THE LEGISLATURE AS THE PLACE FOR CRAFTING POLICIES FOR CORPORATIONS: A COMMENT ON PROFESSOR EDWARDS’ PROPOSAL

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INTRODUCTION

Congratulations to Professor Edwards on presenting an interesting idea. I also praise him for turning to that most often overlooked and besmirched branch of government for a solution. I’m talking about the legislature.¹

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¹ Though they experienced a period of neglect earlier in this nation’s history, since the 1900s state legislatures have been improved. Reform efforts have focused on making the legislative process more efficient, building legislative capacity, that is, the ability of legislative bodies to perform the tasks assigned them, and professionalization of the legislators and their staff. See generally PEVERILL SQUIRE, EVOLUTION OF AMERICAN LEGISLATURES: COLONIES, TERRITORIES AND STATES, 1619–2009 at 216–324 (2012) (documenting the development of structures and procedures in state legislatures, including its increased professionalization, from the 19th through 20th centuries); ALAN ROSENTHAL, THE DECLINE OF REPRESENTATIVE DEMOCRACY: PROCESS, PARTICIPATION, AND POWER IN STATE LEGISLATURES 49–84 (1998) (exploring growth of legislative capacity, professionalization, and institutional development of state legislatures from 1960s through 1990s).

Today, one of the major political parties—the Republican Party—has re-recognized the impact that state legislatures have on everyday life. The GOP’s recent alliance with the American Legislative Exchange Council has resulted in the introduction in state legislatures of model bills written by ALEC, and coordination among the several states in advancing similar legislative agendas, regardless of the differences in state laws and cultures. See Editorial, The Big Money Behind State Laws, N.Y. TIMES, Feb. 12, 2012, at A22 (mentioning the influence of ALEC); David Firestone, Is It Too Late for a Democratic ALEC?, N.Y. TIMES, Nov. 10, 2014 (noting the interest of the Democratic Party in
I read Professor Edwards’ paper through the lens of a student of the legislature and the law-making process, so that will be the basis for my commentary. Part I describes the legislature and its powers. Part II summarizes key portions of Professor Edwards’ proposal. Part III takes a more demanding look at the proposal’s possible operation.

I. LEGISLATURE’S ROLE IN GOVERNMENT

A. Legislatures as the Lawmaking Branch of Government

For the greater part of the last 80 years, if not longer, law professors have focused on the courts as initiators of legal change. In light of the judiciary’s performance over that time, that is somewhat understandable. But courts really are not the best institutions for bringing about both wholesale and continuous change in the law. The legislature is. The drafters of the U.S. Constitution knew this, and those who wrote our respective state constitutions seem to have been similarly informed. As Alexander Hamilton put it in Federalist 78, “The legislature not only commands the purse, but prescribes the rules by which the duties and rights of every citizen are to be regulated.”

But when we get to law school, the focus is largely on the common law and the courts. Sometimes not knowing better, we allow our heads to be filled with notions that courts wield all the power, and resolve most social and legal problems. That is not true, and it was not the Framers’ design. The Framers had a more modest vision for the courts and that is the reason courts were characterized as the least dangerous branch.
According to Hamilton, courts “have neither force nor will, but merely judgment and must depend on the aid of the executive arm even for the efficacy of its judgments.” He is also falsely credited with writing in Federalist 78 that courts lack “the power of the executive branch and the political passions of the legislature.” What is true is that the legislative and executive branches have bully pulpits by which to communicate to the citizenry, and both have the personnel and apparatus to make effective their designs. Of the three branches, the legislature holds the most power because it makes the law. In short, the legislature should be the first place to go when seeking to solve legal and social problems. So, Professor Edwards is absolutely correct in situating legal problem solving in the state legislature.

B. Traditional Limitations on Courts, but Not Legislatures

Let me mention some of the time-honored constraints on courts that generally do not apply to the legislature. This comparison highlights how legislation can likely more fully address pending legal and social problems than can judicial decisions. Legislation does not have to be restricted to the parties who have prompted the legislature to act; and the presumption is that when enacted, the law applies throughout the state. In contrast, court judgments are only binding on the parties before it, and those in privity with those parties. Court judgments do have a broader sweep when, as precedents, the legal rule or principle announced in a case binds courts and parties who were not involved in the litigation.

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Dangerous Branch: The Supreme Court at the Bar of Politics (1962) (discussing the United States Supreme Court's exercise of judicial review and its impact on this nation and urging wise use of that power).

