rest of the world witnessed the initiation of a legal battle. Could Musk retract from the deal? The Twitter Board, notably Chairman Bret Taylor, asserted the board's commitment to completing the transaction at the agreed-upon price and followed with taking legal action to enforce the deal.[132] In a tweet just hours after Musk filed for separation, Taylor stated, "We are confident we will prevail in the Delaware Court of Chancery."[133]

Twitter had compelling reasons to uphold the deal. As of July 8, 2022, the company's shares closed at $36.81 per share.[134] The merger agreement stipulated that Musk was to acquire those same shares at $54.20, representing a premium of over 47% on the market price. Even if the attempt to finalize the deal was unsuccessful, the $1 billion breakup fee may have served as a significant incentive. Additionally, there was a substantial reputational risk involved. If Twitter did not make an effort to compel Musk to proceed with the acquisition, they may have been burdened with his allegations of false statements, unless they challenged his assertions.[135]

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[128] Twitter spokesperson Brian Poliakoff cited a June statement in which Twitter reaffirmed they "'intend to close the transaction and enforce the merger agreement at the agreed price and terms.'" Anat Alon-Beck, *Let the Games Begin!*, FORBES (July 9, 2022), https://www.forbes.com/sites/anatalonbeck/2022/07/09/let-the-games-begin/?sh=2b66f98378d9.

[129] Robert Williams, *Twitter Debuts 'Monetizable' Metric for Its 126M Users*, MARKETINGDIVE (Feb. 8, 2019), https://www.marketingdive.com/news/twitter-debuts-monetizable-metric-and-reveals-it-has-126m-users/547990/.

[130] *Id.*

[131] *See* Letter from Elizabeth Warren, U.S. Senator, to Dr. Robyn Denholm, Chairman of the Board, Tesla, Inc. (Dec. 18, 2022), https://www.warren.senate.gov/imo/media/doc/2022.12.18%20Letter%20to%20Tesla%20Board%20on%20Musk%20Concerns.pdf [hereinafter Warren Letter].

[132] Bret Taylor (@btaylor), X (formerly TWITTER) (July 8, 2022, 5:51 PM), https://twitter.com/btaylor/status/1545526087089696768?cxt=HHwWgMClwbTy5_IqAAAA.

[133] *Id.*

[134] YAHOO!FINANCE, https://finance.yahoo.com/lookup?s=TWTR (last visited Jan. 26, 2024).

[135] *See* Warren Letter, *supra* note 123.

Twitter was not alone in facing these types of buyer's remorse challenges; the ongoing economic downturn significantly disrupted the mergers and acquisitions ("M&A") market. Numerous companies grappled with the impact of an economic downturn amid near 40-year high inflation rates, escalating interest rates, surging oil and gas prices, a contraction in crypto markets, a pullback in tech growth, increasing layoffs, and socioeconomic and political turmoil stemming from the conflict in Ukraine. The repercussions of these factors were felt across the board, with numerous public companies witnessing a decline in their stock values. These challenges extended to the private markets, where the valuations of private companies were also experiencing downward trends. This dynamic landscape was reshaping the M&A market, impacting companies that were robust at the outset of 2022 but found themselves struggling for survival within a matter of months.

We all know how the saga ended. It reached its conclusion as Musk ultimately completed (or was compelled to complete) the deal in October 2022, assuming the role of Twitter's CEO. According to press reports, "[t]o finance his Twitter deal, [Musk] loaded the company with $13 billion in debt, putting it on the hook to pay more than $1 billion annually in interest alone."[136] It is worth noting that this annual interest obligation exceeded the company's cash flow for the entire year of 2021.

The heavily indebted financial structure immediately sparked issues for Twitter.[137] A significant number of employees,[138] including crucial compliance, privacy, and security executives, faced layoffs, prompting regulatory concerns. [139] Advertisers swiftly departed from the platform.[140] Just two weeks after his acquisition of Twitter, Musk raised alarms about potential bankruptcy.[141] Changes that Musk made to Twitter's account moderation policy led to an "unprecedented" surge in hate speech on the platform. Analysts indicated that the debt-financed takeover essentially drained the company's financial resources solely into servicing

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[136] Mike Isaac & Ryan Mac, *Elon Musk, Under Financial Pressure, Pushes to Make Money From Twitter,* N.Y. TIMES (Nov.3, 2022), , https://www.nytimes.com/2022/11/03/technology/elon-musk-twitter-money-finances.html; Hyunjoo Jin & Chibuike Oguh, *Explainer: How Elon Musk Funded the $44 Billion Twitter Deal*, REUTERS (Oct. 28, 2022), https://www.reuters.com/markets/us/how-will-elon-musk-pay-twitter-2022-10-07/.

[137] *See* Warren Letter, *supra* note 131.

[138] Sheila Dang, *Twitter Says 50% of Staff Laid Off, Moves to Reassure on Content Moderation*, REUTERS (Nov. 4, 2022), https://www.reuters.com/technology/twitter-exec-says-50-employees-lost-jobs-following-acquisition-2022-11-04/.

[139] Zack Whittaker & Ingrid Lunden, *Twitter Chief Information Security Officer Lea Kissner Departs*, TECHCRUNCH (Nov. 10, 2022), https://techcrunch.com/2022/11/10/twitter-lea-kissner-departs/; Matt Kapko, *Twitter, Amid Security and Compliance Officer Exodus, Could Run Afoul of FTC Rules*, CYBERSECURITYDIVE (Nov. 10, 2022), https://www.cybersecuritydive.com/news/twitter-ciso-resigns/636315/.

[140] Halisia Hubbard, *Twitter Has Lost 50 of Its Top 100 Advertisers Since Elon Musk Took Over, Report Say*s, NPR (Nov. 25, 2022), https://www.npr.org/2022/11/25/1139180002/twitter-loses-50-top-advertisers-elon-musk#:~:text=via%20Getty%20Images-,Half%20of%20Twitter's%20top%20100%20advertisers%20appear%20to%20no%20longer,%24750%20million%20just%20in%202022.

[141] Katie Paul & Paresh Dave, *Musk Warns of Twitter Bankruptcy as More Senior Executives Quit*, REUTERS (Nov. 11, 2022), https://www.reuters.com/technology/twitter-information-security-chief-kissner-decides-leave-2022-11-10/.

the debt, leaving little room for other investments or operational enhancements.[142]

Although the aforementioned details related to Twitter (now X Corp.) may seem tangential to the focus of this Article, they lay the groundwork for understanding why Mr. Musk may have chosen to transition the corporate structure to Nevada. While navigating these issues and corporate maneuvers, Musk incurred tremendous legal and financial strife under Delaware jurisdiction. Hence, through meticulous evaluation, he sought a more favorable state in which to incorporate, one which would provide a legal and regulatory framework that would harmonize with the company's governance structure and goals.

The central focus of this Article diverges from examining the potential harm to Twitter's users or broader discourse. While acknowledging the impact on users as stakeholders, it is essential to clarify that the consequences for users, although significant, fall outside the specific scope of this Article. However, it is recognized that this aspect could be a subject for exploration in future work. Instead, this Article concentrates on dissecting Mr. Musk's acquisition deal with Twitter and his subsequent actions as CEO, actions that have raised numerous concerns. Specifically, the analysis zeroes in on the harm incurred by shareholders, emphasizing their perspective as a primary focus of investigation. In light of these concerns and the shareholder-oriented lens, the decision to shift the corporate structure to Nevada is likely influenced by particular benefits to the CEO and management team and preferences arising from the legal and regulatory framework in that state.[143]

Overall, these corporate maneuvers necessitate meticulous evaluation of the legal and business landscape to harmonize with the company's goals.

2. Twitter's Relocation Puzzle: Evaluating the Shift Away from Delaware

We now know that Musk designated X Corp. as the successor to Twitter, Inc., and that Musk opted to restructure Twitter, rebranding the company by replacing Twitter's familiar blue bird logo with a considerably more sinister one - X.[144] Additionally, Musk changed the corporate structure through an outbound merger, moving Twitter from Delaware to Nevada and making it a subsidiary of X Holdings.[145]

Entrepreneurs, much like Musk, have the liberty to incorporate (charter) their businesses in any state within the United States, irrespective of whether they conduct actual business operations in that state.[146] This approach, which revolves around individual states, enables each state to formulate its own set of corporate laws and regulations. The competition among states for chartering business is driven by the desire to generate revenue from the sale of incorporation products,

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[142] Lauren Hirsch, *Can Elon Musk Make the Math Work on Owning Twitter? It's Dicey,* N.Y. TIMES (Oct. 30, 2022), https://www.nytimes.com/2022/10/30/technology/elon-musk-twitter-debt.html.

[143] *See infra* Section IV analysis on Nevada law and fiduciary duty.

[144] X Corp. is a wholly owned subsidiary of X Holdings Corp., which is also owned by Musk.

[145] *Id*.

[146] *Id*.

including franchise taxes, fees, and various registration services.

The rebranding of Twitter is just one among many controversial decisions orchestrated by Musk, each carrying significant implications. Initially one of many U.S. public companies incorporated in Delaware, Twitter underwent a radical transformation under Musk's ownership. It transitioned to a private company, thereby restricting liquidity options for the new private entity existing shareholders. This shift potentially poses challenges for dissatisfied shareholders looking to sell their stock and exit the company.

