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Volume 84  
Number 4 *Corporate Governance and  
Shareholder Rights in a Time of Financial Crisis:  
How the North Dakota Publicly Traded  
Corporations Act Changes the Landscape*

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Article 10

1-1-2008

## North Dakota's Novel Approach to Corporate Governance: A Shifting Landscape in Corporate Management or a Futile Assertion of Large Shareholders' Rights

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### Recommended Citation

Dahl, Stacey (2008) "North Dakota's Novel Approach to Corporate Governance: A Shifting Landscape in Corporate Management or a Futile Assertion of Large Shareholders' Rights," *North Dakota Law Review*. Vol. 84 : No. 4 , Article 10.

Available at: <https://commons.und.edu/ndlr/vol84/iss4/10>

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NORTH DAKOTA'S NOVEL APPROACH  
TO CORPORATE GOVERNANCE:  
A SHIFTING LANDSCAPE IN CORPORATE MANAGEMENT  
OR A FUTILE ASSERTION OF LARGE  
SHAREHOLDERS' RIGHTS?\*

I. INTRODUCTION

For many Americans, the sudden and shocking failure of the Enron Corporation will be remembered as the most significant corporate event of their generation.<sup>1</sup> Indeed, the infamous collapse of the energy giant has proven not to have simply been a seminal business event.<sup>2</sup> Enron's demise and the wake of successive corporate scandals<sup>3</sup> have led to discussions and subsequent measures that have marked a turning point in United States corporate governance.<sup>4</sup>

With these scandals emerged a national dialogue focusing on corporate accountability and protection of shareholders who invest in those institutions.<sup>5</sup> One observer noted, "America's shareholders are growing restless, and the bosses of the companies they own seem increasingly nervous as

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\*Winner of the 2008 North Dakota State Bar Foundation Outstanding Note/Case Comment Award.

1. Richard D. Cudahy & William D. Henderson, *From Insull to Enron: Corporate (Re)Regulation After the Rise and Fall of Two Energy Icons*, 26 ENERGY L.J. 35, 36 (2005).

2. Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855, 855-56 (2003).

3. See, e.g., John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor's Perspective*, 76 U. COLO. L. REV. 57, 84 (2005) ("Enron was a failing company propped up by accounting games, deceptive transactions, and financial statement manipulation."). For example, Enron had been fraudulently reporting its financial situation to the Securities and Exchange Commission on its 10-Q and 10-K forms. *Id.* at 71. The WorldCom scandal also involved accounting fraud, which included operating costs being improperly recorded as capital expenditures to disguise huge losses as profit. Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L.Q. 357, 369-70 (2003). The Adelphia scandal arose out of a \$2.5 billion accounting scandal that subsequently led to Adelphia's bankruptcy. *Id.* at 370-71.

4. Elson & Gyves, *supra* note 2, at 855-56; see Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) (stating that the Sarbanes-Oxley Act, in which Congress legislated several corporate governance measures into the federal securities law, is not only a considerable change in substantive law, but also a divergence in the mode of regulation).

5. See Gregory Scott Crespi, *Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace?*, 32 J. CORP. L. 381, 382 (2007) ("[C]orporate governance practices have come under close scrutiny.").

they peer out from behind their boardroom curtains.”<sup>6</sup> In the 2007 legislative session, North Dakota interjected itself into this ongoing national debate of management in public corporations by enacting the North Dakota Publicly Traded Corporations Act (NDPTCA).<sup>7</sup> The statute pulls together many issues for which activist shareholder groups advocate: limiting director term limits, restricting poison pills, separating the roles of chairman and chief executive officer, permitting votes on compensation reports, and altering plurality voting to majority voting regarding directors, among others.<sup>8</sup>

This note focuses on public corporations, companies that are permitted to offer securities for sale to the general public, usually through the stock markets.<sup>9</sup> Furthermore, this note analyzes and critically evaluates both the purpose and the practical effect of North Dakota’s newly enacted law. Part II provides an overview of the structure and history of corporations as well as their governance practices in America.<sup>10</sup> Part III describes the competing philosophies that surround the corporate governance process.<sup>11</sup> Part IV takes a critical and skeptical look at the desirability and feasibility of applying the NDPTCA.<sup>12</sup>

## II. OVERVIEW AND BACKGROUND OF CORPORATE GOVERNANCE IN AMERICA

Part II provides an overview of corporations beginning with Section A, which presents a general summary of corporate governance.<sup>13</sup> Section B

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6. Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1504 (2006) (quoting *Ownership Matters; Shareholder Democracy*, ECONOMIST, Mar. 11, 2006, at 10).

7. N.D. CENT. CODE ch. 10-35 (2007).

8. *Id.* §§ 10-35-06(1)-(3); 10-35-09(2)-(3); 10-35-12(5); 10-35-22; 10-36-06(4) (2007). Crystal R. Reid, *Corporate Landscape Changing*, BISMARCK TRIB., May 6, 2007, at B1.

9. ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 89 (2d ed. 2004). Publicly held companies are: (1) corporations traded on a national securities exchange; and (2) those with 500 or more shareholders and \$10 million or more in assets. Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313, 317 (2007). The North Dakota Century Code makes clear that the NDPTCA applies “only to a publicly traded corporation . . . during such time as its articles state that it is governed by this chapter.” § 10-35-03(1).

10. *See* discussion *infra* Part II (discussing the organization, roles, and evolution of corporations and the governance process).

11. *See* discussion *infra* Part III (examining the various opinions of what the shareholders’ role should be in a corporation).

12. *See* discussion *infra* Part IV (providing a skeptical analysis of which corporations may have an interest in the NDPTCA, which entities may benefit from the existence of this law, how the law addresses recent corporate scandals, and the difference of certain language in the NDPTCA compared with contemporary corporate law).

13. *See* discussion *infra* Part II.A (presenting a broad definition of what corporate governance is and various sources of governance for corporations).

discusses the organization of the corporation, including the various roles performed within the corporate structure.<sup>14</sup> Section C provides a brief history of the American corporation, as well as historical efforts aimed at reforming corporations.<sup>15</sup>

#### A. WHAT IS CORPORATE GOVERNANCE?

While several definitions of corporate governance exist, generally the term governs the internal affairs of the corporation, such as the “structure, relationships, . . . and objectives of the corporat[ion].”<sup>16</sup> Traditionally, state law has provided the framework for the internal structure with regard to the affairs of the corporation.<sup>17</sup> This framework is recognized as the “internal affairs doctrine.”<sup>18</sup> Each state in the United States has a statute or set of laws that governs how corporations in that state are structured, the process for incorporation, and the configuration of the board of directors.<sup>19</sup>

Pursuant to the internal affairs doctrine, state courts are obligated to accept the law of the incorporating state, even if that state’s law is inconsistent with the law of the forum state.<sup>20</sup> Although some states try to regulate foreign corporations in certain circumstances,<sup>21</sup> the legitimacy of this is dubious.<sup>22</sup> For example, in *CTS Corporation v. Dynamics Corporation of America*,<sup>23</sup> the United States Supreme Court nearly made it a constitutional mandate that the state of incorporation possess the authority to regulate the internal affairs of the corporation.<sup>24</sup>

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14. See discussion *infra* Part II.B (describing the responsibilities of directors, officers, and shareholders).