6 The Federalist, supra note 3, at 465.

7 That untruthful attribution is widespread over the internet. See also Benjamin Pomerance, Justices Denied: The Peculiar History of Rejected United States Supreme Court Nominees, 80 ALB. L. REV. 627, 628 n.4 (repeating the attribution and citing The Federalist No. 78, at 393 (Alexander Hamilton) (Garry Willis ed., 1982)).

8 See generally Abner J. Mivka and Eric Lane, Legislative Process 28 (3d ed. 2009) (Table 1-2).


11 See Restatement (Second) of Judgments § 62 cmt. a at 124–25 (discussing basic principle and three exceptions).
Legislative investigations and hearings can be wide-ranging and are not confined to the parties or facts that prompted the hearing.\(^\text{12}\) Notwithstanding this broad investigatory power, there is usually no requirement that a statute be supported by a factual record.\(^\text{13}\) The legislature cannot create a “roving commission to inquire into evils and then, upon discovering them, do anything [it] pleases,”\(^\text{14}\) but it can create administrative-type bodies with rule-making powers, so long as there is an “intelligible principle” behind that delegation of authority.\(^\text{15}\) Courts do not have similar powers of delegation or open-ended inquiry. Relatedly, court rulings are limited to the facts before them – usually as presented by the parties in the case – and judicial decisions are constricted by prudential limitations, such as standing, mootness, and redressability.\(^\text{16}\)

Legislation can be written to apply differently in slightly different situations, that is, with flexibility. Legislation may have prospective effect, retroactive application, or both.\(^\text{17}\) In most instances, judicial pronouncements are substantially less fluid, as they apply the day of decision to all entities similarly situated to those before the court.\(^\text{18}\) Legislation – particularly when it expresses the will of those to be governed by it – is the most effective and efficient way to make legal changes. In light of this, I again applaud Professor Edwards’ decision to focus on state legislatures in addressing perceived legal or social problems. Simply put, state legislatures are important.

\section*{II. PROFESSOR EDWARDS’ PROPOSAL}

Let me summarize Professor Edwards’ essential points. He proposes that other states challenge Delaware’s dominance as the nation’s leading issuer of corporate charters. To do so, a state would have to identify business law areas in which it was willing to diverge from Delaware, and then use that point of departure to attract corporations to

\begin{thebibliography}{10}
\bibitem{12} Singer & Singer, \textit{supra} note 9, §§ 12:1, 12:6.
\bibitem{13} \textit{Id.} §§ 11:11, 11:12, 12:14.
\bibitem{14} Cf. Panama Refining Co. v. Ryan, 293 U.S. 388, 435 (1934) (Cardozo, J., dissenting); see also \textit{ALA Schechter v. United States}, 295 U.S. 551, 551 (1935) (Cardozo, J., concurring) (maintaining that legislative delegation to executive was too broad).
\bibitem{16} This is especially true of lawsuits arising under Article III of the U.S. Constitution. \textit{See} Charles Alan Wright and Mary Kay Kane, \textit{Law of Federal Courts} §§ 12, 13 (8th ed. 2017).
\bibitem{17} Singer & Singer, \textit{supra} note 10, §§ 33:3, 41:2.
\bibitem{18} Singer & Singer, \textit{supra} note 9, § 1:2.
\end{thebibliography}
the state. If the state has identified an area ripe for variation and has chosen well, it could reap the reward of corporations’ reincorporating (or creating a subsidiary) in the chosen state. To ensure that it has chosen well, Professor Edwards proposes that states “simultaneously gather information useful for further amending and promoting its corporate law.”

Professor Edwards outlines some of the contours of these state laws. To ensure that new corporate governance provisions are fully heard and understood by investors, he says that states might require only midweek announcements of governance changes and that each provision be announced separately. Corporations will apparently be restricted in the governance rules they can adopt. Finally, the corporate laws would be subject to sunset, to ensure that unpopular or unsuccessful experimental provisions don’t remain on the statute books.

Professor Edwards’ proposal might be irresistibly attractive to state legislators. He is encouraging states to create a revenue stream funded by corporations, an inanimate (and sometimes faceless) entity. This stream of income would then be available for the legislature to spend at its discretion. Implicit in his proposal is that state legislatures have the desire, competence and capacity to execute his proposal. I’ll spend the balance of my commentary exploring that.

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19 Benjamin P. Edwards, Crafting Fee-Shifting Policy Crafting Fee-Shifting Policy, 20 TENN. J. BUS. L. 933, 936 (2019).

