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Has New York Effectively Challenged Delaware's Market Dominance With Recent Amendments to the New York Business Corporation Law?

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RECENT DEVELOPMENT IN NEW YORK LAW

Has New York effectively challenged Delaware’s market dominance with recent amendments to the New York Business Corporation Law?

INTRODUCTION

For over 70 years, Delaware has cornered the market for corporate charters.\(^1\) The Delaware General Corporation Law ("DGCL") provides the most flexibility to, and imposes the fewest restrictions upon, corporate management.\(^2\) Since corporate management chooses the state in which to incorporate,\(^3\) Dela-

\(^1\) The system of incorporation by state chartering has given rise to interstate competition for the revenues derived from being the domicile of a corporation. See Curtis Alva, Delaware and the Market for Corporate Charters: History and Agency, 15 DEL. J. CORP. L. 885, 888 (1990); Roberta Romano, Competition for Corporate Charters and the Lesson of Takeover Statutes, 61 FORDHAM L. REV. 843, 843 (1993). Since the 1920s, Delaware has dominated the market for corporate charters. See Demetrios G. Kaouris, Is Delaware Still a Haven for Incorporation?, 20 DEL. J. CORP. L. 965, 966 (1995). More public corporations, including a majority of publicly traded companies in the Fortune 500, are incorporated in Delaware than in any other state. See id. In fact, 43.7% of corporations listed on the New York Stock Exchange have Delaware charters. See N.Y.S.E. Guide (CCH) 715-800 (1992). Furthermore, a large number of companies that reincorporate choose to do so in Delaware, regardless of their location. See Kaouris, supra, at 966. Kaouris posits that Delaware’s success in the market for corporate charters indicates that its corporate law is the “most developed and responsive” of all the states. Id. at 966-67.

\(^2\) See Kaouris, supra note 1, at 972, 972 n.49. For example, Delaware is one of the least restrictive states in regards to questioning management compensation, rejecting insider transactions on the basis of self-dealing and permitting indemnification of officers and directors for liability incurred in connection with their positions within, and services to, the corporation. See id. at 972 n.49.

\(^3\) See Alva, supra note 1, at 887. The incorporator generally becomes a shareholder, officer or director of the newly formed corporation. Absent bad faith, the incorporator will choose a domicile that encourages, rather than hinders, the growth, profitability and efficiency of its corporation. See id. at 887 n.6; see also First National City Bank v. Banco Para el Comercio Exterior de Cuba, 462 U.S. 611, 621
ware's substantive corporate laws account, at least in part, for Delaware's market dominance. Enhancing corporate franchise revenue provides strong motivation for states to follow Delaware's lead. Although such incentives would appear to support a "race to the bottom," the results actually support a "race to the top." A less restrictive approach to corporate law not only increases corporate franchise revenue, but also enables corporations to function more efficiently.

Never a worthy adversary of Delaware in the market for corporate charters, New York has theoretically lost millions of
dollars in potential corporate filing fees and unclaimed property from New York-based corporations that have incorporated outside of the state. The majority of these corporations have incorporated in Delaware.9 More than 30 years since its last overhaul,10 the New York Business Corporation Law ("BCL") was comprehensively amended on August 26, 1997 (effective date February 22, 1998 ("Effective Date")).11 Many believe that these amendments will "make New York more competitive with such business-friendly states as Delaware."12 Although these statutory advancements do provide greater incentives for corporations to incorporate in New York,13 the amendments to the BCL are insufficient to pose any serious threat to Delaware for two primary reasons. First, the DGCL is only one of many advantages to incorporating in Delaware and, arguably, not the most influential.14 Second, an analysis of the amended BCL provisions,

9 See Dominic Bencivenga, At Long Last, a Bill, N.Y. L.J., July 31, 1997, at 5; see also Delaware v. New York, 507 U.S. 490 (1993) (holding that New York must return $360 million of unclaimed money to Delaware, the state in which the financial institutions were incorporated).

10 See id. at 5; see also Simeon Gold & Donna Killmon, Amendments to New York's Business Corporation Law, N.Y. L.J., Aug. 14, 1997, at 1 (explaining the recent changes to the BCL). In comparison, the DGCL has been amended hundreds of times since it was first adopted in 1899. See Alva, supra note 1, at 896. In 1996, the DGCL was amended for the seventh consecutive year. See Lewis S. Black, Jr. & Frederick H. Alexander, Analysis of the 1996 Amendments to the Delaware General Corporation Law 311 (Aspen Law & Business, 1997).


12 Bencivenga, supra note 9, at 5; Peppers et al., supra note 11, at 6.

13 See infra Part II (explaining how the New York amendments compare to Delaware law).

14 See Alva, supra note 1, at 893. Delaware's success is a result of: (1) its highly developed statutes and case law, which together provide greater predictability of outcome; (2) a small and well experienced judiciary; (3) the large number of corporations already domiciled there, which increases both the rate at which precedents are set and the relative importance of franchise tax revenue; (4) a required supermajority vote of two-thirds of the General Assembly to amend the DGCL, which makes it more difficult to reverse favorable provisions; (5) the powerless and few competing interest groups; (6) the powerful presence and influence of the Delaware Bar Association in connection with the legislative process; (7) the efficiency and expediency of the corporation service companies, which send representatives to the Delaware Bar Association to provide legislative recommendations; and (8) the specialized, jury-free chancery courts with direct appellate review by the Delaware Supreme Court. See id. at 893, 895, 898, 902-03; see also Kaouris, supra note 1, at 972-78 (discussing the advantages of Delaware incorporation).

New York is not in a position to emulate Delaware's successful paradigm.
and one troublesome provision which was not repealed, indicates that the BCL still fails to address corporate needs as well as the DGCL does. Part I of this Recent Development will discuss the latest improvements to the BCL. In Part II, certain amended provisions of the BCL will be compared to their DGCL counterparts to determine whether New York has successfully improved its competitive advantage. Ultimately, this Recent Development concludes that although New York has fashioned many necessary improvements to the antiquated BCL, New York's legislative failings spell doom for its standing in the market for corporate charters.