15. See discussion *infra* Part II.C (describing the evolution of the American corporation and historical reform efforts as compared to contemporary governance issues).

16. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1411 (2005); see Hillary A. Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456, 460 (2004) (“The term ‘corporate governance’ is widely used to refer to the balance of power between officers, directors, and shareholders.”).

17. Veasey & Di Guglielmo, *supra* note 16, at 1411.

18. PINTO & BRANSON, *supra* note 9, at 14.

19. *Id.*

20. See *McDermott Inc. v. Lewis*, 531 A.2d 206, 209, 212 (Del. 1987) (applying Panama law even though the rules were barred under Delaware law and the law of other states).

21. See, e.g., CAL. CORP. § 2115 (2007) (regulating corporations that have fifty percent of property, payroll and sales factors, and outstanding securities in California).

22. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) (“No principle of corporation law and practice is more firmly established than a State’s authority to regulate domestic corporations.”).

23. 481 U.S. 69 (1987).

24. *CTS Corp.*, 481 U.S. at 89.

Delaware, the place of incorporation to more than half of the country's public corporations, has developed a body of law that is greatly respected and considered highly influential in the area of corporate law.<sup>25</sup> One reason so many corporations choose to incorporate in Delaware is that its bar and judiciary are considered extremely knowledgeable in understanding the intricacies of corporate law.<sup>26</sup> Further, Delaware's case law leads to predictability and stability for corporate planning and strategy.<sup>27</sup>

Until 2002, corporate governance was principally an issue of state law.<sup>28</sup> The federal government's role prior to 2002 was limited to the disclosure of information to investors, mostly concerning initial public offerings and securities trading.<sup>29</sup> The subsequent enactment of the Sarbanes-Oxley Act, the federal government's response to several large corporate scandals, included a number of provisions impacting corporate governance.<sup>30</sup> For example, Sarbanes-Oxley requires the Securities and Exchange Commission (SEC) to promulgate rules compelling issuers to disclose whether they apply a code of ethics to senior financial officers,<sup>31</sup> obliges independent audit committees for all listed companies,<sup>32</sup> and prohibits corporations from giving credit to officers or directors (with some exceptions).<sup>33</sup> Sarbanes-Oxley also added numerous provisions increasing or creating civil and criminal consequences, including an additional felony for securities fraud<sup>34</sup> and federal protection for whistleblowers.<sup>35</sup>

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25. See HARRIET SMITH WINDSOR, DIVISION OF CORPORATIONS, DELAWARE DEP'T OF STATE DIV. OF CORPS., 2006 ANNUAL REPORT 1, available at [http://www.corp.delaware.gov/2006%20Annual%20Report%20with%20Signature%20\\_2\\_.pdf](http://www.corp.delaware.gov/2006%20Annual%20Report%20with%20Signature%20_2_.pdf) (reporting that sixty-one percent of the Fortune 500 companies and half of the United States firms traded on the New York Stock Exchange and NASDAQ are incorporated in Delaware). In addition, the Delaware Court of Chancery is a 215-year-old court that has written and shaped much of the modern corporate case law. *Id.*

26. PINTO & BRANSON, *supra* note 9, at 16.

27. *Id.*

28. Jeffrey D. Hern, *Delaware Courts' Delicate Response to the Corporate Governance Scandals of 2001 and 2002: Heightening Judicial Scrutiny on Directors of Corporations*, 41 WILLAMETTE L. REV. 207, 207-08 (2005).

29. *Id.* at 207-08 (citing Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1438 (1992)).

30. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

31. Sarbanes-Oxley, § 406, 15 U.S.C. § 7264 (2002).

32. Sarbanes-Oxley, § 301, 15 U.S.C. § 78j-1(m)(3) (2002).

33. Sarbanes-Oxley, § 402(a), 15 U.S.C. § 78m(k) (2002). The company may offer credit if it is a financial institution extending credit in the ordinary course of business and the terms are the same as those offered to the public. *Id.*

34. Sarbanes-Oxley, § 807, 18 U.S.C. § 1348 (2002).

35. Sarbanes-Oxley, § 301, 15 U.S.C. § 78j-1(4) (2002); Sarbanes-Oxley, § 1107, 18 U.S.C. § 1513 (2002); Sarbanes-Oxley, § 806, 18 U.S.C. § 1514A (2002).

Additionally, the SEC and other federal agencies remain sources of corporate governance in public companies.<sup>36</sup> The SEC's role in corporate governance arises "from its mission to protect investors, maintain market [integrity], and facilitate capital formation."<sup>37</sup> At times, the SEC has taken a less direct approach to governance, such as encouraging the securities exchanges to pass governance rules as a way to advance investor protection.<sup>38</sup> More direct regulatory attempts by the SEC have taken the form of disclosure regulation as opposed to imposing overt governance requirements.<sup>39</sup> For example, pursuant to Sarbanes-Oxley, the SEC enacted rules, which require management participation in the assessment and certification of internal controls in public corporations.<sup>40</sup>

Corporations also have internal documents that provide additional sources of governance, such as the articles of incorporation.<sup>41</sup> The articles of incorporation provide a corporation's functions, objectives, and some matters of governance.<sup>42</sup> "The articles of incorporation are wholly [publicly] filed with the secretary of state."<sup>43</sup> To complete the formation process, the corporation must also adopt a set of bylaws, which are not publicly filed as are the articles of incorporation.<sup>44</sup> The corporation's bylaws also include various provisions with respect to the governance and internal affairs of the corporation.<sup>45</sup> Bylaws often set the rules for important functions of governance, such as rules for shareholder meetings; how the board of directors will operate (including election and removal); and the rules with respect to officers, agents, and employees, among others.<sup>46</sup>

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36. Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 892 (2007). Agencies other than the SEC tend to play smaller roles. *Id.* For example, the Office of Federal Housing Enterprise Oversight and the Commodities Futures Trading Commission provide governance structures and rules specific to the companies and industries they regulate. *Id.* at 892 n.29.

37. *Id.* at 893 (quoting SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation* (2007), available at <http://www.sec.gov/about/whatwedo.shtml>).