Twitter going dark means that it is no longer operating as a public entity. It is no longer bound by the same regulatory requirements applicable to public companies. The regulatory burden on private firms is typically lighter, granting them greater flexibility and autonomy in their operations compared to publicly traded counterparts.[147]

Another notable decision made by Musk involved a significant reduction in Twitter's workforce, leading to the destabilization of the company's status as a technology business. This move not only impacted the livelihoods of dismissed employees but also rendered the platform unusable for those who remained,[148] not to mention the controversy around hate speech, free speech and monitoring the online platform.[149]

For a corporate law scholar, Musk's decision to relocate Twitter from Delaware to Nevada holds utmost significance. Many corporate law scholars, like myself, view Nevada corporate law as a market for lemons, suggesting that it does not provide optimal protections for shareholders.[150] Not only did the shift from being a public company in Delaware to a private entity in Nevada raise concerns about the diminished liquidity options for shareholders and the potential challenges they may face if dissatisfied with Musk's management of the company, but Musk just moved it to Nevada. As noted above, Nevada law allows for a greater degree of flexibility when it comes to corporate governance matters. A Nevada corporation has the authority to include provisions in its articles of incorporation that eliminate or limit the personal liability of directors to the corporation or its shareholders for monetary damages for certain breaches of fiduciary duty.

Nevada corporate law has evolved over time to substantially limit liability for breaches of fiduciary duties, which is otherwise a foundational element of traditional American corporate law.[151] One scholar, Michal Barzuza, was not at all surprised about Musk's decision to incorporate (charter) his new ventures in Nevada. Barzuza has been writing about Nevada's efforts to emerge as a viable

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[147] Anat Alon-Beck, *The Beginning of a Musk Controlled Twitter Era,* FORBES (Oct. 27, 2022), https://www.forbes.com/sites/anatalonbeck/2022/10/27/the-beginning-of-a-musk-controlled-twitter-era/?sh=5265b5a03162.

[148] *See The Year Twitter Died*, VERGE, https://www.theverge.com/c/23972308/twitter-x-death-tweets-history-elon-musk (last visited Jan. 26, 2024).

[149] *See id.*

[150] See above discussion on Nevada as a market for lemons.

[151] Mary Wood, *Businesses that Incorporate in Nevada Face Little Liability, Barzuza's Research Shows*, UVA LAW (Feb. 19, 2013), https://www.law.virginia.edu/news/201302/businesses-incorporate-nevada-face-little-liability-barzuzas-research-shows.

competition to Delaware by providing additional incentives to corporations. Nevada offered firms more lenient corporate laws. Specifically, Nevada now offers a shield for directors and officers from liability related to breaches of widely accepted duties of care, good faith, and now, even loyalty, which are fundamental aspects of our U.S. corporate law.[152]

Nevada's emergence as a jurisdiction with a threshold of low liability standards has occurred with relatively little public notice. Nevada has undergone substantial legal reforms in order to compete with Delaware in our interstate market for corporate charters. It absolves officers and directors from liability associated with their management and oversight duties for their corporation. Barzuza believes that other companies will follow Musk's steps and relocate to Nevada. However, this new approach allows Nevada to attract specific types of companies ("lemons") that seek a more robust protection for its managers and directors, as compared to the (shareholder) protections provided by Delaware law. In other words, Nevada could end up capturing a very specific niche within our interstate market for corporate incorporation.[153]

3. Unpacking Tesla's Move: Implications and Considerations

Elon Musk's contemplation of moving Tesla to Texas adds complexity to the ongoing discourse on corporate charter competition, echoing the recent legal challenges faced by TripAdvisor in its relocation attempt from Delaware to Nevada. The potential move prompts scrutiny into Texas's legal landscape, its approach to conflicts of interest, and fiduciary duties.

Texas's legal environment, shaped by recent cases and legislative changes, becomes a crucial factor in evaluating Tesla's relocation. A specialized Texas court, the Texas Business Court ("TBC"), is in the works, but its effectiveness remains to be seen.

For the success of Texas as a corporate hub, it needs laws conducive to business, judges well-versed in commercial litigation, a supportive infrastructure, and efficient staff. While I'm cautious, given my risk-averse nature, about recommending litigation in a state with uncertain outcomes, Musk, a known risk-taker, might be one of the first examples in such a court.

The implications extend beyond Tesla, impacting the broader competition between states for favorable corporate governance environments. Texas aims to position itself as a competitor to established corporate hubs like California and New York, challenging Delaware's prominence.

In terms of procedures, regardless of Musk'' decision, it's crucial for Tesla's shareholders that proper protocols are followed. The concept of a "special committee" in corporate law, comprising independent directors, could play a pivotal role. However, appointing members may be challenging, requiring specific expertise relevant to the matter at hand.

Even if a recommendation is made to move Tesla to Texas, there are inherent risks, including the lack of established legal precedence, potential

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[152] *Id*.
[153] *Id*.

uncertainties in decisions, and the fact that the Texas court would still need to decide according to Delaware law until the relocation is completed. Any move would have to meet Delaware law requirements for fair process and substantive results.

The shareholder approval percentage for relocation, as per the Tesla COI, requires a supermajority of two-thirds of the total voting capital shares. Despite attempts to remove this provision, the requirement remains, emphasizing the stringent standards set by Delaware for such significant decisions.

III. WHO WILL BE THE NEXT CONTENDER – NEVADA, TEXAS, WYOMING OR THE FEDERAL GOVERNMENT?

We cannot solely attribute to Delaware the practice of "chartermongering," which entails actively enticing corporations to choose a particular state for incorporation with the aim of generating state revenue.[154] The state did not always hold its current position as the preferred choice for incorporation. The competition among states for corporate charters dates back to the late 1800s and early 1900s, marking the initial era when states commenced vying to attract corporations within their borders. The subsequent section provides a historical account of this phenomenon.

A. Exploring Lessons from the First State: New Jersey's Historical Significance

The concept of a regulatory "race to the bottom" traces its origins to the early 1900s.[155] In 1933, the phrase gained prominence following the decision by Justice Louis Brandeis of the U.S. Supreme Court in *Liggett v. Lee*.[156] However, well before this concept became popular, New Jersey was the United States' first "Mecca for Corporations."[157] The legend suggests that New Jersey's reign began in 1891 when a young attorney from New York, James D. Bill, successfully persuaded New Jersey Governor Leon Abbett to transform the state into a premier destination for corporations. [158]

Bill successfully persuaded Governor Abbett that it would be advantageous

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[154] Kahan & Kamar, *supra* note 12; Kahan & Kamar, *supra* note 8; Bebchuk & Hamdani, *supra* note 8; Bebchuk, *supra* note 21; Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003); Romano, *supra* note 21; ROMANO, *supra* note 21; Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REGUL. 209 (2006); Romano, *supra* note 91; Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUD. 31 (2017); Sarath Sanga, *Network Effects in Corporate Governance*, 63 J.L. & ECON. 1 (2020); Gillian Hadfield & Eric Talley, *On Public Versus Private Provision of Corporate Law*, 22 J.L. ECON. & ORG. 414 (2006).

[155] It was Justice Louis Brandeis of the U.S. Supreme Court who referred to the "race to the bottom" in his decision in Ligget Co. v. Lee, 288 U.S. 517 (1933).

[156] *Id*.

[157] Christopher Grandy, *New Jersey Corporate Chartermongering, 1875–1929*, 49(3) J. ECON. HIST. 677 (1989).

[158] It was Justice Louis Brandeis of the U.S. Supreme who Court referred to the "race to the bottom" in his decision in Ligget Co. v. Lee, 288 US. 517 (1933).

for the New Jersey government to implement a fresh set of corporate laws, relaxing existing regulations to grant corporations the flexibility to engage in unrestricted competition within the marketplace.[159] In return, the state would levy fees for incorporation services, including a designated incorporation fee, an annual "franchise" tax, and other associated services. At the time, New Jersey was grappling with a severe fiscal crisis.[160] Governor Abbett, recognizing the potential benefits, convinced state officials to experiment with these novel ideas, offering a new revenue stream. Taxing corporations for services, which appeared less politically sensitive than taxing residents, proved to be a successful strategy. This approach generated significant revenue for New Jersey, to the extent that by 1902 the state had achieved financial success through its incorporation business. Consequently, New Jersey managed to eliminate all property taxes and completely pay off its state debt within a decade. [161]

By 1912, New Jersey had exerted a transformative influence on the corporate laws of other competing states. These states sought to attract businesses by adopting New Jersey's corporate laws, legal framework, and practices. Delaware emerged as a notable example, replicating New Jersey's statutes nearly word for word. However, this imitation alone did not lead to immediate success. It took several years and a market shock before corporations began to shift their preference from New Jersey to Delaware.[162] Multiple theories exist to explain this transition.