I. NECESSARY IMPROVEMENTS TO THE BCL

A. Modernization of Voting Rights

Although “owner participation in corporate governance is necessary and proper[,]” a trend against maximum participation has developed over the past few decades. This trend developed from: (i) the increasingly common substitution of market discipline for legal rules and (ii) the belief in majority rule, a
derivation of our democratic principle of one person - one vote." Yet, the question arises as to what is the proper statutory response to the "inherent conflict between protecting the rights of the minority while allowing the democratic majority to rule[?]"

Although some may argue that supermajority voting requirements are more beneficial, the statutory imposition of a simple majority standard is actually the more beneficial approach since it does not preclude self-imposed higher voting requirements. The imposition of a minimum majority vote increasingly leaves corporate governance in the appropriate hands of the contracting

tributed to judicial-institutional decisions on governance); see also Lucian Arye Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 HARV. L. REV. 1820 (1989). Bebchuk discusses four popular market disciplinary rules which influence managerial decisions. See id. at 1841. First, "[t]he managerial labor market induces managers to be concerned about the effect of their actions on share value and on shareholders' interests" since current compensation and future employment potential are tied to a corporation's success during such managers' tenure. Id. at 1841. Second, the market for corporate control is premised on the notion that if management implements value-decreasing programs, the value of the shares will drop and the corporation will become a prime takeover target. See id. at 1843-44. Third, the market for additional capital conditions a corporation's access to equity markets on management's value-maximizing behavior. See id. at 1844. Lastly, the product market imposes constraints on management since inefficient activity will result in inadequate products, thus reducing the corporation's ability to effectively compete for consumers. See id. at 1845.

Although Bebchuk attempts to discredit the efficacy of each individual market, these four markets working in conjunction with one another clearly shield shareholders from the agency costs associated with management's self-interested, though not necessarily value-decreasing, proposals. See John C. Coffee, Jr., The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 COLUM. L. REV. 1618, 1619 (1989) (noting that the "focus has generally shifted from law to economics and, more specifically, to the question of whether market forces provide an adequate substitute for actual bargaining" in the debate over contractual freedom in corporate law).

See Brett W. King, The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection, 21 DEL. J. CORP. L. 895, 896 (1996) (analogizing managerial power to that of governmental power). The author states that "[i]n both the Constitution and the corporate charter, the 'natural' desire [is] to let the majority rule through a 'fair,' one person-one vote system." Id. at 895-96.

King, supra note 19, at 896 (arguing that "a supermajority rule reduces externalities among voters but increases the cost of decision making"). Recently, supermajority voting has been employed by management as an anti-takeover defense under the guise of protecting minority shareholders from "coercive, front-end loaded, two tier tender offers." Id. at 918-19. Such tactics actually resulted in the entrenchment and unjust enrichment of incumbent management by discouraging and increasing the cost of legitimate offers. See id. at 919. Thus, supermajority voting does not necessarily lead to the protection of minority shareholders.
parties: shareholders, management and the corporate entity.\(^{21}\) The corporate charter and bylaws, which together comprise the written contract among the parties, serve as a means by which the contracting parties can accept the minimal statutory requirements or opt out, voluntarily agreeing to a higher standard of participation.

By reducing the minimum vote statutorily required for certain extraordinary transactions to a simple majority, New York has chosen to provide its corporations with this contractual freedom.\(^{22}\) The recent amendments apply to all companies that incorporate within the state subsequent to the Effective Date. With the exception of shareholder action by written consent, which applies both prospectively and to pre-existing corporations, corporations already in existence must choose to opt into these reduced requirements by charter amendment before they can reap these statutory benefits.\(^{23}\) Shareholder action by written consent may now be effected by a majority, rather than unanimity, of the votes required by law or by the charter to approve the specific proposal.\(^{24}\) Charter amendments restricting the board's power or transferring such power to shareholders may now be approved by a majority of the votes of all outstanding shares entitled to vote thereon, rather than the previous requirement of a unanimous vote.\(^{25}\) The number of votes required

\(^{21}\) The “nexus of contracts” theory contends that “the corporate entity is nothing more than a metaphor for a conglomeration of a series of voluntary agreements among the various participants in the enterprise.” Bebchuk, supra note 18, at 1821, 1821 n.2; see also Buxbaum, supra note 16, at 915-17 (explaining the emergence of the “nexus of contracts” theory). In deference to the common law freedom of contract principles, parties should be permitted to shape their own arrangements, and corporate law should provide only standard forms that the contracting parties may choose to follow. See Bebchuk, supra note 18, at 1821. Yet, legal rules have not relaxed to the extreme point of serving only as standard forms. Rather, the trend is for legal rules to provide a minimum level of protection in accordance with our standards of justice and equity, allowing the contracting parties to choose an appropriate level of protection at or above that which is statutorily imposed. See id.

\(^{22}\) See supra notes 24-28 and accompanying text.

\(^{23}\) See supra note 11, at 6. Since a charter amendment is required to opt in to these reduced voting requirements, this is a classic example of freedom to contract. Shareholders who do not wish to reduce the corporation's voting requirements can simply withhold their consents.

\(^{24}\) See N.Y. BUS. CORP. LAW, ch. 449, sec. 35, § 620, 1997 N.Y. Laws 1332, 1346. In the past, courts have disfavored and often invalidated attempts to delegate the board's duty to exercise its best judgment under the circumstances. See Coffee, supra note 18, at 1642-44. Although this restriction did not prove burdensome on pub-
to amend the corporate charter for the purpose of increasing a director quorum has been reduced from two-thirds to a majority of the votes of all outstanding shares entitled to vote thereon. Arguably, the most significant of all the BCL amendments is the reduction of votes required to approve a merger or consolidation from two-thirds to a majority of the votes of all outstanding shares entitled to vote thereon. Similarly, asset dispositions, share exchanges and corporate dissolutions may now be approved by a majority of the votes of all outstanding shares entitled to vote thereon, as opposed to the previous two-third requirement. Reducing the statutorily imposed minimum vote for these transactions from a supermajority to a simple majority comports with the notion that leaving contractual provisions in the hands of the contracting parties is more beneficial than blindly imposing blanket regulation.