38. *Id.*

39. *Id.*

40. *Id.* (citing Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Rates, Exchange Act Release Nos. 33-8238 & 34-47, 986, 68 Fed. Reg. 36, 636, Aug. 14, 2003, available at <http://www.sec.gov/rules/final/33-8238.htm>).

41. 18A AM. JUR. 2D *Corporations* § 171 (2004).

42. *Id.*

43. PINTO & BRANSON, *supra* note 9, at 13.

44. *Id.*

45. *Id.* A corporation's bylaws address issues such as shareholder's meetings (for example, location and voting rights), the function of the board of directors, and key provisions regarding the rules of officers and employees. *Id.* at 13 n.47.

46. *Id.*

Finally, corporate law, as interpreted by the judiciary, also provides important guidance.<sup>47</sup> Case law supplies the principles of fiduciary duties, norms, expectations, and standards designed to impact the organization, relationships, and objectives of corporations.<sup>48</sup> This arrangement allows flexibility and avoids the one-size-fits-all approach that would otherwise accompany an expansive and unyielding codified system.<sup>49</sup> Apart from the state, federal, and internal regulatory framework of corporations, the various roles of directors, shareholders, and managers also play a pivotal role in the governance process.<sup>50</sup>

## B. ROLES ASSUMED WITHIN THE STRUCTURE OF THE CORPORATION

One central and venerable principle of American corporate law is that the board of directors is granted the power to manage the corporation.<sup>51</sup> After they are elected to the board, “directors act as fiduciaries [toward] the corporation”<sup>52</sup> and generally consider it a fiduciary duty to maximize shareholder gains.<sup>53</sup> The actual number of directors is usually a matter settled in the articles of incorporation or bylaws.<sup>54</sup> The management of a corporation is vested heavily in its board of directors, leaving only a few specific shareholder voting rights.<sup>55</sup> The board of directors, while maintaining its supervisory role, gives officers in the corporation the flexibility to execute the board’s directives.<sup>56</sup>

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47. Veasey & Di Guglielmo, *supra* note 16, at 1411.

48. *Id.*

49. *Id.* at 1412.

50. See discussion *infra* Part II.B (examining the different roles of those involved with the corporate governance process).

51. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2007) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”); N.D. CENT. CODE § 10-19.1-32 (2007) (“The business and affairs of a corporation must be managed by or under the direction of a board.”); MODEL BUS. CORP. ACT § 8.01(b) [hereinafter MBCA] (“All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors.”). See also N.Y. BUS. CORP. LAW § 701 (McKinney 2003) (following a statutory similar in substance, but one that does not follow the MBCA). “[T]he business of a corporation shall be managed under the direction of its board of directors.” *Id.*

52. PINTO & BRANSON, *supra* note 9, at 123.

53. Crespi, *supra* note 5, at 386 (citing NAT’L ASSOC. OF CORP. DIRS., REPORT OF THE NACD BLUE RIBBON COMMISSION ON DIRECTOR COMPENSATION: PURPOSES, PRINCIPLES, AND BEST PRACTICES I (1995)).

54. PINTO & BRANSON, *supra* note 9, at 124.

55. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 569 (2006); Lucian Arye Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391 tbl.2 (2003).

56. PINTO & BRANSON, *supra* note 9, at 123.

The officers, charged with managing the daily operations of the corporation, receive their operational authority from the board of directors.<sup>57</sup> Officers also assume a fiduciary duty toward the corporation and are considered “agents” of the corporation.<sup>58</sup> Often, authority is concentrated in the chief executive officer and other senior level management.<sup>59</sup>

The shareholders, considered by many to be the owners of the corporation, possess the residual claim on assets.<sup>60</sup> While shareholders have the right to elect and remove directors, they generally have a limited role in corporate decision-making.<sup>61</sup> As a general rule, shareholders possess the right to elect directors, vote on vacancies, and vote on amendments to the articles of incorporation and bylaws.<sup>62</sup> However, corporate changes must be proposed by the board of directors.<sup>63</sup>

With respect to governance matters in publicly traded firms, the issues that arise are commonly related to the nature of the ownership in the corporation.<sup>64</sup> For example, the shareholders of a publicly traded company are largely dispersed.<sup>65</sup> Most disputes in the governance of publicly traded companies arise out of shareholders’ limited rights to participate in the management versus the directors’ province to operate free from shareholder interference.<sup>66</sup>

As a result of this arrangement, there is a separation of control and ownership.<sup>67</sup> This arrangement provides for little direct oversight by shareholders.<sup>68</sup> It does not mean, however, that shareholders are left without

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57. *Id.* at 126.

58. *Id.*

59. *Id.* at 127.

60. *Id.* at 106. *But see* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 604 (2006) [hereinafter Bainbridge, *Limited Shareholder Voting Rights*] (explaining that while shareholders own the residual claim on the corporation’s earnings and assets, “[o]wnership of the residual claim is not the same as ownership of the corporation itself”). For it to be possible to own the corporation, a corporation would have to be capable of being owned. *Id.* However, this is impossible due to the corporation’s status as a work of “legal fiction.” *Id.*; *see also* Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 804 (2007) (“Corporations are independent legal entities that own themselves; shareholders own only a security, called ‘stock’ with very limited legal rights.”).

61. Anabtawi, *supra* note 55, at 569.

62. PINTO & BRANSON, *supra* note 9, at 107. Additionally, shareholders may vote on other issues such as mergers and liquidation. *Id.*

63. Stout, *supra* note 60, at 793 (citing Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 310 (1999)).

64. PINTO & BRANSON, *supra* note 9, at 87.

65. *Id.* However, some public firms “have a concentration of shareholders that act together to control the corporation through the election of directors.” *Id.* at 88. In this situation, public stockholders assume a minority position. *Id.*

66. *Id.* at 87.

67. *Id.*

68. *Id.*



protection.<sup>69</sup> In addition to market constraints, shareholders also have legal protections including: management's fiduciary duty, proxy battles to change management, tender offers to remove managers, and regulations of the SEC.<sup>70</sup>

### C. HISTORY OF AMERICAN CORPORATIONS AND GOVERNANCE PRACTICES

Early in American history, companies were publicly chartered largely for public utility purposes, such as inland navigation and toll roads.<sup>71</sup> However, as the eighteenth century ended, the young nation needed credit and an infrastructure to assist development, and the corporate structure best met those needs.<sup>72</sup> The corporate form provided a legal framework suited to gathering the vast amount of money needed to grow capital-intensive industries and accomplish business and pecuniary objectives.<sup>73</sup>

As the Industrial Revolution transformed the economy during the nineteenth century, America experienced increasing wealth and power concentrated in corporations.<sup>74</sup> During this time, the public began to invest in corporations.<sup>75</sup> Yet it was not until the late nineteenth century that technological innovation, especially railroads, began to give corporations a strong, influential, and long-lasting place in the economy.<sup>76</sup> The success of the economy was met with increasing skepticism in the latter part of that century when abuses grew rampant, especially in large corporations.<sup>77</sup> Justice Brandeis remarked that states had historically limited incorporation practices because “[t]here was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations.”<sup>78</sup>

Furthermore, in the late nineteenth century, states around the country began liberalizing their corporation statutes, taking steps such as lowering

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69. *Id.* at 88.