The conventional theory posits that the turning point occurred when New Jersey, under the administration of Governor Woodrow Wilson, enacted seven stringent antitrust laws.[163] It is argued that it was only after the implementation of these laws that companies started leaving New Jersey and choosing Delaware for reincorporation. This theory suggests that the new antitrust laws disrupted the implicit contract between New Jersey and the large corporations that were incorporated there. [164]

Regardless of whether one is persuaded by the traditional theory or not, the establishment of state chartering was fundamentally grounded in two key principles: the internal affairs doctrine and U.S. Supreme Court rulings under the commerce clause. These foundational principles played a pivotal role in shaping the landscape of corporate law and governance at the state level. Ever since, various jurisdictions aim to compete with Delaware by providing unique legal, tax, or regulatory environments that can align with the specific needs and strategies of individuals or businesses. These states seek to attract corporations and individuals by offering alternative frameworks that may be more advantageous for certain activities or organizational structures.[165]

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[159] Grandy, *supra* note 157.

[160] *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] An alternative theory proposed by Sanga offers another perspective on the decline of New Jersey. *See* Sanga, *supra* note 154.

[165] *See* Anne Anderson, Jill Brown & Parveen Gupta, *How State Competition for Corporate Charters Has Changed the Delaware Effect*, CLS BLUE SKY BLOG (Oct. 16, 2017), https://clsbluesky.law.columbia.edu/2017/10/16/how-state-competition-for-corporate-charters-has-

Notably, Nevada and Wyoming have emerged as key players in this competition, actively enticing companies by providing management-friendly corporate laws, along with low incorporation fees and taxes. These states have strategically positioned themselves to attract businesses by offering favorable legal and financial environments for corporate operations.[166]

If you turn to the state websites of Nevada and Wyoming, you can make comparisons between them and Delaware based on the following factors: First, secrecy about beneficial ownership. Do stockholders have an obligation to reveal their identities to the state or can they stay undisclosed? Second, filing reports, such as annual reports. Do companies have to issue a special annual report before the anniversary of their incorporation date? Third, secrecy about management. Do companies have to disclose the identity of their officers or managers? Fourth, stock structure. Can companies issue unlimited stock of any par value? Fifth, nominee shareholders. Can companies use nominee shareholders? Finally, exculpation and indemnification provisions. Are the companies allowed to indemnify officers, directors, employees, or agents?

These governance issues are frequently debated between corporate governance scholars and considered indicators of whether a particular state favors the interests of stockholders or management, and how they affect agency problems.[167]

In order to highlight the concept of competitive federalism and fully understand motivations behind choice of state charter, it may be helpful first to explore a scenario in which a choice was made by Elon Musk to incorporate would-be unicorns outside of Delaware. The reasons behind the selection of a particular incorporation location can provide insights into the considerations and goals of Elon Musk, his affiliated companies and perhaps other tech entrepreneurs.

B. Nevada on the Horizon: Examining Changes to Duty of Loyalty

changed-the-delaware-effect/ ("[O]ver the last few years, several states have begun to compete. For example, Nevada and Wyoming have sought to attract more companies with management-friendly corporate laws and low fees and taxes. Their state websites make comparisons with other states based on factors like: 1) whether stockholders must reveal their identities to the state, 2) whether companies must issue an annual report before the anniversary of their incorporation date, 3) whether they must disclose the identity of their officers or members, 4) whether unlimited stock is allowed, of any par value, 5) whether nominee shareholders are allowed, and 6) whether a statute requires that the company indemnify officers, directors, employees, and agents. These hot-button governance issues are often marketed as indicators of whether a state favors stockholders or management, complementing academic debates about legal variations between Delaware and other states that affect the extent of agency problems.").

[166] *See* Anderson, Brown & Parveen, *supra* note 165.

[167] The agency problem refers to a conflict of interest that may arise in situations where an individual or entity (the principal) hires another party (the agent) to act on its behalf. The issue arises from the divergence of interests between the principal and the agent, as their objectives may not align perfectly. The agent is entrusted with making decisions and taking actions on behalf of the principal, but there is a risk that the agent may prioritize personal interests or goals that are not in line with those of the principal.

> "*I tell my students, Nevada is where you incorporate if you want to do frauds*."
>
> – Ann Lipton on Twitter[168]

Nevada made numerous efforts to compete with Delaware over the years. In 1987, Nevada adopted most of Delaware's corporate law statutes but changed its exculpation clause. Nevada's exculpation clause is drastically more protective of directors and officers than Delaware's, because Nevada allows firms to waive liability for directors and officers for breaching the duty of loyalty and of good faith. It offers less protections to shareholders.[169]

Delaware corporate law is the "gold standard" for corporate law scholars and practitioners, in terms of good corporate governance practices. Delaware corporate law is commonly taught in most corporate law school classes across the United States. Unless one attended law school in Nevada, one probably never heard about Nevada corporate law as a law student. Nevada corporate law offers a market product filled with asymmetric information for the benefit of directors, to the detriment of shareholders. Nevada law offers strong protection of the business judgment rule to directors, and its corporate governance norms may harm shareholders.

For nearly two centuries, a fundamental principle in Anglo-American corporate law has been the fiduciary duty of loyalty. The duty of loyalty is considered the most rigorous and frequently contested obligation imposed on corporate managers. This duty, which governs financial or other conflicts of interest and mandates that managers prioritize the corporation's interests over their own serves as a crucial policy tool to address the most detrimental intra-firm agency costs.[170]

Professionals, scholars and legal experts consistently regard the duty of loyalty as the paramount fiduciary obligation. The duty's significance is attributed to its importance in facilitating effective corporate stewardship and fostering investment and entrepreneurship. Extensive literature in law and finance has highlighted the positive impact of sound management of conflict of interest situations in promoting company value and robust capital markets. Unlike other "default rules," which parties can easily modify in corporate law, the duty of loyalty is "immutable," meaning that it is much harder to eliminate, tailor or otherwise "weaken" the duty of loyalty via "private ordering."[171] "Private ordering" refers to the ability of individuals and entities to establish their own rules, agreements, and governance structures voluntarily, without significant interference from external authorities.

To illustrate, let's go back to the Musk example. As noted, Musk used X

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[168] Ann Lipton (@AnnMLipton), X (formerly TWITTER) (Apr. 10, 2023, 5:48 PM), https://twitter.com/AnnMLipton/status/1645544410665435137.

[169] Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935 (2013).

[170] Gabriel Rauterberg & Eric L. Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075 (2017).

[171] Rauterberg & Talley, *supra* note 170.

Corp., a Nevada private shell corporation, in a merger transaction to eliminate Twitter, the Delaware corporate entity (as we know it). Twitter, Inc., was merged into X Corp. where the surviving entity is now a privately held Nevada corporation.[172] Musk not only changed Twitter's bird brand to X, which sent the world buzzing, but also changed its corporate governance and ethics norms. Under Nevada law, bringing an action against Musk will be more uncertain than it was under Delaware law.

For those following Musk, this move or strategy might not be surprising after all. Musk, likely displeased with his very public entanglements with the Delaware courts, opted to move his new ventures to Nevada, the "Delaware of the West."[173] This means that Musk might be able to avoid future fiduciary duty liability obligations by moving Twitter to Nevada.[174]

Charter choices matter greatly to investors, i.e., shareholders. Twitter's move to Nevada affects management, shareholders, stakeholders and the public as a whole. Following Musk's acquisition, Twitter went dark, becoming a private firm with higher levels of opacity and agency costs.[175] The opacity contributes to the asymmetry of information between management and shareholders, limited availability of information to the general public, and no transparency regarding the firm's financial, operations or overall internal workings. A public firm is subject to strict regulatory requirements and disclosure obligations. But a private firm is not. Unfortunately, firms with higher agency costs, like Twitter, which would benefit most from more regulation, may choose to incorporate in locations with more lenient laws than Delaware.

Nevada's corporate legal framework differs from the norms established by traditional American corporate law, especially from Delaware's theory on liability of breaches of fiduciary duty. Therefore, Musk's shareholders, operating under Nevada's state incorporation law, may find that Nevada's state laws provide less stringent safeguards against breaches of fiduciary duties, emphasizing the need for shareholders to thoroughly understand the legal landscape governing their corporations.

Despite the recent Musk-Twitter case, the common view amongst corporate law scholars is that Delaware does not need to fear losing its place as the "mecca" of incorporation. Some think that the real threat to Delaware's dominance and hegemony is from the federal government, in the form of further interference and federalization of corporate law.[176] I personally feel that Delaware is going to continue to be the number one choice for unicorn firms.

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[172] Hemmersmeier, *supra* note 14.

[173] Kahan & Kamar, *supra* note 16.

[174] Let's not forget that Musk was recently forced to buy Twitter thanks to a publicized pre-trial in Delaware courts. If Musk had not submitted, the Delaware Court of Chancery would have had to explain to him that he cannot back out of an agreement he voluntarily entered into simply because he doesn't want to be a part of it anymore. Musk is also currently facing several other lawsuits in Delaware courts.

[175] "*Going Dark" – A Process for Delisting and Deregistration of Public Company Securities*, DUDNICK, DETWILER, RIVIN AND STIKKER, LLP, https://www.ddrs.com/going-dark-a-process-for-delisting-and-deregistration-of-public-company-securities/ (last visited Jan. 26, 2024).

[176] *See* Bainbridge, *supra* note 16.