The BCL now more clearly acknowledges weighted and tenured voting rights. Unequal voting (or classified) stock serves

lic corporations, close corporations were at times adversely affected by the invalidation of certain arrangements which seemed perfectly reasonable under the circumstances. See id.; see also McQuade v. Stoneham, 189 N.E. 234 (N.Y. 1934) (exemplifying the adverse effect of such restrictions on close corporations).

Numerous revisions to the BCL clarify the distinction between shares eligible to vote and eligible votes. See, e.g., N.Y. BUS. CORP. LAW, ch. 449, sec. 2, § 104(d)(4), 1997 N.Y. Laws 1332, 1333 (allowing holders of a majority of the votes of all outstanding shares entitled to vote to amend the certificate of incorporation where no directors or officers hold office); N.Y. BUS. CORP. LAW, ch. 449, sec. 15, § 513(e), 1997 N.Y. Laws 1332, 1336 (requiring a majority of votes cast to approve the repurchase of shares at higher than fair market value); N.Y. BUS. CORP. LAW, ch. 449, sec. 24, § 603(a), 1997 N.Y. Laws 1332, 1341 (permitting bylaws to be amended, adopted or repealed by a majority of the votes of all outstanding shares entitled, at the time, to vote in the general election for directors); N.Y. BUS. CORP. LAW, ch 449, sec. 27, § 608(a)-(b), 1997 N.Y. Laws 1332, 1341 (permitting a special meeting to be called for the purpose of electing directors by 10% of the votes of all outstanding shares entitled to vote thereon); N.Y. BUS. CORP. LAW, ch. 449, sec. 34, § 616(a)-(b), 1997 N.Y. Laws 1332, 1345-46 (basing greater requirement as to quorum or vote of shareholders on the number of votes, not the number of shares); N.Y. BUS. CORP. LAW, ch. 449, sec. 47,
three primary purposes: (i) improving a corporation's ability to thwart hostile takeover bids,\(^3\) (ii) improving a corporation's financing flexibility,\(^3\) and (iii) protecting minority shareholders.\(^3\) Often concentrated within the hands of management, "supervoting stock"\(^3\) can ensure that a merger transaction will not be consummated without management's seal of approval.\(^3\) Although this appears to result in a divergence of interests, man-

716(c), 1997 N.Y. Laws 1332, 1350 (permitting action for the removal of an officer to be brought by 10% of votes of outstanding shares whether or not otherwise entitled to vote); N.Y. BUS. CORP. LAW, ch. 449, sec 49, § 803(a), 1997 N.Y. Laws 1332, 1350 (permitting a charter amendment by the affirmative vote of a majority of the outstanding shares and requiring a higher vote to amend or repeal provisions that provide for greater voting requirements); N.Y. BUS. CORP. LAW, ch. 449, sec. 57, § 908, 1997 N.Y. Laws 1332, 1356 (permitting authorization of a guarantee, not in furtherance of corporate purposes, by two-thirds of votes of all outstanding shares entitled to vote thereon); N.Y. BUS. CORP. LAW, ch. 449, sec. 60, § 912(d)(3), 1997 N.Y. Laws 1332, 1357 (requiring a majority of votes of outstanding voting stock to approve a business combination with an interested shareholder); N.Y. BUS. CORP. LAW, ch. 449, sec. 64, § 1002(a), 1997 N.Y. Laws 1332, 1364 (permitting the certificate of incorporation to provide for a specified number or proportion of shares, or votes of shares, to approve dissolution); N.Y. BUS. CORP. LAW, ch. 449, sec. 65, § 1005(a)(3)(A), 1997 N.Y. Laws 1332, 1365 (permitting, upon dissolution, the sale of remaining assets and distribution of consideration received to be approved by a majority of votes of all outstanding shares entitled to vote thereon); N.Y. BUS. CORP. LAW, ch. 449, sec. 66, § 1103(b)-(c), 1997 N.Y. Laws 1332, 1365 (permitting meeting for dissolution to be called by 10% of votes of all outstanding shares entitled to vote thereon); N.Y. BUS. CORP. LAW, ch. 449, sec. 67, § 1104(a)-(b), 1997 N.Y. Laws 1332, 1365 (permitting one-half of the votes of all outstanding shares entitled to vote to petition for judicial dissolution); N.Y. BUS. CORP. LAW, ch. 449, sec. 68, § 1104-a(a), 1997 N.Y. Laws 1332, 1365 (allowing at least 20% of the votes of all outstanding shares entitled to vote to petition for judicial dissolution of close corporations under certain circumstances).

\(^3\) See Buxbaum, supra note 16, at 1713 ("The current revival of nonvoting common stock—and the reinvention of its correlate, supervoting shares—is the result of the search for ‘showstopping’ defenses to hostile takeover bids."); see also Carol Goforth, Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late, 43 AM. U. L. REV. 379, 409 n.181 (citing research performed on the effectiveness of using unequal voting as an anti-takeover device).

\(^2\) See Buxbaum, supra note 16, at 1714; see also Douglas C. Ashton, Revisiting Dual-Class Stock, 68 ST. JOHN'S L. REV. 863, 876 (1994) (arguing that the creation of a new class of stock is often used to raise capital).


\(^2\) "Supervoting stock" is a term of art that describes a class of stock with greater voting rights than the other classes of stock. See David S. Freeman, Shark Repellant Charter and Bylaw Provisions, 16 J. CORP. L. 491, 507 (1991).

\(^3\) See Buxbaum, supra note 16, at 1714 (citing SUBMITTING ON SHAREHOLDER PARTICIPATION AND QUALITATIVE LISTING STANDARDS, N.Y. STOCK EXCH., DUAL CLASS CAPITALIZATION 3 (1985) (Initial Report)).
agers, in this scenario, are also shareholders, thus reducing agency costs. Classified stock also provides a corporation with the opportunity to develop separate equity markets. Since investors often have different interests and concerns, differentiated equity will appeal to a wider range of investors. For example, short-term investors are interested in a quick profit, while long-term investors may be more interested in exercising significant control over a company. Furthermore, classified stock enables corporations to establish a classified board, which provides greater accountability to shareholders. In response to the market's demand for statutory protection of classified stockholders, the amended BCL includes a revised separate voting requirement for charter amendments that adversely affect a particular class. Thus, minority shareholders are protected from certain charter amendments that could maximize the value of certain shares at the expense of others.