70. *Id.*

71. Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the “New” Good Faith*, 56 AM. U. L. REV. 211, 220 (2006).

72. *Id.*

73. *Id.* at 220-21.

74. PINTO & BRANSON, *supra* note 9, at 5.

75. *Id.*

76. Duggin & Goldman, *supra* note 71, at 220 (citing LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 390 (3d ed. 2005)).

77. *Id.* at 221.

78. *Id.* (citing *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 549 (1933) (Brandeis, J., dissenting)). In *Liggett*, Justice Brandeis noted that historically “the duration of corporate franchises was generally limited to a period of 20, 30, or 50 years.” *Liggett*, 288 U.S. at 555.

taxes and generally allowing management more flexibility.<sup>79</sup> These changes often involved giving more authority to management rather than to shareholders.<sup>80</sup> For example, the ultra vires doctrine, which served to limit corporate activities to its prescribed charter powers, was eroded.<sup>81</sup> Further, the notion reemerged that the authority of the board of directors was “original and undelegated,” rather than delegated from the shareholders.<sup>82</sup> Proxy voting also changed; where previously banned in the nineteenth century, it became the twentieth century norm.<sup>83</sup> Finally, shareholders lost the authority to remove members of the board at will.<sup>84</sup>

During this period of time, monopolies dominated markets and fraud was pervasive, two trends which undermined confidence in the economy.<sup>85</sup> Around the mid-1910s, individual and institutional investors increasingly became important sources of public security financing.<sup>86</sup> Suspicion of corporations remained as corporate power continued to grow.<sup>87</sup> The corporate abuses and fraud facilitated considerable public distrust of large corporations and those who managed them.<sup>88</sup>

The Wall Street crash in 1929 brought yet more scrutiny from lawmakers.<sup>89</sup> In response to the financial disaster, the federal government passed securities legislation.<sup>90</sup> Interestingly enough, it was not the American corporate structure that was the target of reforms.<sup>91</sup> For example, the federal securities acts of 1933 and 1934 did not seek to protect or empower shareholders.<sup>92</sup> Rather, the laws were focused on supporting the principles of a healthy free market.<sup>93</sup> The enactment of these new laws

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79. PINTO & BRANSON, *supra* note 9, at 5. In the late nineteenth century, for example, New Jersey modified its incorporation statute to remove restrictions on “capitalization and assets, mergers and consolidations, the issuance of voting stock, the purpose(s) of incorporation, and the duration and locale of business.” Tsuk Mitchell, *supra* note 6, at 1515 (quoting SCOTT R. BOWMAN, *THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, AND IDEOLOGY* 60 (1996)). Other states also began liberalizing their general incorporation statutes as well, including Delaware. *Id.*

80. PINTO & BRANSON, *supra* note 9, at 5.

81. Tsuk Mitchell, *supra* note 6, at 1522.

82. *Id.* (citing MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 99 (1992)).

83. *Id.*

84. *Id.*

85. Duggin & Goldman, *supra* note 71, at 221-22.

86. Tsuk Mitchell, *supra* note 6, at 1521.

87. PINTO & BRANSON, *supra* note 9, at 5.

88. Duggin & Goldman, *supra* note 71, at 222.

89. PINTO & BRANSON, *supra* note 9, at 5.

90. *Id.*

91. Duggin & Goldman, *supra* note 71, at 222.

92. Tsuk Mitchell, *supra* note 6, at 1512.

93. *Id.*

restricted corporate power, like the prohibition of monopolies<sup>94</sup> and the issuance and trading requirements established by the Securities Act of 1933<sup>95</sup> and the Securities Exchange Act of 1934.<sup>96</sup> These measures, for the most part, did not directly impact corporate governance structures.<sup>97</sup>

Since the scandals of WorldCom, Enron, Adelphia, and others erupted, some are once again questioning the trust placed in American corporations.<sup>98</sup> The nature of the concern, however, is considerably different.<sup>99</sup> From the late twentieth century to the present, as exemplified in Enron and others, problems and scandals are interpreted as having more to do with internal issues of the corporation, rather than how corporate strength is applied within the economy.<sup>100</sup> Some scholars argue these collapses point to a failure of corporate governance structures and principles to prevent exploitations.<sup>101</sup> These events and subsequent investment losses reasonably explain why governance issues are presently under intense scrutiny, especially the relationship between directors and shareholders.<sup>102</sup>

This renewed corporate scrutiny may also explain North Dakota's willingness to adopt a novel act that so significantly departs from any other corporate statute in the United States.<sup>103</sup> Keep in mind, however, that while the NDPTCA itself is a novel statute, the arguments surrounding increased shareholder participation are not new.<sup>104</sup> The following discussion explores the differing philosophies of corporate governance.<sup>105</sup>

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94. Duggin & Goldman, *supra* note 71, at 222-23.

95. *Id.* at 223 (citing 15 U.S.C.A. §§ 77a-77aa (1997 & Supp. 2006)).

96. *Id.* (citing 15 U.S.C.A. §§ 78a-78mm).

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. See *Hearing on HB 1340 Before the H. Comm. on the Judiciary*, 60th N.D. Legis. Sess. 1 (Jan. 24, 2007) [hereinafter *Hearing*] (testimony of William H. Clark, Jr.) ("The ultimate goal of Chapter 10-35 is to improve the performance of publicly traded companies by providing a new model of corporate governance."). In addition, noting the recent scandals in publicly traded companies, "[t]he need for an alternative model of good corporate governance like Chapter 10-35 remains as important as ever." *Id.* at 2.

104. See Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 410 (1998) (noting that scholars and practitioners have long debated the allocation of power between directors and shareholders).

105. See discussion *infra* Part III (comparing and contrasting the ideas and ideals surrounding the shareholder democracy theory and the director primacy theory).