Unicorn companies continue to have multiple incentives to opt for incorporation in Delaware and not move to Nevada. First, they may seek to preserve the option of going public in the future as a Delaware corporation.[177] This is evident from previous experience, where even among startup companies that initially incorporated in California, many chose to switch to Delaware before conducting an IPO.[178]

Second, Delaware is renowned for being management-friendly. Unicorn founders are motivated to maintain control over their companies by staying private for extended periods, avoiding exposure of their management decisions, trade secrets, and strategies to the scrutiny of the public market.[179] The favorable legal and managerial environment in Delaware aligns with the strategic goals of unicorn firms in retaining control and flexibility in their growth trajectories.[180]

While it is not uncommon for high-profile entrepreneurs like Elon Musk to establish new entities for various business purposes, and for these ventures to raise large amounts of funds while they are still privately held, the choice of incorporating in Nevada is relatively rare and may carry specific strategic or legal considerations, shown by Musk's recent decision.[181]

Elon Musk's decision to move away from Delaware doesn't necessarily mark the end of his legal ties with the Delaware court system. While reincorporating in Delaware is common and straightforward, the process of

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[177] For a discussion on the motives to go public, see Richard A. Booth, *The Limited Liability Company and the Search for a Bright Line Between Corporations and Partnerships*, 32 WAKE FOREST L. REV. 79, 89-92 (1977). *See also* J.C. Brau & S.E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 J. FIN. 399 (2006) (survey on decisions to do an IPO).

[178] *See* Mitchell A. Kane & Edward B. Rock, *Corporate Taxation and International Charter Competition*, 106 MICH. L. REV. 1229, 1282 (2008).

[179] *See* Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs* 1 (Mar. 7, 2018), https://ssrn.com/abstract=3017610, posted on Harv. Corp. Gov. Blog (Sept. 28, 2017). *See* Alon-Beck, *supra* note 122; Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 88 TENN. L. REV. 983 (2020); Anat Alon-Beck, Robert N. Rapp & John Livingstone, *Investment Bankers as Underwriters: Barbarians or Gatekeepers? A Response to Brent Horton on Direct Listings*, 73 SMU L. REV. 251 (2020). *See* Gad Weiss, *A Theory of Seed Financing* (forthcoming, on file with author).

[180] Les Brorsen, *Looking Behind the Declining Number of Public Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 18, 2017), https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/. *See* Sergey Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence from Unicorns* 25-26 (Harv. Bus. Sch., Working Paper No. 18-037, 2017), https://www.hbs.edu/faculty/Publication%20Files/18-037_02aee6d2-1209-449e-84df-c3730b4d7b4b.pdf; MCKINSEY & CO., MCKINSEY GLOBAL PRIVATE MARKET REVIEW 2018, THE RISE AND RISE OF PRIVATE MARKETS, https://www.mckinsey.com/~/media/McKinsey/Industries/Private%20Equity%20and%20Principal%20Investors/Our%20Insights/The%20rise%20and%20rise%20of%20private%20equity/The-rise-and-rise-of-private-markets-McKinsey-Global-Private-Markets-Review-2018.ashx (Feb. 2018); *see* Matt Levine, *Unicorns Take Different Paths to Being Public*, BLOOMBERG (Mar. 27, 2018, 10:13 AM), https://www.bloomberg.com/opinion/articles/2018-03-27/unicorns-take-different-paths-to-being-public [https://perma.cc/2V8M-KRFZ]. *See also* Andrew Nussbaum, Steve Cohen & Karessa Cain, *Private Equity – Year in Review and 2020 Outlook*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 8, 2020), https://corpgov.law.harvard.edu/2020/02/08/private-equity-year-in-review-and-2020-outlook/.

[181] *See Id.*

relocating and leaving the state raises questions about ease and feasibility. I discuss several cases about Delaware's legal history that can provide insight into this matter below.

C. Eyeing Wyoming: Prospects for the Digital Asset Corporations

Wyoming has set its sights on a promising new segment of the market for corporate charters: digital asset businesses. In a strategic move, Wyoming jurisdiction is actively working to attract these entities by implementing progressive legislation and offering a safe harbor, creating a regulatory environment that is particularly conducive to the needs of companies operating in the digital asset space.[182]

Wyoming is pushing this strategy, not by changing its corporate laws, but rather by introducing exemptions to state securities laws and banking regulations. According to Matera, this application of credible "commitment theory" and network theory to Wyoming's approach suggests that building a reputation and demonstrating commitment to tech-incorporators is a promising strategy. However, success requires a confluence of events that takes time.[183]

Time will tell whether Wyoming will be able to establish supremacy in digital assets. Wyoming first has to cultivate expertise that is challenging for other jurisdictions to easily replicate. Additionally, it must secure a share of the charters market before potential federal legislation and regulatory bodies preempt Wyoming's law for cryptocurrencies.[184] If successful, Wyoming's strategy is likely to position the state as a leader in the blockchain segment of the market. However, I believe that despite these changes, Delaware is still expected to maintain dominance in the broader gamut of corporate law. I plan to write a separate article documenting these developments in the future.

D. Texas under Scrutiny: Evaluating the Potential amidst the Establishment of Business Courts

Texas is renowned for fostering a business-friendly environment characterized by low taxes and minimal government regulation. However, the state has been subject to persistent criticism for the perceived drawbacks in its legal system, marked by issues of being slow, unpredictable, and costly. This critique has been seen as a potential obstacle to economic growth and development within the state.[185]

Despite the business-friendly reputation, Texas stands out as having a legal system that has seen minimal updates since the late 1960s. This situation has led to elected judges presiding over a wide range of cases, from intricate large-scale

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[182] Pierluigi Matera, *Delaware's Dominance, Wyoming's Dare: New Challenge, Same Outcome?*, 27 FORDHAM J. CORP. & FIN. L. 73, 74 (2022).

[183] *Id.* at 74.

[184] *Id.* at 74.

[185] *Texas Creates New Business Court*, GIBSON DUNN (July 25, 2023), https://www.gibsondunn.com/texas-creates-new-business-court/.

commercial litigation to more commonplace family law disputes and personal injury claims. The absence of specialized business courts, a feature present in nearly thirty other states, contributes to the challenge, as these judges may lack exposure to the intricacies of complex business cases. Additionally, unlike their federal counterparts, they often handle these cases without the support of full-time clerks, adding further complexity to the judicial process, especially when dealing with substantial volumes of legal documentation. [186] But, this might be changing soon to some degree.

1. Establishment of the Texas Business Courts: Addressing Opportunities

On June 10, 2023, Governor Greg Abbott signed House Bill 19 into law, marking a significant development in Texas's legal landscape. This legislation has given rise to new specialty courts, notably the Texas Business Court ("TBC"), designed to address large and intricate business disputes more efficiently. These specialized courts operate with significantly limited jurisdiction and aim to streamline the resolution process for complex business matters.

The fundamental features of the business courts, as introduced by House Bill 19, include the following. The TBCs are established to adjudicate matters involving substantial amounts in controversy. With concurrent jurisdiction with district courts, the business courts handle specific actions where the amount in dispute exceeds $5 million, while some actions are under their jurisdiction only if the dispute surpasses $10 million. This heightened amount requirement aims to relieve court backlogs by offering a specialized venue for resolving significant and intricate disputes. It also enables the court to set fees that cover its costs, as mandated by the statute.[187]

Moreover, to ensure efficiency in handling complex cases, the business courts are authorized to conduct remote proceedings and utilize existing courtrooms when necessary.[188]

Additionally, the business courts possess limited jurisdiction over specific categories of business-related disputes. Categorized into eleven divisions based on administrative judicial regions, they cover the entire state. The court has jurisdiction over actions exceeding $5 million in areas like corporate governance, derivative proceedings, actions against owners, and securities-related actions.[189]

For actions with amounts exceeding $10 million, the jurisdiction extends to qualified transactions, contractual or commercial transactions agreed upon by the parties, and actions arising from violations of the Finance Code or Business and Commerce Code.[190]

Given recent developments painting Texas as a potential competitor to

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[186] *Id.*

[187] *Texas Business Courts*, BAKERHOSTETLER (Sept. 13, 2023), https://www.bakerlaw.com/insights/texas-business-courts/.

[188] *Id.*

[189] *Id.*

[190] *Id.*

Delaware as a corporate law powerhouse, a recent proposed amendment to the Texas Business Organizations Code carries extra relevance. The proposed amendment states the following:

> BURDEN OF PROOF IN CERTAIN DERIVATIVE PROCEEDINGS. Notwithstanding any other law, in a derivative proceeding by a shareholder that alleges an act or omission related to the improper consideration of environmental, social, and governance criteria in the performance of the act or omission, the burden of proof is on the corporation to prove the act or omission was in the best interest of the corporation.[191]

While Governor Abbott has pitched ideas that would allow Texas to compete with Delaware, it might be difficult for him to show companies that organization in Texas would not carry implications based on political grounds. For instance, Texas has proposed amendments that would permit shareholders to bring suits for fiduciary duty claims against public companies that provide benefits for women to travel for abortion care. Additionally, Attorney General Ken Paxton is one of those suing to block a Department of Labor rule.

Texas refuses to do business with those financial institutions that it sees as boycotting oil companies. With these recent intersections between business and politics, companies choosing to incorporate in Texas might have cause for concern that their decisions will be scrutinized under a political lens.