B. Increased Financing Flexibility

1. General Finance

New York has responded to its corporations' needs for more financial flexibility with a series of beneficial amendments. Prior to the amendments, New York distinguished between capital and earned surplus, such as the former requirement that

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55 See WILLIAM L. CARY & MELVIN ARON EISENBERG, CORPORATIONS 136 (7th ed. 1995) ("The basic elements of common stock, preferred stock and debt are often just ingredients for designing more exotic corporate securities.").

56 See generally VICTOR BRUDNEY & MARVIN A. CHIRELSTEIN, CORPORATE FINANCE 133-35 (3rd ed. 1987) (comparing the functions of common stock and senior securities such as preferred stock and debt).

57 See Buxbaum, supra note 16, at 1715-16.

58 See N.Y. BUS. CORP. LAW, ch. 449, sec. 50, § 804(a), 1997 N.Y. Laws 1332, 1351. Similar to its DGCL counterpart section 242, section 804 was revised to require that all series of stock within a class that would be affected by a proposed charter amendment vote together as one class and that if a proposed charter amendment adversely affects only one series or class of stock, such affected holders will vote together as a single class. Compare N.Y. BUS. CORP. LAW, ch. 449, sec. 50, § 804(a), 1997 N.Y. Laws 1332, 1351, with DEL. CODE ANN. tit. 8, § 242 (1996).

59 See N.Y. BUS. CORP. LAW, § 102(a)(2) (McKinney 1986) (repealed 1997) (defining "capital surplus" as "surplus other than earned surplus"); see also N.Y. BUS. CORP. LAW § 102(a)(6) (McKinney 1986) (repealed 1997).

"Earned surplus" means the portion of the surplus that represents the net earnings, gains or profits, after deduction of all losses, that have not been distributed to the shareholders as dividends, or transferred to stated capital or capital surplus, or applied to other purposes permitted by law. Unre-
corporations provide special notice with any dividend paid from sources other than earned surplus. The BCL amendments have nullified this distinction, freeing corporations from the vexatious calculations formerly required under the defunct section 517. Likewise, the BCL now permits the flexible management of a corporation's stated capital. The board may reduce stated capital by applying to a purchase, redemption, conversion or exchange some or all of any stated capital attributed to such shares and/or any unallocated stated capital. Since surplus equals "the excess of net assets over stated capital," the reduction of stated capital results in an increased surplus. Since certain value-increasing transactions may only be funded from surplus, such as paying dividends and effecting stock repurchases and redemptions, increasing surplus enables corporations to par-

alized appreciation of assets is not included in earned surplus.

Id.


See N.Y. BUS. CORP. LAW, ch. 449, sec. 17, § 516(a)(4), 1997 N.Y. Laws 1332, 1339. This amendment does not apply, however, to shares issued without par value and for which the consideration was set by the shareholders. See id. "[T]he board [of directors] shall not reduce the stated capital represented by such shares except to the extent, if any, that the board was authorized by the shareholders to allocate any portion of such consideration to surplus." Id.

See N.Y. BUS. CORP. LAW § 102(a)(13) (McKinney 1986).

See N.Y. BUS. CORP. LAW, ch. 449, sec. 18, § 517, 1997 N.Y. Laws 1332, 1339. Increased surplus that results from reduced stated capital, known as reduction surplus, "can be distributed to shareholders directly" or "used to eliminate an earned surplus deficit, thereby freeing future earnings for distribution." CARY & EISENBERG, supra note 35, at 1365.

ticipate in market-friendly transactions. The BCL has also loosened restrictions upon redemptions, conversions and exchanges. In terms of redemptions, the BCL now permits the issuance of redeemable common stock, provided however, that there are outstanding shares of another class or series of common stock that is not redeemable.\(^4\) Corporations may now issue equity or debt securities whether they are convertible or exchangeable into cash, property, or securities.\(^4\) Restrictions on the issuance of preferred stock are now left substantially in the hands of management.\(^4\) Additionally, companies that incorporate after the Effective Date, or that opt in, may now distribute shares of any class or series to shareholders of any class or series, and preemptive rights will no longer be granted in connection therewith.\(^5\) Lastly, contrary to traditional common law notions of valid consideration, acceptable consideration for issuance of securities now includes binding obligations to pay cash or other property as well as binding obligations to perform services with agreed values.\(^5\) In light of such changes, New York corporations


\(^5\) See infra Part I.C.1; see also infra notes 55 and 56 and accompanying text.

are now better able to respond to market demands.

2. Pre-emptive Rights

"At common law[,] ... each existing shareholder [of a corporation] had the right to subscribe to her proportionate part of a new issue of stock of the class she held" in order to protect herself from issuances that would dilute her ownership rights and interests. As the tide turned against the granting of pre-emptive rights, many modern corporate statutes provided a presumption against pre-emptive rights, absent a contrary charter provision. Previously failing to follow this trend, New York now presumes in section 622 that shareholders have no pre-emptive rights, absent a charter provision to the contrary. The reversal of this antiquated presumption enables the contracting parties to determine whether such rights are appropriate for their given circumstances without the looming imposition of an outdated concept.

C. Corporate Governance Issues

1. Director Flexibility

Since the operation of the corporation's business vests with the board of directors, providing flexibility to the board improves
corporate efficiency. Thus, the BCL now presumes that the board of directors has the power to change the number of shares of preferred stock, absent a contrary charter provision. Although questionable on the surface, authorizing the board of directors to amend the charter, which is the basic contractual agreement among the parties, in this instance empowers management to make necessary financial decisions without being inhibited by the time-consuming shareholder approval process. Similar results had been attained in the past by having shareholders approve blank stock. "Blank stock," preferred stock authorized completely without attributes, enables directors to issue new series of preferred stock absent shareholder approval of a charter amendment. Such ends may now be achieved more directly by use of the new statutory provisions.

Another way in which New York has allowed for greater flexibility in the governance of close corporations is through the relaxation of quota requirements. Now, the board of directors of a corporation needs only one member to constitute a board. Likewise, a committee of the board of directors may be com-

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52 See N.Y. Bus. Corp. Law, ch. 449, sec. 3, § 402, 1997 N.Y. Laws 1332, 1333 (requiring an express charter provision to limit the board's presumed authority to change the number of authorized shares of preferred stock); N.Y. Bus. Corp. Law, ch. 449, sec. 6, § 502, 1997 N.Y. Laws 1332, 1333-34 (allowing existing corporations to amend their certificate of incorporation in order to avail themselves of the flexibility enjoyed by new corporations).