### III. COMPETING PHILOSOPHIES SURROUNDING CORPORATE GOVERNANCE

There is presently a spirited debate among several prominent corporate law academics and observers regarding the role of shareholders in a public firm.<sup>106</sup> Section A considers the argument of certain scholars that increased participation is healthy for public corporations.<sup>107</sup> Section B considers the potential consequences of increasing shareholder participation.<sup>108</sup>

#### A. SHAREHOLDER DEMOCRACY

According to some prominent academics, the time has come to re-evaluate the relationship structures of American corporate law.<sup>109</sup> They advocate for the idea of a shareholder democracy, where shareholders have a stronger voice in the management of corporations.<sup>110</sup> Such a role assumed by shareholders would improve corporate governance arrangements.<sup>111</sup> The support for increased shareholder participation comes from the notion that shareholders are the principals of the corporation and management is in place to act as “agents” in directing the firm.<sup>112</sup>

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106. See, e.g., Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1739 (2006) [hereinafter Bainbridge, *Director Primacy*] (noting that increasing shareholder power would result in inefficiencies); Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1784-85 (2006) (arguing that substantial impediments facing shareholders should be reduced when they seek to replace incumbent directors and that shareholders should have more power to make decisions to change governance arrangements); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) [hereinafter Bebchuk, *Increasing Shareholder Power*] (questioning the distribution of power between boards and shareholders under current corporate law); see also Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 *passim* (2003) (stating the case for shareholder access to the corporate ballot and proposed SEC Rule 14a-8); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1759 (2006) (responding to Bebchuk's shareholder proposals from the perspective of an open but traditionalist perspective); Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 60, at 636 (arguing against increasing shareholder power as evidenced by the benefits provided in the director primacy model).

107. See discussion *infra* Part III.A (noting the arguments for increased shareholder participation).

108. See discussion *infra* Part III.B (analyzing the director primacy model of corporate governance).

109. See Bebchuk, *Increasing Shareholder Power*, *supra* note 106, at 913 (arguing that the time has come to allow shareholders to make “rules-of-the-game” decisions, because for too long it has been a process controlled by management and directors).

110. See *id.* at 850 (explaining that management and shareholders' interests do not always “fully overlap,” and increased participation by shareholders “can provide constraints and incentives that reduce deviations from shareholder-value maximization”).

111. *Id.*

112. See *id.* at 911 (noting that managers are “imperfect agent[s] for shareholders”). But see PINTO & BRANSON, *supra* note 9, at 106 (stating that there is no actual legal principal/agent relationship between shareholders and directors in the corporate context).

Additionally, proponents of the shareholder democracy concept contend management will not always maximize the long-term value of their shares, because management has priorities and interests that may diverge from shareholders.<sup>113</sup> For example, directors have little incentive to ensure a strong financial performance in the corporation since they do not themselves possess a significant financial interest in it.<sup>114</sup> Consequently, agency costs can arise from this departure of interests.<sup>115</sup> As a result, agency costs could have the effect of decreasing shareholder value.<sup>116</sup> Without adequate oversight from shareholders, management may inappropriately divert resources, reject acquisitions that could benefit shareholders, over-invest in certain areas, etc.<sup>117</sup> Accordingly, increasing shareholder influence and power over the decision-making process provides “constraints and incentives” on management and takes an essential step towards resolving the agency issue.<sup>118</sup>

Additionally, Delaware’s dominance as the major state of incorporation has been criticized as producing “a race to the bottom” because the laws favor management.<sup>119</sup> Critics argue that management of a corporation will seek to incorporate into states that have pro-management laws in order to protect their interests, such as Delaware.<sup>120</sup> Since a state has an economic incentive to encourage corporations to incorporate within their borders,<sup>121</sup> the theory argues that other states will follow that method to attract

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113. See Bebhuk, *Increasing Shareholder Power*, *supra* note 106, at 908 (arguing that increased shareholder participation would reduce agency costs between directors and shareholders).

114. Stout, *supra* note 60, at 790.

115. PINTO & BRANSON, *supra* note 9, at 102. From a law and economics approach, the relationship between the shareholders and management is described as an agency relationship. *Id.* In the corporate context, the managers (acting as agents of the shareholders who are considered the principal) may have interests that diverge from shareholders and will not always act in the shareholders’ interests. *Id.* This increases the agency costs. *Id.* Agency costs can involve monitoring expenditures, bonding expenses (where the agent tries to assure the principal that costs will be curtailed), and residual losses. *Id.*

116. Bebhuk, *Increasing Shareholder Power*, *supra* note 106, at 850.

117. *Id.*

118. *Id.*

119. PINTO & BRANSON, *supra* note 9, at 15-16 (citing *Liggett v. Lee*, 288 U.S. 517, 557-58 (1933) (Brandeis, J., dissenting)).

120. *Id.* at 16.

121. See STATE OF DELAWARE DEPARTMENT OF FINANCE, 2005 DELAWARE FISCAL NOTEBOOK, available at [http://finance.delaware.gov/publications/fiscal\\_notebook\\_05/Section02/sec2page24.pdf](http://finance.delaware.gov/publications/fiscal_notebook_05/Section02/sec2page24.pdf) (stating that in 2005, franchise fees paid by corporations and other entities to the State of Delaware generated around \$500 million, or over seventeen percent of the state’s general fund revenues).

businesses, leaving shareholders without a state or set of laws that adequately protect their interests.<sup>122</sup>

On the other side of the debate, critics argue vigorously against the notion that Delaware corporate law has caused a “race to the bottom.”<sup>123</sup> Indeed, many see Delaware’s and other states’ “management friendly” laws as benefiting shareholders, not harming them.<sup>124</sup> Section III.B addresses the rationale for maintaining the division between shareholders and managers.<sup>125</sup>

## B. DIRECTOR PRIMACY

From a director primacy perspective, Delaware has not caused a “race to the bottom” because it would be counterintuitive for a board to incorporate into a state that would hurt shareholders and possibly result in devalued shares.<sup>126</sup> This would harm both management and shareholders because lower valued shares could possibly make the corporation a target for a takeover.<sup>127</sup> Hence, the management of the underperforming company would likely be replaced with new management by the purchasing corporation.<sup>128</sup> Accordingly, management will search for a state of incorporation that will enhance the value of the corporation’s shares.<sup>129</sup> Under a director primacy theory, risk and flexibility and a rejection of the “shareholder democracy” notion both go toward running an efficient, profitable corporation.<sup>130</sup>

### 1. *Risk and Flexibility*

The director primacy philosophy provides that the board of directors is in the best position to deal with all of the corporation’s constituents, which include shareholders, employees, creditors, customers, suppliers, and

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122. See William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 665-66 (1974) (noting the competition between state governments to attract corporations by offering the most advantageous laws to management).

123. PINTO & BRANSON, *supra* note 9, at 16.

124. *Id.*

125. See discussion *infra* Part III.B (putting forth the justifications for maintaining separation of directors and shareholders).