The appointment of judges to the business courts is vested in the governor, with advice and consent from the Senate. Judges serve two-year terms, with the possibility of reappointment, and must meet specific qualifications, including being a U.S. citizen, at least 35 years old, a resident of a relevant county for five years, and a licensed attorney with a decade or more experience in areas such as complex civil business litigation or business transaction law.[192]

As noted Delaware's judiciary operates without a jury, which allows for expedited and efficient resolution of corporate litigation and disputes. This distinctive characteristic enhances Delaware's appeal as a jurisdiction for businesses seeking swift legal resolutions. Notably, if the Texas Business Court were to incorporate a jury system into its proceedings, it might compromise its ability to compete with Delaware. Delaware's system, which lacks a jury by default, aligns with the efficiency sought by corporations in complex business matters.

It's important to note that, in contrast, the Texas Constitution allows a party to elect to have a jury.[193] This flexibility in the Texas legal framework introduces an additional layer of consideration for businesses. The constitutional question of whether the Texas Business Court can operate without a jury, while noteworthy, falls outside the scope of this Article. The primary emphasis remains on the distinctive features of Delaware's legal environment and their implications for corporate litigation and dispute resolution. The choice to involve a jury may

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[191] H.B. No. 4794 (Tex.), https://capitol.texas.gov/tlodocs/88R/billtext/html/HB04794I.htm.
[192] *Id.*
[193] Tex. Const. art. 1, § 15.

introduce complexities that could potentially impact the efficiency and expeditious nature of corporate legal proceedings, a factor that has contributed to Delaware's historical prominence in corporate law matters.

Texas is not alone. In recent years, several states have followed Delaware's footsteps, with four introducing business courts since 2019 and others enhancing existing structures. Notably, Utah, Wyoming, Texas, and Georgia stand among the states that have embraced the creation of statewide business courts. A primary impetus driving the establishment of these business courts is the pursuit of efficiency, coupled with the specialized business acumen exhibited by the appointed judges. These state business courts, emerging as a noteworthy trend, signify a reaffirmation of the broader concept of state chartering. The recognition of the importance of expeditious and expert resolution in business-related legal matters underscores the evolving legal landscape as states adapt and refine their judicial structures to meet the demands of the corporate sector.[194]

2. Challenges and Criticisms Surrounding Texas's Business Courts

Concerns about the constitutionality of appointing judges rather than electing them have sparked debates, potentially leading to constitutional challenges. The outcome of these challenges remains uncertain until the Supreme Court of Texas addresses them, and several procedural steps must occur before the business courts face this constitutional hurdle.[195]

If we compare this to Delaware courts, we will find significant differences. In Delaware, the process for appointing Superior Court Judges involves nomination by the governor and confirmation by the Senate. These judges are appointed to serve for longer terms, twelve-year terms, and are required to have a deep understanding of business law.[196]

The Superior Court bench can consist of up to twenty-one judges, among whom one is appointed as the president judge, responsible for administrative duties within the court. Additionally, three judges serve as resident judges and must reside in the county of their appointment. An essential factor in ensuring impartiality and preventing political capture is the commitment to maintaining a balanced representation on the bench. To achieve this, a critical provision mandates that no more than a simple majority of judges can be affiliated with a single political party. This measure aims to foster a diverse and bipartisan composition among judges, reinforcing the principle of unbiased and fair judicial decisions.[197]

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[194]The concept of state chartering is well established in U.S. corporate law, as "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations…" CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89. For further reference on state laws being the place to look for director powers, as well as reinforcement of the concept of corporations as "creatures of state law," see *Burks v. Lasker*, 441 U.S. 471, 478.

[195] *See* BAKERHOSTETLER, *supra* note 187.

[196] *Id.*

[197] *Id*.

E. Assessing the Potential for Competitive Vertical Federalism

Is Washington, D.C. the most formidable contender to Delaware in offering premier corporate laws? There have been numerous attempts and proposals to federalize corporate law over time.[198] However, as of yet, these proposals have not been successful.

State laws continue to play a primary role in governing corporate governance matters, reflecting the historical and ongoing reliance on state chartering in regulation of corporations. At the same time, critics of the state charter competition argue that by allowing corporations to compete and offer such lenient treatments, laws and regulations, states now allow corporations to engage in harmful practices towards stakeholders, such as consumers, customers, workers, the environment and society at large. This competition can also undermine investor protection and overall financial stability.

In 1974, William Cary published his famous article, *Federalism and Corporate Law: Reflections Upon Delaware*.[199] Cary argued that we should impose national standards for corporate governance, highlighting the need to address the drawbacks of regulatory competition. Needless to say, this view was not adopted. States still compete with each other and there is no federal corporate law.

Proponents of the current system argue that there is no need to have uniform national standards. Moreover, they argue that stricter rules, laws and regulations will unnecessarily create burdens for businesses and even hinder economic activity and stifle growth in the United States. They believe that charter competition allows

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[198] Accountable Capitalism Act, S. 3348, 115th Cong. (as introduced in the Senate, Aug. 15, 2018). *See also* Workplace Democracy Act, H.R. 5728, 115th Cong. (2018); Workplace Democracy Act, S. 2142, 114th Cong. (2015) (reintroduced 2018); Employees' Pension Security Act of 2009, H.R. 4281, 111th Cong. (2009); Employees' Security Pension Act of 2008, H.R. 5754, 110th Cong. (2008). The ACA was introduced by Senator Elizabeth Warren, a leading candidate for the 2020 Democratic presidential nomination. The goal of deeply reconsidering business and corporate law (in order to rethink capitalism) was also pursued by the Reward Work Act, which accompanied the ACA. Reward Work Act, S. 2605, 115th Cong. (as introduced in the Senate, Mar. 22, 2018). The Reward Work Act was co-sponsored by Senators Warren, Sanders, and others. The Reward Work Act was in line with the Workplace Democracy Act and Employees' Pension Security Acts re-introduced from 1992 to 2018 by Senator Sanders. The ACA, along with the other aforementioned bills, would have established the right for employees to elect 40 percent of directors on less than or equal to $1 billion company boards and the right for employees to elect one-third of directors on other listed company boards. It would have also required one-half employee representation on single-employer pension plans. *See* Ewan McGaughey, *Democracy in America at Work: The History of Labor's Vote in Corporate Governance*, 42 SEATTLE U.L. REV. 697, 697 (2019). The Reward Work Act also provided for a ban of open-market stock buybacks, which might be seen as overwhelmingly benefitting executives and activist hedge funds at the expense of workers and retirement savers. Warren and Sanders' proposed reforms advocated the so-called codetermination system, which is inspired by Germany's corporate governance. This would have resulted in a critical shift from shareholder-centric governance to a more stakeholder-friendly approach. *See* Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. L. 381, 386-87 (2016). For criticism of this approach in the context of the American corporate system, see Jens Dammann & Horst Eidenmüller, *Codetermination: A Poor Fit for U.S. Corporations*, 3 COLUM. BUS. L. REV. 870, 875-77 (2021). On ACA, see Carew S. Bartley, *The Accountable Capitalism Act in Context and Its Implications for Legal Ethics*, 33 GEO. J. LEGAL ETHICS 373 (2020).

[199] Cary, *supra* note 21.

corporations to choose flexible and lenient rules that may lead to increased prosperity and competitiveness.

An economic crisis can trigger an introduction to a federal chartering effort. Historically, in response to crises and corporate scandals, the federal legislature did intensify its involvement in corporate matters.[200] Over the years, there has been a gradual erosion of state corporate law at the hands of federal interventions. Periodically, in response to crises and corporate scandals, the federal legislature intensifies its involvement in corporate matters.[201]

In his recent book, *The Federalization of Corporate Governance*, Marc Steinberg delves into the historical process of federalization in the United States, tracing its beginnings in 1903. He found that there were many efforts for federalization, however, they were not enacted.[202]

During that period from 1903 to 1914, Congress witnessed the presentation of over twenty bills advocating for federal chartering and the establishment of minimum substantive standards. Notably, Presidents Roosevelt and Taft supported the concept of federal chartering.[203]

In the subsequent two decades, an additional seven bills with similar objectives were introduced. However, it wasn't until fifty years later that another legislative effort materialized, marked by Senator Howard Metzenbaums "Protection of Shareholders Rights Act of 1980."[204]

Nearly four decades later, Senator Elizabeth Warren's recent proposal, the "Accountable Capitalism Act,"[205] revisits these historical concepts and efforts by advocating for federal chartering of relatively large publicly held enterprises.

1. Evaluating Warren's Accountable Capitalism Act: Implications for U.S. Corporate Law and Beyond

The proposed Accountable Capitalism Act, advocated by Senator Elizabeth Warren, seeks to reshape fundamental aspects of U.S. corporate law, challenging the established principles of corporate federalism, shareholder primacy, and

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[200] For New Deal era legislation touching on corporate matters, see Reconstruction Finance Corporation Act of 1932, U.S.C. §§ 601-619 (repealed 1957); Banking Act of 1933, Pub. L. 73-66, 48 Stat. 162; Securities Act of 1933, 15 U.S.C. § 77a-77mm; Securities Exchange Act of 1934, U.S.C. §§ 78a-78qq; Banking Act of 1935, Pub. L. 74-305, 49 Stat. 684.; Sarbanes-Oxley Act 15 U.S.C. §§ 7201-7266; Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J., 1521, 1538, 1544-46 (2005); James S. Linck et al., *The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors*, 22 REV. FIN. STUD. 3287, 3294 (2009). Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. §§ 5301-5641. *See* Brian Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 75-76 (2015).