53 See Buxbaum, supra note 16, at 1685 ("[F]lexibility is inconsistent with a requirement for shareholder approval of stock issuance in all but the smallest corporation."). But see id. at 1695 (warning that charter provisions transferring significant voting power to the board of directors jeopardize the proper functioning of the "'market for voice[,]’ ... an essential underpinning of the entire efficiency-monitoring concept").


55 See Buxbaum, supra note 16, at 1685 (referring to “blank stock” as a term of art). Preferred stock attributes typically include “rights, preferences and privileges." Id. at 1684. Such attributes may, if incorporated by agreement, include dividend rights, liquidation preferences, voting rights, pre-emptive rights and conversion rights. See Cary & Eisenberg, supra note 35, at 133-36.

56 See Buxbaum, supra note 16, at 1684-85 (noting that the board of directors utilizes boilerplate language in the certificate of incorporation in order to gain authorization for the issuance of “blank stock”).

57 See N.Y. Bus. Corp. Law, ch. 449, sec. 38, § 702, 1997 N.Y. Laws 1332, 1348. The new amendment removes the requirement that a board of directors must consist of at least three persons and sets the default number, if not specified in the articles of incorporation, as one. See id.
prised of as few as one director. Lastly, in recognition of the prevalence of technology, New York will now presume that telephonic board meetings are acceptable, absent a contrary charter provision. While courts have become increasingly concerned with maximizing share value, this friendlier approach to managerial power will not necessarily lead to value-minimizing behavior.

Although granting wide latitude to management, shareholders can still seek the protection of the “Classified Board,” which consists of board members elected by and dedicated to the needs of a particular class of shareholders. To ensure that Classified Boards provide a higher degree of accountability, the BCL requires that each class within a Classified Board consists of directors nearly equal in number. Some additional protection is supplied by the requirement that the vacancy of a director who had represented a particular class of shareholders be filled only by other directors who had been elected by the same class of shareholders, until such shareholders can elect a replacement. These restrictions preserve the integrity of the Classified Board in its quest for shareholder protection.

To further facilitate director flexibility, New York has followed the trend against invalidating interested director transactions. The BCL now permits corporations to loan money to, or

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64 See id.; see also Bevis Longstreth, Warren E. Buffet On Corporate Constituency Laws and Other Newfangled Ideas: An Imaginary Conversation, 19 CARDOZO L. REV. 363, 368 (1997) (noting that the best interests of the corporation is synonymous with the best interests of the shareholders).
65 See generally CARY & EISENBERG, supra note 35, at 422-24 (discussing classified stock as one of the easiest and most effective means of assuring board representation for minority shareholders).
66 See N.Y. BUS. CORP. LAW § 704(a) (McKinney 1986).
67 See N.Y. BUS. CORP. LAW, ch. 449, sec. 40, § 705(d), 1997 N.Y. Laws 1332, 1348; N.Y. BUS. CORP. LAW § 705(c) (McKinney 1986).
68 See N.Y. BUS. CORP. LAW § 713(a) (McKinney 1986) (stating that “[n]o contract or other transaction between a corporation and one or more of its directors ... shall be either void or voidable for this reason alone”); see also Kaouris, supra note 1, at 982-83.

At common law, all interested director transactions were ‘voidable at the election of the corporation.’ As the law evolved, interested director transactions approved by a majority of disinterested directors were upheld, if
guarantee the obligations of, their directors with either shareholder or board approval.\textsuperscript{69} Holders of a majority of shares entitled to vote on the transaction, exclusive of any shares held of record or beneficially by the director at issue, shall constitute a quorum for the purpose of approving such a transaction.\textsuperscript{70} Alternatively, the board of directors of a corporation incorporated after the Effective Date, or of a pre-existing corporation that opts in, may approve such a transaction if the board determines that the transaction benefits the corporation.\textsuperscript{71} This more lenient stance on interested director transactions enables corporations to compete more effectively for value-maximizing managers.

\textsuperscript{69} See NY. BUS. CORP. LAW, ch. 449, sec. 45, § 713, 1997 N.Y. Laws 1332, 1349-50. New York has recognized that the revised version of section 714 “provide[s] a corporation with additional flexibility while the existing provisions in the BCL regarding interested directors should serve to protect the corporation against overreaching.” MEMORANDUM IN SUPPORT, supra note 41, at A-702.

\textsuperscript{70} See NY. BUS. CORP. LAW, ch. 449, sec. 45, § 714, 1997 N.Y. Laws 1332, 1350.

\textsuperscript{71} See id. The director who benefits from the transaction may not participate in the approval of such transaction. See id. If the votes of the disinterested directors would be insufficient to constitute an act of the board pursuant to the BCL or the corporation’s bylaws, then unanimous approval of the disinterested directors is sufficient to approve the transaction. See id.
2. Informational Issues

New York has alleviated some burdensome statutory rights to corporate information. Shareholders have the right to inspect the books and records of the corporation "for any purpose reasonably related to such person's interest as a shareholder."72 However, when this right is now exercised, corporations no longer bear the burdens of (i) providing documentation not in their possession, (ii) providing the requested information in any format other than that in which they maintain such information and (iii) providing such information to former employee claimants under section 630.73 With respect to non-shareholders, non-employee third party creditors no longer have the right to obtain lists of the officers or directors of a corporation.74 Furthermore, claimants who retain the right to such lists no longer have access

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72 NY. BUS. CORP. LAW, ch. 449, sec. 37, § 624(b), 1997 N.Y. Laws 1332, 1347. This language mimics § 220 of the DGCL. See DEL. CODE ANN. tit. 8, § 220(b) (1991). For an application and analysis of § 220 by the Delaware Chancery Court, see Compag Computer Corp. v. Horton, 631 A.2d 1 (Del. 1993). See also Skouras v. Admiralty Enters. Inc., 386 A.2d 674, 679-80 (Del. Ch. 1978) (holding that a stockholder's request to examine a closely held company's books and records in order to investigate his suspicions of corporate mismanagement constituted a "proper purpose" as per the statute); Skoglund v. Ormand Indus., 372 A.2d 204, 207 (Del. Ch. 1976) (stating that the right of a stockholder to inspect books and ledgers is measured by the propriety of his purpose).