126. PINTO & BRANSON, *supra* note 9, at 16.

127. *Id.*

128. *Id.*

129. *Id.*

130. See discussion *infra* Part III.B (analyzing how a corporate board can effectively serve as an entity for efficient decision-making and why the notion of a shareholder democracy is a misnomer).

others.<sup>131</sup> In the public company, it is necessary to have a way of gathering the preferences of various constituencies and convert them into collective decisions.<sup>132</sup> Having a centralized decision-making body allows the firm to be responsive to the shareholder who is concerned about the value of his or her stock, the customer who cares about the product, and the worker concerned about wages and his or her work environment.<sup>133</sup> The problem with shareholder activism is that it interrupts the means by which a large public firm is able to operate; the centralized and flexible decision-making process that is well-suited for a large corporation is disrupted.<sup>134</sup>

In addition to efficiencies, the board of directors can provide risk-based decisions via the business judgment rule.<sup>135</sup> Generally, the business judgment rule is described as a presumption that “in making a business decision the directors of a corporation acted on an informed basis . . . and in the honest belief that the action taken was in the best interests of the company [and its shareholders].”<sup>136</sup> The business judgment rule protects not only the decision itself, but also serves to protect directors from incurring personal liability.<sup>137</sup>

The rule essentially promotes the maximization of stockholder value.<sup>138</sup> Stockholders benefit from a profitable company that can attract capital and expand earnings as well as earning potential.<sup>139</sup> Shareholders expect a board not to be risk averse.<sup>140</sup> If a corporation’s goal is one of economic maximization, then shareholders’ reactions are not necessarily economically optimal.<sup>141</sup> Shareholder reactions do not always take into consideration the risk necessary for achieving higher rewards, and to that end, these reactions should not be encouraged or facilitated.<sup>142</sup> If corporations choose to modify their structure, directors must be careful so as not to be risk averse in

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131. See Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 60, at 626 (stating that one virtue of a public corporation is that it provides structured upper management well-suited to making important decisions).

132. *Id.* at 622.

133. *Id.*

134. *Id.* at 626.

135. E. Norman Veasey, *The Stockholder Franchise Is Not a Myth: A Response to Professor Bebchuk*, 93 VA. L. REV. 811, 815 (2007).

136. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 747 (Del. Ch. 2005) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

137. Veasey & Di Guglielmo, *supra* note 16, at 1422.

138. *Id.*

139. *Id.*

140. *Id.*

141. Veasey, *supra* note 135, at 815.

142. *Id.*

executing their statutory directive to manage the business and affairs of the corporation.<sup>143</sup>

## 2. *Rejection of the “Shareholder Democracy” Notion*

As previously stated, shareholder democracy envisions shareholders having a more active role in the management of a corporation, thereby improving corporate governance.<sup>144</sup> The idea of a shareholder democracy certainly holds an emotional appeal.<sup>145</sup> Yet for critics, the idea is eschewed that corporations should be compelled to embrace political principles, such as the notion of shareholder democracy.<sup>146</sup> Indeed, a proponent of the NDPTCA stated, “Being incorporated in North Dakota will represent a new seal of approval for publicly[]traded corporations committed to corporate democracy and improved performance.”<sup>147</sup> However, the characterization of a corporation embodying true democratic principles is a somewhat unfair and unrealistic mixing of two diverse institutions that are governed by different models.<sup>148</sup> The fusion, though improper, endures because of “intelligentsia’s far greater comfort and familiarity with political models and events than with knowledge and appreciation of how markets function.”<sup>149</sup> These political and corporate institutions are not one and the same.<sup>150</sup> The modern corporation is not a political creation; rather, it is a conception of market forces.<sup>151</sup>

The comparison of political and corporate democracy is unfair on several grounds.<sup>152</sup> For example, note the voluntary nature of investing into a corporate entity as opposed to the reality that living in a polity is

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143. *Id.* at 814.

144. *See* discussion *supra* note 109 (making the case for allowing shareholders to formulate “rules-of-the-game” decisions, rather than leaving the process to be controlled by management and directors).

145. Stout, *supra* note 60, at 803. “This larger myth of the benefits of shareholder control has captured hearts and minds not because it is based on evidence but because it has tremendous emotional appeal.” *Id.*

146. Henry G. Manne, *The “Corporate Democracy” Oxymoron*, WALL ST. J., Jan. 2, 2007, at A23.

147. *Hearing*, *supra* note 103, at 1 (testimony of William H. Clark, Jr.).

148. Manne, *supra* note 146, at A23.

149. *Id.*

150. *Id.*

151. *Id.* There is virtually no aspect of the corporation, also known as “capitalism’s greatest invention,” that cannot be traced to market influences. *Id.*

152. *See* Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1397 (2006) (“[C]orporations and political states are marked by differences so fundamental that it is dangerous to extrapolate lessons from one realm to the other.”).



involuntary.<sup>153</sup> People have the choice of investing in various other forms of entities besides the corporate form, such as limited liability companies, partnerships, or nothing at all.<sup>154</sup>

Further, the very idea of corporate democracy is undemocratic in several ways.<sup>155</sup> Power among shareholders is based upon the amount of money invested in the corporation, not based upon an individual's status as a citizen, which is the case in a political democracy.<sup>156</sup> Finally, a so-called corporate democracy could actually work to disenfranchise other corporate stakeholders like customers and employees, unless they have the desire and means to purchase stock.<sup>157</sup> Disenfranchisement occurs because the shareholders possess the authority to make decisions for the corporations other non-shareholder stakeholders, such as the employees and consumers.<sup>158</sup>

While it is true that there are other legitimate and sound theories for distributing control this way, it serves to note that using the term "corporate democracy" or "shareholder democracy" is misleading and often misapplied.<sup>159</sup> Our nation's government derives legitimacy from the idea of a "government of the people, by the people, for the people."<sup>160</sup> However, a "democracy" with respect to shareholders is a narrow goal, which aims only at increasing corporate decision-making participation<sup>161</sup> and is almost entirely motivated by financial incentives.<sup>162</sup> Presently there is no substantive concept of shareholder democracy unrelated to market demands.<sup>163</sup> In addition to the "shareholder democracy" rationale for enacting this legislation, there are other reasons to be skeptical of the NDPTCA.<sup>164</sup>

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153. *Id.* at 1398.

154. *Id.*

155. Thomas J. Woo, *Corporate Governance and the "D-Word,"* 63 WASH. & LEE L. REV. 1579, 1579 (2006).

156. *Id.*

157. *Id.*

158. *Id.* at 1587-88.

159. *Id.* at 1579.