[201] *See* Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 260, 266 (1980). *See, e.g.*, Stephen M. Bainbridge, *Fee Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 874-75 (2016) (discussing fee shifting bylaws). *See also* Bainbridge, supra note 95, at 6-9.

[202] MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE (2018).

[203] *Id.*

[204] *Id.*

[205] Accountable Capitalism Act, S. 3348, 115th Cong. (as introduced in the Senate, Aug. 15, 2018).

director independence.

Senator Warren argued that her proposed legislation addresses the escalating issue of inequality in the United States, however, her critics argue that it might inadvertently harm the very workforce it aims to assist.[206]

At the core of Senator Warren's plan is the mandate for federal charters for U.S. corporations surpassing $1 billion in revenues. This proposition is also very relevant for this Article, as discussed, due to the fact that large corporations have a nationwide impact; however, it raises several concerns about potential pitfalls. Mainly, the concern that nationalization of corporate law revolves around the potential erosion of the longstanding tradition of horizontal competitive federalism within corporate law. This shift could upset the delicate equilibrium upheld by state-level corporate laws, posing risks to the intricate balance that currently exists. It also poses a risk of mismanagement by Congress.

While federal laws regulating securities law and certain types of business conduct apply universally, the unique aspect of U.S. corporate law is the decentralization of laws defining shareholder rights in relation to boards of directors to the state level. Senator Warren perceives this decentralization as a flaw, while others, such as Yale Law professor Roberta Romano, argue that it constitutes the brilliance of American corporate law.[207]

Ralph Winter, a senior judge on the U.S. Court of Appeals for the Second Circuit, is also one of the outspoken critics of this proposal and even provided a response titled *State Law, Shareholder Protection, and the Theory of the Corporation*.[208] In line with the points made in this Article, Winter pointed out that a state adopting unfavorable corporate law principles would struggle to attract and retain corporate charters.[209]

According to Winter, in states that adopt unfavorable corporate laws, shareholders, in response, would seek a reduction in shares issued during initial public offerings to compensate for rules favoring corporate managers at the expense of shareholders.[210] Consequently, companies aiming to raise substantial capital would avoid states with such rules.[211] This in turn, highlights how decentralizing corporate law to the individual states, the way our system currently works, fosters a beneficial "race to the top," showcasing federalism operating effectively.[212] However, the introduction of a single national regulator could jeopardize this entire system.[213]

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[206] James R. Copeland, Commentary, *Senator Warren's Bizarro Corporate Governance*, MANHATTAN INST. (Aug. 16, 2018), https://manhattan.institute/article/senator-warrens-bizarro-corporate-governance.

[207] ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (AEI STUDIES IN REGULATION AND FEDERALISM) (1993).

[208] Winter, Jr., *supra* note 21.

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] *Id.*

[213] *Id.*

2. Sanders and Colleagues Introduce Legislation to Combat Corporate Greed and End Outrageous CEO Pay

Senator Bernie Sanders (I-Vt.) introduced the Tax Excessive CEO Pay Act in January 2024, joined by Senators Elizabeth Warren (D-Mass.), Ed Markey (D-Mass.), and Chris Van Hollen (D-Md.), along with Representatives Barbara Lee (D-Calif.) and Rashida Tlaib (D-Mich.).[214]

The proposed legislation aims to address corporate greed by imposing higher taxes on companies where the compensation of top executives exceeds 50 times that of an average worker.

The Tax Excessive CEO Pay Act proposes a gradual increase in a company's tax rate based on the CEO-to-median-worker pay ratio. If a company's chief executive earns over 50 times more than the median worker but less than 100 times, the corporate tax rate would rise by 0.5 percentage points. [215]

For companies with a ratio exceeding 500 to 1, the tax rate would increase by 5 percentage points. Notably, over 40 U.S. companies, including Apple (1,177 to 1) and McDonald's (1,224 to 1), have CEO-worker pay ratios surpassing 1,000 to 1, as per the AFL-CIO's executive pay tracker.[216]

3. The Evolution of the Federalization of Corporate Governance

Historically, however, the federal government, through its agencies like the SEC, has also played an active role in shaping corporate governance standards in the United States.

This "federalization" process expanded over time, not overnight, as the SEC introduced more guidelines and regulations that had an impact on corporate governance practices.[217] The SEC's primacy charter is to protect investors and the integrity of our public markets while ensuring capital formation. The peak of the SEC's activism and influence over corporate governance was in response to corporate scandals with the enactment of the Sarbanes-Oxley and Dodd-Frank Acts.[218]

Through rulemaking and enforcement actions, the SEC continues to influence corporate governance for public firms, including disclosure requirements, board composition and independence, executive compensation, say on pay, and

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[214] Press Release, Bernie Sanders, U.S. Senator for Vermont, NEWS: Sanders and Colleagues Introduce Legislation to Combat Corporate Greed and End Outrageous CEO Pay (Jan. 22, 2024), https://www.sanders.senate.gov/press-releases/news-sanders-and-colleagues-introduce-legislation-to-combat-corporate-greed-and-end-outrageous-ceo-pay-2/.

[215] Jake Johnson, *Progressive Lawmakers Unveil Bill to Attack 'Disease' of Corporate Greed*, COMMON DREAMS (Jan. 22, 2024), https://www.commondreams.org/news/sanders-corporate-tax.

[216] *Id.*

[217] Marc I. Steinberg, *The Federalization of Corporate Government*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 21, 2018), https://corpgov.law.harvard.edu/2018/06/21/the-federalization-of-corporate-governance/.

[218] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). Steinberg, *supra* note 217.

oversight of auditors.

The SEC's influence is not limited to publicly traded firms. The SEC can regulate private companies as well. The SEC is in charge of preventing fraud within the United States, which means that its enforcement actions applies to all companies, whether or not they are public and registered on the national securities exchanges.

A private company can raise capital in a number of different ways. When a private company sells an investment instrument called a security, then the SEC regulates the offer and sale of such a security. The most notable example of an SEC investigation of a private company is perhaps Theranos.[219] In light of the recent increase in fraud cases among private firms, federal law will continue to impact the governance of privately held corporations to a greater extent than ever before in our country's history.

Critics of Delaware's predominant role argue that federal legislation should oversee extensive domains of corporate law, extending beyond just securities and disclosure. They contend that state legislatures are ill-equipped to regulate the ambitions of capitalism due to the greater likelihood of managers and their lobbyists influencing the state legislative process compared to the federal counterpart.

This Article acknowledges the evolving relationship between state company law and federal law in the context of governance for privately held corporations. It recognizes that federal law is increasingly exerting influence on corporate governance. In fact, the impact of federal law on the governance of privately held corporations is poised to be more substantial than ever before in the history of the United States.

There is a need to scrutinize the dynamics between state company law and federal law, by offering an analysis of current federal historical developments. Such analysis is, however, outside the scope of this Article. By doing so, such literature will add valuable insights to the ongoing discourse on state competition over incorporation business.

Indeed, it is important to acknowledge that charter competition also extends beyond the borders of the United States. This phenomenon occurs in Europe as well, where the liberalization of joint-stock company control paved the way for European countries to engage in competition and enact competitive legislation. This competitive trend unfolded in various European nations, with Spain experiencing it in 1869, Germany in 1870, Belgium in 1873, and Italy in 1883. This liberalization and competitive legislative environment reflects a broader global pattern in the evolution of corporate law and governance.

It is acknowledged that the international aspects fall outside the scope of this current Article and will be explored in future follow-up work.[220] This recognition indicates a potential avenue for further research and expansion into the global dimensions of charter competition and corporate law evolution.

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[219] Elizabeth Holmes, the founder of blood-testing company Theranos, was ultimately found guilty of investor fraud in 2022. Press Release, U.S. Attorney's Off., N. Dist. of Cal., Theranos Founder Holmes Found Guilty of Investor Fraud (Jan. 4, 2022), https://www.justice.gov/usao-ndca/pr/theranos-founder-elizabeth-holmes-found-guilty-investor-fraud.

[220] *See* Anat Alon-Beck, *Blood Listings* (draft on file with author).

IV. NAVIGATING THE COMPLEX LANDSCAPE OF CORPORATE RELOCATIONS

"You can check out any time you like
But you can never leave"
– Eagles, Hotel California[221]

Delaware courts currently grapple with challenging cases that center around whether a board of directors' choice to reincorporate a company outside of Delaware constitutes a breach of fiduciary duty. The outcomes of these legal proceedings will carry substantial implications for corporate chartering, corporate governance, and the fiduciary obligations of directors. These cases stand as pivotal moments that may shape the landscape of corporate law and governance, determining the extent to which companies can relocate and the responsibilities of directors in such decisions.