20 Id. at 937. Primary legislation has its value, but it’s difficult to believe that the state legislature will be the only authority articulating the meaning of the new laws. State agencies and the judiciary will likely continue to interpret and apply the state’s laws, so it’s unclear whether the state legislature could expect to have exclusive influence in this area. Professor Edwards anticipates that there will be judicial interpretation of these laws. Edwards, supra note 19, at 953. Notwithstanding interpretations by the state’s courts and agencies, if the state legislature is attentive to its handiwork, it could be the driving force with principal influence on the meaning of the law.

21 Id. at 951.

22 Id. at 952.

23 Id. at 953. A state probably will not pull the plug on even a failed corporate law experiment if doing so would eliminate or completely change the legal character of businesses operating in that state. More likely, it seems, that state officials would try to induce corporations that were participants in a less-than-successful experiment to be repurposed and to remain registered in the state.
III. A HARDER LOOK

A. General Concerns with the Politics of Lawmaking

Now, to Professor Edwards’ proposal that states can challenge Delaware’s corporate law dominance by adopting desirable corporate law rules unavailable under Delaware law. For those of you who like slogans, I’ll call this “being different from Delaware,” if you will.

Professor Edwards essentially posits that when states pass legislation without considering whether or how to capture information about the law’s impacts, states squander opportunities for continued improvement. To counter that, he suggests that if new state legislation were thoughtfully designed to implement changes and generate useful information, the states would become substantially more efficient laboratories and generate more social welfare. He’s absolutely correct that passing a law sends a message and that the legislature can observe the reaction of those governed by the law, and then assess whether the message sent has been accurately understood and has fostered desired conduct.

But this is an idealized view of the legislature. Namely, that the legislature will be able to identify the public interest and then act in that manner. As Joan Heminway has noted, “the legislative process is inherently political and often partisan, characterized by debate, force of will, hard-fought compromise, and deal-making.” She doesn’t wear rose-colored glasses, when it comes to the legislature.

Legislatures are political in the sense that legislators can test the mood within the state and then act, react, or choose to not act. In other words, legislatures do what they think best, when they think it best. Legislators are also partisan—and we’ve seen too much of that lately—but they most frequently act in a manner that creates clear winners and losers on policy matters. Sometimes the best reason a legislator might have for voting a particular way is that it’s what others in the party wanted. Neither this partisanship nor politics guarantee that laws enacted will be in the public interest. Politics and partisanship can also induce other legislators to not support and even oppose bills coming from the other side of the aisle. It’s the old adage, “If you’re for it, then I’m against it.”

Similarly, once a law has been enacted, some legislators may not be inclined to amend it, having claimed that the original enactment solved the

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problem. Those legislators on the other side of the aisle probably have a greater incentive to oppose any amendatory legislation that would improve the prior enacted legislation and contribute to the success of the other political party. Finally, there is no guarantee that the legislature will capture the information about the law’s impact, competently assess it, and then act in a manner that most benefits the state.

Beyond my worries about the legislature’s willingness and capacity to execute Professor Edwards’ charge, I’m more fearful that state legislatures will get their legislative Acts together (so to speak) and do as he proposes.

B. Race to the Bottom?

That brings me to my primary concern with Professor Edwards’ proposal: it may precipitate a “race to the bottom.” I know in the 1970s that critique was made of how corporate law was developing in the states.

Supporters of the legislation may well know that the enacted law has gaps, but could be content to allow the courts or the agencies to fill in those gaps. Opponents of the law may choose to do nothing in hopes that the fissures in the law undermine its impact.

The Patient Protection and Affordable Care Act, Pub. L. 111-148, is an example of all of this. Once it became apparent that the original law could not achieve its ends, the Obama Administration sought to shore up its shortcomings through executive branch maneuverings and not through legislative amendments, largely because Republicans, who were openly hostile to the law, controlled Congress. See Thomas B. Edsall, Killing Obamacare Softly, N.Y. TIMES, July 27, 2017; Amy Goldstein and Juliet Eliperin, HealthCare.gov: How a start-up failed to launch, WASH. POST, Nov. 3, 2013, at A1.

Professor Edwards’ proposal harkens back to Justice Brandeis’ dissent in New State Inc. Co. v. Liebermann, 285 U.S. 262, 311 (1932) in which he expressed: “It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”

Ideally, both the legislature and the state residents would overwhelmingly agree that the state should engage in this experimentation. See generally Mark Carl Rom, Taking the Brandeis Metaphor Seriously: Policy Experimentation within a Federal System in PROMOTING THE GENERAL WELFARE: NEW PERSPECTIVES ON GOVERNMENT PERFORMANCE (Alan S. Gerber & Eric M. Patashnik eds. 2006).