73 See N.Y. BUS. CORP. LAW, ch. 449, sec. 37, § 624(b), 1997 N.Y. Laws 1332, 1347-48. Section 630 imposes liability for unpaid employee compensation on the ten largest shareholders of a private corporation. See N.Y. BUS. CORP. § 630 (McKinney 1986). Previously, employee claimants were entitled to the same inspection rights as shareholders. New York has seen fit to deny this right to such claimants. See N.Y. BUS. CORP. LAW, ch. 449, sec. 37, § 624, 1997 N.Y. Laws 1332, 1347. This is probably because section 630 gives them recourse against the shareholders individually, not the corporation. See N.Y. BUS. CORP. LAW § 630 (McKinney 1986). Interestingly, while employee interests were adversely affected under section 624, the bulk of protection under section 630 remained intact. See Richard Siegler, Impact of Business Corporation Amendments, N.Y. L.J., Oct. 29, 1997 at 3 (noting that shareholders with significant stakes must be wary since section 630 was not amended); see also Gold & Killmon, supra note 10, at 1 (stating that labor union opposition to the removal of section 630 pressured legislators into keeping the status quo).

Pursuant to section 1315, foreign corporations doing business in New York are also subject to shareholders' rights to obtain shareholder lists. See N.Y. BUS. CORP. LAW, ch. 449, sec. 69, § 1315, 1997 N.Y. Laws 1332, 1365-66. These corporations are no longer required to deliver any information which is not in their possession. They are also not required to deliver the requested information in any format other than that in which they maintain such information. See id. Although this amendment is directed at foreign corporations and, therefore, inapplicable to companies incorporated in New York, it is indicative of New York's more relaxed approach to corporate governance issues.

to the officers’ and directors’ residences. Such information rights have been abridged rightfully. Statutory law should not impose costly, time-consuming burdens on corporations, absent an extremely compelling reason therefor.

D. Modernization of Mergers and Consolidations

1. Hybrid Business Organizations

New York has responded to the increasing popularity of hybrid business organizations. The versatility of limited liability companies has diminished the use of classic business organizations such as the close corporation, the general partnership and the limited partnership. The recent popularity of the limited liability company is attributable to its favorable tax treatment and the opportunity for active participation without the risk of personal liability. Members of a limited liability company may actively participate in management without the potential exposure to personal liability. Furthermore, such members may elect pass-through federal tax treatment. Although New York’s Limited Liability Company Law permits a limited liability company to merge or consolidate with another business entity, the BCL had limited its provisions on mergers and consolidations to corporations interacting with one another. Prior to the BCL amendments, limited liability companies had gone unmentioned. This oversight has been clarified. The ninth article of the BCL, which now expressly grants to limited liability companies the ability to merge or consolidate, will prove useful.

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75 See id.
76 See Kathleen D. Fuentes, Comment, Limited Liability Companies and Opting-Out of Liability: A New Standard for Fiduciary Duties?, 27 SETON HALL L. REV. 1023, 1023 (1997) (addressing the need for higher levels of accountability resulting from the increased flexibility of limited liability companies).
77 See id. See generally N.Y. LIM. LIAB. CO. LAW §§ 401-420, 609 (McKinney 1998).
78 See Fuentes, supra note 76, at 1023.
79 See id.
80 See N.Y. LIM. LIAB. CO. LAW §§ 1001-1004 (McKinney 1998) (allowing for merger or consolidation and stating procedures, contents of certificate and effect of merger or consolidation).
81 See N.Y. BUS. CORP. LAW § 901 (McKinney 1986) (omitting limited liability companies from the express statutory language).
82 See N.Y. BUS. CORP. LAW, ch. 449, sec. 51, § 901, 1997 N.Y. Laws 1332, 1351 (granting limited liability companies the power to merge or consolidate); id. at sec. 52, § 902, 1997 N.Y. Laws 1332, 1351-52 (requiring a plan of merger or consolidation.
to corporations that utilize hybrid business organizations. New York businesses’ utilization of hybrid business organizations in the consummation of complex corporate transactions has now been sanctioned by the state.

2. Appraisal Rights

At common law, minority shareholders had an absolute veto over extraordinary transactions; however, as this burdensome protection gave way to lower voting requirements, appraisal rights were granted as compensation. The BCL now acknowledges that appraisal rights, though effective in some circumstances, are not effective in others. Section 910 grants appraisal rights to non-voting shares that do not survive merger or consolidation. A provision for appraisal rights under these circumstances is appropriate, particularly since appraisal rights are considered the price paid for majoritarian rule. Section 910 now denies appraisal rights to shareholders of a New York public
corporation that merges or consolidates. The denial of appraisal rights to shareholders of a merging public corporation is appropriate, particularly since such shareholders have the protection of a liquid market. This liquid market is arguably a more efficient and effective remedy than the burdensome appraisal proceeding. New York has acknowledged that appraisal rights provide shareholders with a viable remedy to corporate abuse only under certain circumstances.

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87 See N.Y. BUS. CORP. LAW, ch. 449, sec. 59, § 910, 1997 N.Y. Laws 1332, 1357. New York has adopted the "stock market exception" to appraisal rights. See 18A AM. JUR. 2D Contracts § 809 (1985). The stock market exception is justified on two primary grounds: (i) dissenting shareholders are adequately protected by a liquid market for their shares and (ii) given such protection, the "appraisal remedy should not unduly inhibit necessary corporate flexibility." Id. Although the stock market exception has been criticized for reliance on volatile conditions, courts often give substantial weight to the market value when determining the fair value of shares in an appraisal proceeding. See Mills v. Electric Auto-Lite Co., 552 F.2d 1239, 1247 (7th Cir. 1977) (stating that "market value will always be the primary gauge of an enterprise's worth"). Since market forces are inextricably linked to share value, this argument against the stock market exception carries little weight. But see MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS § 7.3, at 81-82 (Little Brown 1976) (postulating that relying merely on market prices serves to harm a large minority block owner due to depressed prices resulting from the sale of a large block of shares).