A. TripAdvisor's Attempted Relocation to Nevada: Legal Considerations in the Context of a Publicly Traded Firm

The directors and senior managers of TripAdvisor Inc., a Delaware corporation, find themselves entangled in litigation in Delaware courts regarding their proposed decision to shift their corporate domicile from Delaware to Nevada. The specific case is identified as *Palkon v. Maffei*, and it is currently under review in the Delaware Chancery Court.[222]

Shareholders acting as plaintiffs are actively seeking legal measures to prevent both TripAdvisor Inc. and its parent company, Liberty TripAdvisor Holdings Inc., from completing the intended reincorporation in Nevada. Notably, both companies have publicly disclosed their intention to undergo this corporate move through proxy filings submitted to the SEC.[223]

The proposed relocation is facing challenges from shareholders who contend that the primary motive behind the reincorporation is to restrict the potential liability of the board of directors and senior management to shareholders. Shareholders allege that the directors are engaged in a conflict of interest transaction, as the move to shift from Delaware to Nevada is perceived as an attempt to provide protection from potential future litigation. This contention raises concerns about the directors' fiduciary duties and the perceived conflict between their personal interests and the interests of the company and its shareholders. The legal dispute will likely scrutinize the motives behind the relocation and assess whether it is a legitimate business decision or a strategy to evade accountability.[224]

Shareholders in Delaware have the right to bring derivative actions on behalf of the corporation if they believe that the directors or officers have breached

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[221] EAGLES, *supra* note 18.
[222] Palkon v. Maffei, No. 2023-0449 (Del. Ch. filed Apr. 21, 2023).
[223] *See* proxy filings.
[224] *Id*.

their fiduciary duties. The court reviews such claims to ensure they are brought in the best interests of the company. The legal proceedings will likely hinge on considerations of corporate governance, fiduciary duties, and the potential implications of such a relocation on shareholder interests.

The outcome of such a case can significantly impact corporate governance and the responsibilities of directors in companies that are incorporated in Delaware. Delaware courts are now asked to decide whether they have the authority to determine whether a corporation's decision to leave the state and reincorporate elsewhere constitutes a breach of fiduciary duty.

1. Delaware Courts Reviewing TripAdvisor's Relocation Attempt

The matter becomes crucial because Delaware has been a traditional hub for corporate chartering and legal jurisdiction, renowned for its well-established corporate laws and the expertise of its courts in handling corporate disputes. If Delaware courts were to rule that leaving the state without due consideration for shareholder interests is a breach of fiduciary duty, it could discourage companies from choosing to reincorporate elsewhere, but also from incorporating in the state.

Nevada, in this context, is positioning itself as a potential competitor to Delaware. By enacting new laws that differ from Delaware's traditional approach, Nevada aims to attract new charter business. The role of Nevada courts is vital in interpreting these new laws and handling corporate disputes that arise as a result of the state's evolving corporate legal landscape.

The competition between Nevada and Delaware over the corporate law market emphasizes the significance of the legal environment in shaping the decisions of companies, directors, and investors. The outcome of cases involving the relocation of corporations will not only impact individual companies but also contribute to the broader competition between states to establish themselves as favorable jurisdictions for corporate chartering and governance.

We should consider this issue within the framework of the Nevada court system. The examination would predominantly center on Nevada's legal structure, laws, and previous legal decisions. How would the Nevada court handle a decision that conflicts with Delaware, and what factors would influence its approach?

2. TripAdvisor's Relocation: A Review and Considerations for Nevada Courts

The question of whether the Nevada court has to respect a decision by Delaware on matters of corporate law raises a complex legal issue related to conflicts of law. Generally, U.S. courts recognize the "full faith and credit" clause of the U.S. Constitution, which requires states to give "full faith and credit" to the judicial proceedings and judgments of other states.[225]

[225] "Full faith and credit" is the requirement, derived from Article IV, Section I of the U.S. Constitution, that state courts respect the laws and judgments of courts from other states. This clause

In the context of corporate law, each state has its own set of laws and legal principles. While states may respect the judgments of other states, there can be instances where there are conflicts between the laws and precedents of different states. In such cases, conflicts of law principles come into play. There are several key factors in determining whether the Nevada court must respect a decision by Delaware, including Choice of Law rules. Nevada courts may consider the choice of law provisions in the specific contracts or corporate charters at issue. If the parties involved have agreed to the application of Delaware law, it could influence the Nevada court's decision.

Nevada courts may refuse to apply the law of another state, here, Delaware, if it goes against the public policy of its forum. Nevada's departure from Delaware precedent, as mentioned in *Guzman v. Johnson*, could be viewed as reflecting Nevada's public policy.[226] Nevada's departure from Delaware precedent is underscored by *Guzman v. Johnson*, where the Nevada Supreme Court made a significant clarification. In contrast to Delaware's long-standing "entire fairness" doctrine, the Nevada court has asserted that its statutory business judgment rule stands as the exclusive standard for assessing fiduciary duty claims against directors and officers, even in situations involving controlling shareholders. This departure implies that Nevada provides directors and officers with broader protections when making business decisions.[227]

Under Nevada's legal framework, plaintiffs seeking to withstand a motion to dismiss must specifically allege that directors and officers not only breached their fiduciary duties but also engaged in intentional misconduct, fraud, or knowingly violated the law.[228] This shift aligns with Nevada's intention to create a legal environment that affords greater latitude to decision-makers within corporations, emphasizing the importance of the state's courts in shaping the landscape of corporate law and governance.[229]

Once more, this also presents a procedural consideration. The Nevada court has deviated from the Delaware tradition by not automatically satisfying standards solely due to the involvement of a controlling shareholder in a transaction. In contrast to Delaware's application of the entire fairness doctrine to both the accused controlling shareholder engaged in self-dealing and the board, Nevada deviates and only applies the Business Judgment Rule ("BJR").[230]

Instead, the Nevada court requires that certain conditions are met for the BJR to apply in self-interested controlling shareholder transactions. Specifically, the transaction at issue is: "(1) negotiated by a properly functioning and

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attempts to thwart conflict among states and safeguard the reliability of judgments across the country. *See* U.S. CONST., art. IV, § 1, https://constitution.congress.gov/browse/article-4/section-1/.

[226] Brian T. Frawley & John L. Hardiman, *Nevada Supreme Court Holds Statutory Business Judgment Rule Applies to All Claims Against Corporate Officers and Directors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 8, 2021), https://corpgov.law.harvard.edu/2021/05/08/nevada-supreme-court-holds-statutory-business-judgment-rule-applies-to-all-claims-against-corporate-officers-and-directors/.

[227] *Id.*

[228] *Id.*

[229] *Id.*

[230] *Id.*

empowered independent committee of the board and (2) subject to a free of coercion and fully informed majority-of-the-minority vote."[231]

While there is a general expectation for states to respect each other's judgments, conflicts of law can arise in situations where legal principles diverge. The Nevada court may need to navigate these complexities and make determinations based on its own legal framework and principles. The specific facts of a case, the legal arguments presented, and the governing law agreed upon by the parties will all play a role in the court's decision.

Let's look at another case. A recent decision from Delaware's Court of Chancery, in a separate case, *Harris FRC Corp.*,[232] pertaining to an outbound merger, may offer valuable insights into the potential approach the court could take in the current case. Notably, it's important to highlight that the same judge, VC Laster, is presiding over both cases.

B. Harris FRC Corp.'s Relocation to New Jersey: Navigating the Legal Landscape in the Context of Private Firms

The *Harris FRC Corp.* case represents a recent ruling by Vice Chancellor J. Travis Laster, who happens to be the same judge presiding over the TripAdvisor case. It's noteworthy to emphasize that, unlike TripAdvisor, which is a publicly traded company, Harris FRC Corp. is a privately held, family-owned company.[233] Moreover, the outbound merger in this case was to the state of New Jersey and not Nevada.[234] To be precise, the company initially incorporated in New Jersey, later relocated to Delaware, and subsequently attempted to depart from Delaware with the intention of returning to its original incorporation state of New Jersey.[235]

The Harris FRC Corp. case revolves around a familial succession dispute. Dr. Harris and his wife, Mary Ellen, founded the corporation and initially held joint ownership of all 1,000 shares. In a strategic move to facilitate control over the company by the future generation, they decided to gift 190 shares to their five children. These shares were transferred through tax-advantaged transactions, including the use of trusts.[236]

The plaintiffs in this case, three of Dr. Harris and Mary Ellen's children, have brought forth allegations. They contend that following their father's health decline, their mother, in collaboration with four close friends and advisors, engaged in a conspiracy to regain control of the company. Additionally, the plaintiffs assert that their mother and her advisors orchestrated the diversion of millions of dollars from the company for personal gain. Furthermore, they claim that methods were devised to prevent the distribution of shares from the trusts ("GRATs").[237]

In their claims, the plaintiffs assert that their mother, acting as a controlling

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[231] *Id.*
[232] Harris v. Harris, 289 A.3d 277 (Del. Ch. 2023).
[233] *Id.*
[234] *Id.*
[235] *Id.*
[236] *Id.*
[237] *Id.*

shareholder, breached her fiduciary duty through self-dealing actions. More specifically, for our analysis, a breach of fair dealing occurred when the mother and her advisors orchestrated an outbound merger from Delaware to New Jersey. This move was strategically designed to eliminate the plaintiffs' ability to bring certain claims.[238]

As noted above, historically, the company had its original incorporation in New Jersey. Subsequently, it underwent a reincorporation process via an inbound merger, relocating to Delaware as a strategic measure to avoid potential litigation in New Jersey. Later on, the company executed an outbound merger, merging back into a New Jersey shell. This move was undertaken for various reasons, including the anticipation of litigation, particularly in Delaware.[239]

The court determined that the advisors, who are the defendants in this case, were well aware of the implications of the outbound merger. The outbound merger, which would have eliminated the company's separate existence as a Delaware corporation, was orchestrated with the specific intent to curtail the plaintiffs' ability to access meaningful books and records under Delaware Code Section 220 and nullify their standing to pursue derivative claims.[240] The defendants deliberately utilized Delaware law to carry out the outbound merger, aiming to sever their connections to Delaware.[241]

Importantly, the court noted that the defendants consciously availed themselves of the benefits of Delaware law by previously engaging in an inbound merger into Delaware, a move intended to assist with litigation in New Jersey.[242] Consequently, the court concluded that the defendants could reasonably anticipate being subject to legal action in Delaware for claims related to that transaction. In light of these considerations, the court affirmed that it is both fair and consistent with due process to adjudicate claims against the defendants concerning the outbound merger in Delaware.[243]

C. Summary: Unpacking the Key Insights on Corporate Charter Competition and Relocation Considerations

To sum up, the analogy to the *Hotel California* song perhaps captures the essence of Delaware courts' jurisdictional implications, according to Bloomberg Law.[244]

It's a jurisdiction you can check into but leaving proves to be a complex endeavor. Much like the song's lyrics, Delaware's legal landscape often creates

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[238] *Id.*

[239] *Id.*

[240] *See* Anat Alon-Beck, *Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information,* 81 MD. L. REV. 1165 (2022).