At least one scholar has already concluded that our current system of competition for corporate charters among the states serves as a laboratory of experimentation and innovation. See Roberta Romano, The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters in PROMOTING THE GENERAL WELFARE: NEW PERSPECTIVES ON GOVERNMENT PERFORMANCE (Alan S. Gerber and Eric M. Patashnik eds. 2006).

In the 1970s through the 1990s there was a spirited debate on the “race to the bottom” thesis. See, e.g., Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits

Some commentators have used the debate as a springboard to address other corporate law governance issues. See, e.g., Barry D. Baysinger and Henry N. Butler, Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law, 10 J. CORP. L. 431 (1985) (rejecting uniformity, whether imposed by a model statute or through federal regulation, on most corporate law matters in favor of determination by state regulators, which could result in greater variety in each jurisdiction); Lynn M. LoPucki, Corporate Charter Competition, 102 MINN. L. REV. 2101 (2018) (examining role of Delaware’s judiciary and legislature in fostering state’s dominant leadership position in corporate charter competition and concluding that Delaware corporations are loosely regulated and insulated from the democratic process); Jason M. Quintana, Comment: Going Private Transactions: Delaware's Race to the Bottom, 2004 COLUM. BUS. L. REV. 547 (concluding that laxity in state laws on corporate managers’ decisions to convert a public company into a private one is evidence of a race to the bottom); Steven A. Ramirez, The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top, 24 YALE J. REG. 313 (2007) (proposing a depoliticized administrative agency that promulgates corporate governance standards for public companies and those standards should be informed by economic and financial science).

Commentators had earlier noted the shortcomings of state regulation of corporations and identified issues that might be addressed through legislation. At its starkest, some maintained that state corporate law should consist primarily of enabling statutes while others promoted protective provisions to safeguard shareholder and creditor interests. See, e.g., Alfred F. Conrad, An Overview of the Law of Corporations, 71 MICH. L. REV. 623 (1973) (brief history of corporate law in other nations, extensive survey of corporate law and issues in U.S., noting multiplicity, contradictions and conflicts in the laws; questioning the suitability of federalization or state uniformity in the area); Melvin Aron Eisenberg, The Model Business Corporation Act and the Model Business Corporation Act Annotated, 29 BUS.
Then the scenario was posited that in the absence of meaningful regulation of corporate managers—by either state or federal officials—stockholders would divest their stock from corporations in which the managers placed their personal interests above those of the corporation. This divestment would, in effect, be an assessment by investors that the corporation’s principles were inimical to those of its shareholders. To prevent this race to the bottom, legal scholars proposed more rigid regulation of corporations. In contrast, a different group of scholars contended that corporate legal developments were benefitting corporate investors and facilitating a “race to the top.”

Law. 1407 (1974) (reviewing drafting history and content of American Bar Foundation’s Model Business Corporation Act and proposing pathway to obtain a “true model business corporation act”); Ernest L. Folk III, Some Reflections of a Corporate Law Draftsman, 42 Conn. Bar J. 409 (1968) (state corporate law draftsman predicting that the states will continue to enact lax laws that give corporate managers wide flexibility); Benjamin Harris, Jr., The Model Business Corporation Act – Invitation to Irresponsibility?, 50 NW. U. L. Rev. 1 (1955) (noting the Model Business Corporate Act confers discretion and protection on corporate managers while failing to hold management responsible to corporation’s shareholders or to the public); Richard W. Jennings, The Role of the States in Corporate Regulation and Investor Protection, 23 L. & CONTEMP. PROB. 193 (1958) (exploring issues and trends in state corporate and securities legislation and hoping that uniform revision and integration of the laws doesn’t defeat the goal of improving the law); Elvin R. Latty, Why Are Business Corporations Laws Largely “Enabling”?, 50 CORNELL L.Q. 599 (1965) (answering question posed in title by observing that drafters of corporate laws in U.S. are not interested in dealing with abuses that might arise from the how corporations are legally structured); Donald E. Schwartz, Symposium – Federal Chartering of Corporations: An Introduction, 61 Geo. L.J. 71 (1972) (surveying history of efforts to federalize the charting of corporations, reviewing some shortcomings of state corporate laws, and mentioning issues that would have to be addressed for federalization to be effective); Comment, Law for Sale: A Study of the Delaware Corporation Law of 1967, 117 U. Pa. L. Rev. 861 (1969) (detailed history of creation of Delaware’s corporation law and analysis of report prepared by the statute’s reporter; concluding observations on growth of corporation’s management power that might be checked by internal corporate reforms).