160. *Id.* at 1587 (quoting President Abraham Lincoln, The Gettysburg Address (Nov. 19, 1863)).

161. *Id.*

162. Tsuk Mitchell, *supra* note 6, at 1576.

163. *Id.*

164. See discussion *infra* Part IV (analyzing whether corporations will utilize the NDPTCA in any large number (if at all), whether the law fixes the fraud of recent corporate scandals, and several unique provisions included in the NDPTCA).

## IV. A SKEPTICAL ANALYSIS OF THE NDPTCA

It is important to note that incorporating under the NDPTCA is an entirely optional decision for a corporation.<sup>165</sup> The NDPTCA does not affect publicly traded corporations already incorporated in North Dakota, unless they choose to amend their articles of incorporation to be included under the new statute.<sup>166</sup> Existing corporations in North Dakota, public or non-public, are currently subject to North Dakota's Business Corporation Act (BCA).<sup>167</sup> The NDPTCA is not mandatory, so any new public corporation may still incorporate only under the BCA, and be subject to the provisions of the BCA alone.<sup>168</sup> On the other hand, if a corporation wanted to place itself under the NDPTCA, the corporation would additionally opt into the NDPTCA and would then be governed by both the NDPTCA and the BCA.<sup>169</sup>

To the extent that the NDPTCA has provided an additional choice for corporations, the law may be viewed as attractive since an increase in choice is thought to be desirable in almost every market.<sup>170</sup> In fact, "the more-choice-is-better" argument is central to the "race-to-the-top" or shareholder democracy advocates.<sup>171</sup> These advocates have long argued that the lack of choice for increased shareholder power in the market has resulted in reduced shareholder wealth and benefited opportunistic managers.<sup>172</sup>

However, despite the NDPTCA's provision of an additional option for corporations, reasons remain to doubt any actual benefit.<sup>173</sup> To begin, it is relatively unclear whether corporations or shareholders actually want these measures, especially *all* of the provisions contained in the law.<sup>174</sup> After all, the very nature of statutory law cannot account for the wide range of

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165. N.D. CENT. CODE § 10-35-02(6) (2007) ("Publicly traded corporation' or 'corporation' means a corporation as defined in section 10-19.1-01:(a). That becomes governed by chapter 10-19.1 after July 1, 2007; and (b). The articles of which state that the corporation is governed by this chapter.").

166. *Id.*

167. *Id.* § 10-19.1.

168. *See id.* § 10-35-02(6) (maintaining that the articles of incorporation must state that the corporation will be governed by the NDPTCA).

169. *Id.*

170. *See* Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961, 991 (2001) (responding to a proposed federal regulatory scheme that would arguably increase shareholder welfare).

171. *Id.* at 966.

172. *Id.*

173. *See id.* at 964 (remaining skeptical of a proposed rule that would increase shareholder power).

174. *See* Veasey, *supra* note 135, at 814-15 (stating that adopting governance proposals that reach too far could have adverse and unintended consequences).

characteristics and circumstances of diverse corporations.<sup>175</sup> Even if the provisions of the NDPTCA appealed to a corporation, the corporation could adopt any one of the provisions (or all of them) in chapter 10-35 of the North Dakota Century Code simply by amending their articles of incorporation or bylaws.<sup>176</sup> Indeed, many boards are already modifying their policies on governance matters regarding poison pills, staggered boards, and changing plurality to majority voting.<sup>177</sup>

In the following discussion, Section A includes an analysis of which corporations may be interested in incorporating under this statutory scheme.<sup>178</sup> Section B discusses whether this law begins to fix or address the governance problems associated with recent corporate scandals.<sup>179</sup> Section C includes an analysis of who may benefit and who may not under this new law.<sup>180</sup> Finally, Section D notes the unique language applied in the NDPTCA in comparison with contemporary corporate statutory language.<sup>181</sup>

#### A. WHO MIGHT UTILIZE THE NDPTCA?

Potential benefits mentioned with the adoption of this law were increased revenue through franchise fees, infrastructure growth (needing more attorneys as a result of corporations incorporating into the state, resulting in increased litigation) and national recognition.<sup>182</sup> Setting national recognition aside, for the other “benefits” to be realized, public corporations would actually have to incorporate in North Dakota.<sup>183</sup> However, it is relatively unclear which corporations would find this law desirable, and further, might actually take steps to incorporate under this new

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175. *Id.* at 825.

176. *See* PINTO & BRANSON, *supra* note 9, at 13 (noting that the bylaws of a corporation contain many of the governance structures with respect to the corporation); Anabtawi, *supra* note 55, at 569 (stating that corporate statutes generally grant shareholders the right to adopt, amend, and repeal bylaws).

177. Veasey, *supra* note 135, at 814.

178. *See* discussion *infra* Part IV.A (discussing scenarios under which companies might incorporate under the NDPTCA).

179. *See* discussion *infra* Part IV.B (analyzing the gap between what the NDPTCA addresses and recent corporate scandals).

180. *See* discussion *infra* Part IV.C (exploring which types of shareholders are likely to be the beneficiaries of the NDPTCA and which are not).

181. *See* discussion *infra* Part IV.D (taking note of the unique statutory language contained in the NDPTCA).

182. *Hearing*, *supra* note 103, at 2 (testimony of William H. Clark, Jr.). “Enactment of Chapter 10-35 will be an opportunity for North Dakota to portray itself as committed to the future of capitalism and to strengthening the economy for the benefit of everyone.” *Id.*

183. *See id.* (noting the franchise fees and infrastructure growth potential).

law.<sup>184</sup> The following discussion may not be an exhaustive list of ways a corporation could incorporate under North Dakota's new statute, but provides three basic incorporation scenarios for doing so.<sup>185</sup>

1. *Existing Public Corporation's Board of Directors Reincorporating by Choice*

The first option for utilization of the NDPTCA would be that an existing corporation's board of directors would choose to reincorporate under this new statute.<sup>186</sup> However, this seems unlikely since one important factor when choosing a state of incorporation is centralized management; that is the ability to make efficient decisions for the corporation.<sup>187</sup> Since aspects of this law would take authority away from management in various ways, management would almost certainly be hesitant to even consider this law.<sup>188</sup> Managers making the decision of where to incorporate, or even considering a reincorporation, would likely choose a state that embraces a centralized management system.<sup>189</sup>

Since an incumbent board of directors is unlikely to initiate this action on its own, an alternative plan of action might be to change the make-up of the board by electing directors who would pledge to reincorporate the company under the NDPTCA.<sup>190</sup> However, replacing even a majority of directors on the board could take some time, especially if the directors' terms are staggered.<sup>191</sup> It could take shareholders more than one annual election cycle to replace a majority of the board.<sup>192</sup>

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184. See *Hearing on HB 1340 Before the S. Comm. on Appropriations*, 60th N.D. Legis. Sess. (March 19, 2007) (statement of Secretary of State Al Jaeger) (“[W]e don’t know . . . we have no idea of where [the corporations are] going to come from.”).