[241] *Harris*, 289 A.3d 277.

[242] *Id.*

[243] *Id.*

[244] Matthew Bultman, *TripAdvisor's Planned Nevada Move Puts Delaware in Tricky Spot*, BLOOMBERG LAW (May 11, 2023), https://news.bloomberglaw.com/securities-law/tripadvisors-planned-nevada-move-puts-delaware-in-tricky-spot.

lasting ties, particularly in corporate matters. Once a company avails itself of Delaware's benefits, whether through incorporation or other legal actions, it may find that the jurisdictional connection endures, and legal matters may need to be addressed within the confines of Delaware courts. [245]

The sentiment expressed by Keith P. Bishop, the former California state regulator of securities and financial institutions, at an interview on this for Bloomberg Law, adds an ironic twist to the serious situation.[246] With Delaware attracting numerous publicly traded corporations, the idea that a company might face challenges leaving Delaware for another state reflects a certain irony. It emphasizes the potential complexity and lasting ties that corporations may encounter once they become part of Delaware's legal landscape. The juxtaposition of Delaware's appeal for incorporation with the notion of limitations on leaving adds an interesting layer to the corporate legal dynamics. [247]

Bishop and other legal observers are concerned that Delaware, which long benefited from corporations seeking refuge in its favorable legal environment, might be tempted to curb its own corporations from leaving for other states. This introduces another layer of complexity as explained above from the nuanced perspective of Conflict of Law issues and is outside the scope of this Article. As noted, while efforts to impede emigration from Delaware could potentially backfire, triggering other states to follow suit and view such moves as a breach of fiduciary duty, it also raises concerns about the potential reluctance of corporations to move out (via outbound merger) of Delaware.[248]

The cautionary note suggests that corporations, even if currently free to migrate to or from Delaware, might hesitate to do so, anticipating challenges in departing should the appeal of Delaware's legal framework diminish in the future.[249] From my perspective, it's crucial to distinguish between small and medium enterprises and large venture-backed firms. This analysis may be more relevant for privately held companies of smaller scale, especially those that are family-owned or have a very limited number of stakeholders, rather than innovation driven firms.

As mentioned earlier, innovation-driven firms seeking an exit through an IPO are less likely to be impacted, given that Delaware law currently represents the gold standard in corporate governance. I do not anticipate this situation changing in the foreseeable future.

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[245] *Id.*

[246] *Keith P. Bishop*, ALLEN MATKINS, https://www.allenmatkins.com/professionals/bishop-keith.html (last visited Jan. 26, 2024); *see* Keith Paul Bishop, *Lawsuit Challenges TripAdvisor's Proposal to Move from Delaware to Nevada*, ALLEN MATKINS BLOG (Apr. 26, 2023), https://www.calcorporatelaw.com/lawsuit-challenges-tripadvisors-proposal-to-move-from-delaware-to-nevada; *see also* Keith Bishop, *TripAdvisor Suit Invites Delaware to Become the Hotel California*, JD SUPRA (May 1, 2023), https://www.jdsupra.com/legalnews/tripadvisor-suit-invites-delaware-to-7340658/ [hereinafter Bishop, *Hotel California*].

[247] Bultman, *supra* note 244.

[248] Bishop, *Hotel California*, *supra* note 246.

[249] *Id.*

Another side note. This is not the first, or probably the last time, that Delaware courts are accused of driving corporations away from the state. For example, Former Attorney General Bill Barr recently wrote an opinion column in the Wall Street Journal, titled *Delaware Is Trying Hard To Drive Away Corporations*.[250] Barr is concerned that Delaware is aligning itself with other blue states by embracing environmental, social and governance ("ESG") principles, in a framework that may reject shareholder value as the primary guiding principle in corporate law.[251] Indeed, this article substantiates her assertions. Over the past twelve years, Delaware has successfully drawn in the largest private innovation-driven firms.

Vice Chancellor Laster also set the record straight and stated that to the extent that directors of Delaware corporations choose in good faith to pursue an ESG initiative, they must possess a rational belief that it will enhance the value of the corporation for the long-term benefit of its stockholders.[252]

This Article further rejects the "extreme claim"[253] that state competition has resulted in a race to the bottom. In fact, I find that it supports the "race to the top" theory. I posit that unicorn firm managers who can choose between laws that favor managers but reduce overall value or laws that disfavor managers but increase overall value will choose the former because they want to raise capital from investors. That is why, for example, states like Nevada are not going to take Delaware's place; instead Nevada should be looked at as a market for lemons. The real threat to Delaware perhaps comes from the federal government, in the form of intervention via new corporate governance mandates.

This new and developing dynamic, however, highlights the important intricate balance between jurisdictional choices, corporate governance, and the evolving landscape of corporate law.

V. CONCLUSION

In the United States, companies enjoy the flexibility to establish their corporate entities in any state, regardless of their operational footprint in that specific region. This sets the stage for interstate competition, as states actively vie for businesses, aiming to attract them for incorporation and generate revenue through mechanisms like franchise taxes and various fees. Coined "competitive federalism," this approach empowers states to develop and enforce their distinct set of corporate laws and regulations.

Traditionally, Delaware did not hold a dominant position in the domain of

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[250] William P. Barr & Jonathan Berry, *Delaware Is Trying Hard to Drive Away Corporations,* WALL ST. J. (Nov. 24, 2023), https://www.wsj.com/articles/delaware-is-trying-hard-to-drive-away-corporations-business-environmental-social-governance-investing-780f812a.

[251] *Id.*

[252] J. Travis Laster, Hon., *Attorney General Barr Could Use Some Help on Delaware Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 2, 2023), https://corpgov.law.harvard.edu/2023/12/06/attorney-general-barr-could-use-some-help-on-delaware-law/.

[253] *See* Kahan, *supra* note 37, at 5.

privately held corporations. Scholars argued that privately held companies typically favored incorporation in states where their headquarters or primary place of business was situated. However, findings presented in this Article reveal a significant transformation in private markets.

This Article explores the metamorphosis of the market for privately held corporations, focusing on the evolution of unicorn firms and their impact on corporate law and governance in the United States. It unveils how unicorn firms, despite their private status, wield considerable influence over the landscape of incorporation and regulatory competition. The Article refutes the concept of a "race to the bottom" in corporate law standards, advocating for the theory of a "race to the top" propelled by strategic decisions of managers seeking to attract capital.

The analysis delves into the incorporation choices of unicorns, providing unique insights into the factors that sway their decisions. It challenges the prevailing notion that states like Nevada or Texas might supplant Delaware, proposing instead that Nevada and Texas should be seen as a market for suboptimal choices. The Article posits that the federal government's intervention with new corporate governance mandates poses a more substantial challenge to Delaware. This complexity underscores the considerations that both public firms and private unicorn managers weigh when selecting legal frameworks for their operations.

Emphasizing the impact of standardized documents, particularly those offered by the NVCA, the Article underscores Delaware's favored status for venture-backed startups. The NVCA's endorsement of Delaware as the preferred forum selection further cements its position, citing reasons such as the modern DGCL, well-established case law, the prestigious Court of Chancery, and an efficient Secretary of State's office. That is unlikely to change anytime soon.

The reputation and track record of Delaware's legal system, especially concerning corporate law, plays a significant role in a company's incorporation decisions. For a corporate attorney to recommend an uncharted state court to their client, that state would need to demonstrate a robust legal infrastructure, clear and well-established corporate laws, and a history of fair and efficient handling of corporate matters. The reputational risk for both the attorney and the company would indeed be substantial if the chosen state couldn't offer the same level of legal predictability, expertise, and efficiency as more established jurisdictions.

Relocation out of Delaware is a complex decision involving legal, strategic, and reputational considerations. While challenges to Delaware's dominance may emerge, any state aiming to attract significant corporate charters would need to build and maintain a legal framework that instills confidence among corporations and their legal advisors.

In conclusion, this Article contributes novel insights into the dynamics of private company charter competition, bridging the understanding gap in the market for corporate law. It illuminates the strategic considerations of unicorn firms, shaping the trajectory of incorporation choices and regulatory landscapes in the United States.