88 Market mechanisms are, indeed, sufficient to protect dissenting shareholders without the onerous burden of subjecting the public corporation, as well as the individual shareholders, to an appraisal proceeding. Dissenting shareholders who wish to resell generally face little difficulty since the market often responds favorably to the announcement of extraordinary transactions. Additionally, bidders generally price their offers above market value to attract interested sellers with a premium. Thus, not only do public dissenters have access to a liquid market, but they have access to a stimulated market. See generally EISENBERG, supra note 87, § 7.3, at 79 (discussing the pros and cons of appraisal rights in publicly-held corporations and noting that "[i]n contrast [to shareholders in closely held corporations] a shareholder in a publicly held corporation normally can withdraw by selling his shares on the market").

For a discussion on the effectiveness of appraisal proceedings, see Bebchuk, supra note 18, at 1852-56. Addressing "whether appraisal rights can be designed to perform their desired screening function with appropriate precision," Bebchuk argues that the appraisal remedy is an inefficient means by which to protect minority shareholders. Id. at 1853-54. First, "rational ignorance problems," combined with exorbitant transaction and litigation costs, would deter a substantial number of shareholders from filing for appraisal. Id. Second, the anticipation of shareholders invoking the appraisal remedy would not necessarily deter management from adopting potentially value-decreasing programs since management's cost-benefit analyses of such programs will account for the added expense. See id. at 1854. Lastly, courts are generally incapable of accurately determining the fair value of a dissenter's shares. See id. at 1854-55. Without an accurate estimation of value, appraisal rights cannot adequately address the imperfections of the amendment process. See id. at 1855-56.
II. HOW THE BCL AMENDMENTS MEASURE UP TO THE DGCL

A. Modernization of Voting Rights

The imposition of unreasonable voting standards conflicts with the principles of contractual freedom. Shareholder action by written consent provides an example of Delaware's more contractual approach to the regulation of shareholder voting. New York follows the stringent common law approach to shareholder action by written consent with minor modification. Skeptical of shareholder action without a meeting, action by written consent was only permitted if unanimously approved. New York has retained the common law presumption, permitting corporations to opt out only by charter amendment and only by reducing the percentage of votes needed to that which would have been sufficient to approve the proposal at an actual meeting. The DGCL presumes that shareholder action without a meeting can be approved by the same percentage of votes which would have been able to approve such action at an actual meeting, absent a contrary charter provision. While it is true that in each state such minimum consent may approve an action, a higher burden is placed upon a New York corporation because it must include an authorizing provision in its certificate of incorporation, or later amend its charter. Furthermore, Delaware, in its effort to
promote freedom of contracts, provides even greater flexibility to its corporations by permitting even lower consent requirements pursuant to a bargained-for charter provision. Market forces respond favorably to contractual freedom since it enables contracting parties to design corporate arrangements best suited for their needs.

A corporation's ability to amend its charter provides another example of the inefficiency of New York's restrictions. The BCL expressly requires the approval of at least two-thirds of the votes of all outstanding shares entitled to vote on a change in the voting percentages of shares, or such greater requirement as may be provided by the charter, whereas the DGCL simply requires majority approval for charter amendments, absent a contrary charter provision. Similarly, although both New York and Delaware provide special voting rights for series or classes of stock adversely affected by proposed charter amendments, Delaware corporations may contract in their charters for majority approval of any increase or decrease (but not below the number of shares outstanding) of the number of authorized shares of any such series or class of stock, notwithstanding the special voting rights discussed above. Delaware clearly realizes the economic importance of leaving voting requirements in the hands of voters.

B. Increased Financing Flexibility

New York still fails to adequately address the financing needs of its corporations. The granting of stock options to key employees, officers and directors is a powerful financial tool that enables a corporation to effectively compete for top executives while simultaneously reducing agency costs. Yet, New York

peers who are on statutory notice of the voting requirements. Thus, New York's classic approach to shareholder written consent fails to achieve its protectionary goal.


97 Stock option plans "assist in attracting and retaining particularly valuable management level personnel" by providing extra compensation inextricably linked to management's performance. 18B Am. Jur. 2d Corporations § 1957 (1966). Stock option plans also reduce agency costs since managers who hold stock options are
continues to require stockholder approval for the issuance of stock options to employees, directors and officers. Concern over share dilution may have prompted this regulation. However, this concern is better addressed by a bargained-for charter provision than by blanket regulation. New York further precludes its corporations from adequately addressing other financial needs by limiting corporations’ ability to repurchase their shares at a price above fair market value (absent shareholder approval), and to pay dividends out of net profits. Stock repurchases above fair market value may be beneficial to the corporation in certain situations, such as where the stock is undervalued in the market or where the corporation must pay a premium to the selling shareholders. Stock repurchases, as well as dividend payments, are integral to the financial health of a corporation since these events send messages of fiscal strength to the market. Limiting the financial responsiveness of New York corporations to market demands discourages incorporation in New York.

C. Extraordinary Transactions

Although New York has made an effort to modernize statutory regulation of certain extraordinary transactions, New York corporations still face obstacles which their Delaware counterparts do not. For example, New York requires the grant of appraisal rights to shareholders, in both public and close corpora-

more attuned to the needs of shareholders. The purpose of stock option plans “is to encourage good performance on the part of the employees being given option rights.”

Id. at § 1960. Stock option plans have also been used in structurally complex transactions. For example, the courts have upheld the use of stock option plans as anti-takeover devices. See generally Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989) (invoking the “business judgment rule” in evaluating the validity of a stock option plan, even where the board was reacting to a takeover threat).

See N.Y. BUS. CORP. LAW, ch. 449, sec. 10, § 505, 1997 N.Y. Laws 1332, 1335 (permitting the issuance of stock to officers, employees or directors only upon shareholder approval or under a plan previously approved by the shareholders). The amendment to this provision merely lowered the required approval from a majority of all outstanding shares to a majority of votes cast. See id.

See N.Y. BUS. CORP. LAW, ch. 449, sec. 15, § 513, 1997 N.Y. Laws 1332, 1337-38 (forbidding a corporation from purchasing more than 10% of its stock from a shareholder of the corporation for more than market value without board and shareholder approval).