Here, when I say “race to the bottom,” I’m talking about what has been classified as “competitive federalism.” That concept, borrowed from political science, is that when state and local officials are allowed to determine their own policies in competition with surrounding communities or states, the officials will act in ways to promote what they perceive as in the public interest. The classic example is a state reducing its public assistance benefits to the level of its neighbors so it doesn’t become a magnet, attracting potential welfare recipients from surrounding states.

Here is an example of competitive federalism based more closely on corporate law, and the current practices of large businesses. A national retailer is thinking of relocating or opening a manufacturing plant or distribution center in the southeastern United States. Georgia has read Professor Edwards’ proposal and is about change its corporate laws so that they are more attractive to this national retailer. Georgia anticipates that these newly enacted laws will clinch a long-term deal with the national retailer. Will not the other states—at least in the southeast—do the same? Doesn’t Tennessee now have an incentive to contact the national retailer and let it know that not only will Tennessee pass laws like those under consideration in Georgia, but it will also give tax breaks and other incentives if the national retailer locates the manufacturing plant or distribution center in the Volunteer State? In fact, filing corporate charter documents and paying associated filing fees are just the beginning. Before incorporating in a jurisdiction, astute corporate managers would also ensure, among other things, that the chosen state’s laws on shareholder derivative lawsuits were favorable, and that the corporation could put favorable choice of law provisions in its contracts.

Who benefits most from this? Not the states, but the

(1989) (expressing more confidence that race to the bottom is inaccurate than that the race to the top is accurate).


31 Id.

32 See Julie Creswell, Cost of Bids to Lure Amazon? See Example at Right., N.Y. TIMES, Aug. 6, 2018, at B1 (discussing competition among cities for the planned second physical headquarters of Amazon.com).

33 It is true that states “compete with each other to create a more favorable climate for business investment,” and that this “interjurisdictional competition creates substantial incentive for states to figure out how to lessen the tradeoff between otherwise competing demands . . . to attract firms and taxpayers across the board.” Jonathan H. Adler, Interstate
corporation. The states maximize “social welfare” by giving corporate welfare; the corporation maximizes its profits.

Indeed, unlike the 1970s “race to the bottom” critique that shareholders were being slighted, if anything, under my “race to the bottom” scenario, the corporation’s shareholders benefit from this competitive federalism, because the corporation gets the best deal at the cheapest price. In short, a corporation can put each state in competition with one another in seeking to become its suitor, and then accept the sweetest deal offered. I think the politics of each state will result in corporate laws that are overly generous toward the corporation; I doubt that these laws will confer comparable benefits on the state or its residents.

34 Professor Roberta Romano seems to come to a similar conclusion after comparing the competition among the states for corporate charters:

There is, to repeat, no evidence that changing statutory domicile and hence state competition harms shareholders, and there is substantial evidence that a domicile change is a wealth-increasing event, although the positive price effects may be a function of the market’s evaluation of anticipated transactions rather than the value of the new domicile itself.


35 Years ago, Professor Roberta Romano proposed an idea somewhat similar to Professor Edwards’. She suggested that the exclusive regulation of U.S. corporations by the federal government was misplaced. In its place she suggested a system based on competitive federalism principles. According to her, corporations should be allowed to select their regulator from among the states, the federal government, or other nations. The competition among the regulators will result in regulatory arrangements compatible with corporate investors’ preferences. Firms then would locate in the domicile investors prefer, reducing the cost of capital. Furthermore, the feedback from the net flow of firms across securities regimes will provide regulators with the incentives and information to adapt their securities regimes to the firms’ domicile decisions. See ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION (AEI Press 2002).

Professor Romano’s proposal has not been adopted so it remains to be seen whether competitive federalism yields an overall boon to corporations, corporate investors and the public at large.
CONCLUSION

State legislatures are important and may fulfill the role originally imagined for them when they were created. I’m less sanguine, however, that they will rise to some of the challenges seemingly inherent in Professor Edwards’ proposal. It is nonetheless a proposal generally worth considering. Though my comments may seem overly critical, congratulations again, Professor Edwards, on your imaginative contribution. Thank you.