See N.Y. BUS. CORP. LAW § 510(a)-(b) (McKinney 1986) (permitting dividends to be paid from surplus only).

See supra Part I.B.1; see also supra note 48 and accompanying text.

See supra note 48 and accompanying text.
tions, in connection with share exchanges\textsuperscript{103} and sales, leases, exchanges or other dispositions of all or substantially all of the assets of a corporation.\textsuperscript{104} Delaware, once again taking the contractual approach to corporate law, permits its corporations to provide for these rights in their charters,\textsuperscript{105} rather than statutorily imposing this burdensome requirement on corporations for which such rights may be inappropriate. As previously discussed, the mandatory imposition of appraisal rights has questionable value;\textsuperscript{106} thus a contractual approach to appraisal rights provides corporations with the ability to decide whether their shareholders need this elusive protection. On the flip side, Delaware had the opportunity to use New York's section 912 as a precedent for an interested shareholder combination provision, which is an anti-takeover measure.\textsuperscript{107} As a result of Delaware's legislative efficiency, section 203 of the DGCL passed with less stringent, though quite effective, restrictions and a flexible "opt out" provision.\textsuperscript{108} Presumably, such provisions are indicative of New York's distrust of management and its dedication to increasing the relative difficulties of extraordinary corporate transactions, which are, in many cases, value-maximizing trans-

\begin{footnotesize}
\textsuperscript{103} See NY. BUS. CORP. LAW, ch. 449, sec. 59, § 910, 1997 N.Y. Laws 1332, 1356-57.
\textsuperscript{104} See id.
\textsuperscript{105} See DEL. CODE ANN. tit. 8, § 262(c) (1991).
\textsuperscript{106} See supra Part I.D.2; see also supra note 88 and accompanying text.
\textsuperscript{107} In 1987, drawing upon section 912 of the BCL, Delaware designed its own provision with respect to interested shareholder combinations. See Alva, supra note 1, at 910. Essentially, these provisions prohibit business combinations with shareholders who have acquired a certain percentage of a company's stock for a certain period of time, unless (i) such acquisition was approved in advance by the board, (ii) the interested shareholder holds a prescribed, extremely high percentage of outstanding stock or (iii) the business combination is approved by a certain number of shareholder votes. See NY. BUS. CORP. LAW, ch. 449, sec. 60, § 912, 1997 N.Y. Laws 1332, 1357.
\textsuperscript{108} Among the substantive changes made to the section 912 precedent were: (i) an increase from ten percent to fifteen percent of shareholder ownership to qualify as an interested shareholder, (ii) a reduction from ninety percent to eighty-five percent of shareholder ownership to qualify for an exception as a bidder, (iii) the exclusion of shares held by inside directors and certain employee stock ownership plans from the eighty-five percent exception calculation, (iv) a two-thirds shareholder approval exception (excluding those votes controlled by the bidder and interested board members), (v) an increase from forty-five to ninety days in which a company could opt out of the statute by board resolution and (vi) the ability to opt out beyond such ninety-day period by a bylaw amendment (which action would become effective in twelve months instead of eighteen). Compare NY. BUS. CORP. LAW, ch. 449, 60, § 912, 1997 N.Y. Laws 1332, 1357, with DEL. CODE ANN. tit. 8, § 203 (1991).
\end{footnotesize}
D. Third Party Rights: Misplaced Paternalism

Not only is New York unjustifiably preoccupied with restricting corporate activity, but it seems even more concerned with protecting the public from the "evil" corporation. Although shareholders have certain basic information rights related to their ownership interests, New York additionally requires domestic and foreign corporations to supply lists of directors, officers and shareholders to certain qualifying shareholders. New York's paternalistic tendencies are further indicative of the moral and political complexities facing highly technical corporate laws in large states. Exemplifying this phenomenon is the most troublesome provision of the BCL, the epitome of New York's legislative failings, section 630. Section 630 imposes joint and several liability upon the ten largest shareholders of a private corporation for unpaid employee compensation. This controversial provision was slated for repeal; however, to the detriment of New York's competitive advantage, labor lobbyists blocked the passage of the amendments until the repeal of section 630 was removed from the bill. Section 630 exemplifies the difficulty legislatures of large states face when enacting corporate statutes or statutory amendments. As a result, corporate laws are not treated as "highly technical devices to facilitate corporate transactions." Keeping section 630 nullifies, at least

109 See supra Part I.C.2.; see also supra note 72 and accompanying text.
111 See Kaouris, supra note 1, at 1005 n.295.
112 See N.Y. BUS. CORP. LAW § 630 (McKinney 1986).
114 See Dominic Bencivenga, At Long Last, a Bill, N.Y. L.J., July 31, 1997, at 5 (explaining how section 630 was removed to ensure passage of the other provisions).
115 See Kaouris, supra note 1, at 1005 n.295 (quoting Leo Herzel & Laura D. Richman, Foreward to R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS F-1 (2d ed. 1994)) (stating that the political environment of large states makes the passage of efficient corporate laws difficult).
116 Id.
in part, the underlying corporate concept of limited liability since the ten largest shareholders of a close corporation, which would probably be all its shareholders, have unlimited personal liability for a potentially endless stream of claims for compensation, including claims for costly benefits and pension payments. Irrespective of the advancements made by the recent amendments to the BCL, this partial eradication of limited liability will dissuade private corporations from choosing New York as their domicile.

CONCLUSION

Although New York has made many necessary improvements to the antiquated BCL, New York has failed to provide its corporations with sufficient contractual freedom to compete in today's market environment. New York still holds the outdated notion that stricter legal regulation provides greater protection. Companies seeking a domicile will choose the state that offers them the greatest opportunity for growth. When statutory protection works in conjunction with principles of contract and market discipline to regulate corporate activity, a corporation's opportunity for growth is maximized. However, when statutory law impedes the efficient functioning of contractual freedom and market discipline, corporations become entangled in a web of conflicting regulations. Rather than having their growth stunted by the BCL, companies will continue flocking to Delaware for the opportunity to partake of its business-friendly paradigm of statutory, as well as non-statutory, features. Until New York can overcome its legislative failings, it will continue to fall well behind Delaware in the market for corporate charters.

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