185. See discussion *infra* Part IV.D.1-3 (discussing several ways a company could, could not, or may not want to apply the NDPTCA to the corporation).

186. See Stout, *supra* note 60, at 793 (noting that it is the board of directors who must initiate changes to the corporation).

187. See Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 60, at 622.

188. See, e.g., N.D. CENT. CODE § 10-35-22 (2007) (limiting the duration of a poison pill, which is an antitakeover device); *id.* § 10-35-24 (restricting the minimum ownership for triggering poison pills); *id.* § 10-35-25 (stating the bylaws or articles of incorporation may restrict or prohibit the adoption of a poison pill by the corporation); *id.* § 10-35-26 (requiring that any antitakeover rule in the articles of incorporation or bylaws have approval of two-thirds of the shareholders and a majority of directors who are not officers in the corporation); *id.* § 10-35-27 (providing that the NDPTCA should be construed to favor shareholders by “enhancing” and “protecting” their rights).

189. See Bainbridge, *Director Primacy*, *supra* note 106, at 1749 (stating that the corporate hierarchy is well-suited to address the issues involving various corporate constituencies).

190. Interview with Joshua Fershee, Assistant Professor of Law, University of North Dakota, Grand Forks, N.D. (Aug. 20, 2007) [hereinafter Fershee].

191. Anabtawi, *supra* note 55, at 569. Staggered boards are put in place so that at any given time a majority of the board will be composed of members who have served at least one year. 2 FLETCHER CYC. CORP. § 334.10. The staggering of terms is usually accomplished by providing at

Further, once these new members are theoretically elected to the board of directors, there is no guarantee they would want to reincorporate to a state where the directors' authority would be significantly weakened by the NDPTCA.<sup>193</sup> Indeed, it may be that a board of directors wanting to appear "shareholder friendly" and who would actually be willing to make such a significant change as to move the state of incorporation, would arguably already be inclined to accept the type of proposals in the NDPTCA.<sup>194</sup> If so, changing the state of incorporation would not be necessary if these changes could all be achieved without going through the process of reincorporation.<sup>195</sup>

## 2. *Reincorporation Forced by Insurgent Shareholders*

The second option, where an insurgent group forces reincorporation, also seems rather unlikely, since shareholders currently lack the authority to initiate a change in the state of incorporation.<sup>196</sup> Presently, there is no state statute which provides a process for reincorporating to a different state.<sup>197</sup> Reincorporation generally takes the form of a merger and only the board of directors may initiate a vote on a merger proposal.<sup>198</sup>

## 3. *New Public Corporation by Volition*

One additional scenario for NDPTCA utilization is a newly created public company that would choose to incorporate under this new law.<sup>199</sup> Yet studies of corporate behavior as companies initially go public do not necessarily support this scenario.<sup>200</sup> This is most evident from studies in the context of initial public offerings, also known as "IPOs."<sup>201</sup> The process of "going public" by corporations gives every incentive to create a governance structure that appeals to investors.<sup>202</sup> If more shareholder control

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the outset that there shall be different classes of directors. *Id.* For example, a board may have the first class holding terms of one year; the second class, two years; and the third class, three years. *Id.*

192. Anabtawi, *supra* note 55, at 569.

193. *See* discussion *supra* note 188 (providing examples of situations where the board of directors' authority would be weakened).

194. Fershee, *supra* note 190.

195. *Id.*

196. Bebchuk, *Increasing Shareholder Power*, *supra* note 106, at 844.

197. *Id.*

198. *Id.*

199. Fershee, *supra* note 190. However, substantial numbers of new incorporations or reincorporations under the NDPTCA appear unlikely. *Id.*

200. Stout, *supra* note 60, at 802.

201. *Id.*

202. *Id.*

over the company meant better returns for shareholders, IPO corporations could potentially boost the amount of capital raised by enacting shareholder-friendly provisions.<sup>203</sup> However, studies indicate that when IPOs use provisions to modify the voting rights of shareholders, they have generally weakened shareholder rights.<sup>204</sup> For example, throughout the 1990s, between thirty-four and eighty-two percent of IPO charters contained provisions for staggered boards, effectively making it more difficult for directors on the board to be removed.<sup>205</sup>

A more recent and remarkable example of the trend to weaken shareholders' authority is found in the Google IPO.<sup>206</sup> Google's use of a dual-class charter<sup>207</sup> virtually left outside investors powerless.<sup>208</sup> Google's dual-class charter gave its founders shares with multiple votes, while the public could only get shares with one vote.<sup>209</sup> Accordingly, if shareholders really wanted more authority over the governance of the corporation (and that in turn would truly maximize shareholder wealth), shareholders would have shunned the Google IPO.<sup>210</sup> Conversely, investors, including sophisticated investors, oversubscribed the stock.<sup>211</sup> In any case, the Google example demonstrated that investors did not consider increased shareholder participation so important as to withhold their investment.<sup>212</sup> While investors themselves may not view increased shareholder participation as a beneficial part of investing their money, Part IV.B evaluates which groups may actually benefit from the NDPTCA.<sup>213</sup>

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203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.*

207. Thomas J. Chemmanur & Yawen Jiao, *Dual-Class IPOs, Share Recapitalizations, and Unifications: A Theoretical Analysis*, 1 (Dec. 2004), <http://www.fma.org/Chicago/Papers/dualclassIPOandunificationandrecapitalization.pdf>. When companies go public, entrepreneurs and insiders incorporate into the charter the voting structure of the shares. *Id.* Most corporations select a single class share structure, which means one share equals one vote. *Id.* However, a considerable minority (roughly eleven percent of U.S. IPOs in 2001 and over sixteen percent in 2002) pick a dual class voting structure, where one class of shares has more voting rights than another class. *Id.*

208. Stout, *supra* note 60, at 802.

209. Lynn A. Stout & Iman Anabtawi, *Sometimes Democracy Isn't Desirable*, WALL ST. J., Aug. 10, 2004, at B2, *available at* [http://online.wsj.com/article/SB109209528252887073.html?mod=todays\\_us\\_marketplace](http://online.wsj.com/article/SB109209528252887073.html?mod=todays_us_marketplace).

210. Stout, *supra* note 60, at 802.

211. *Id.*

212. *See id.* at 802-03 (noting that investors had "revealed" a preference for a corporation in which they retained little power as shareholders).

213. *See* discussion *infra* Part IV.B (evaluating the potential benefits and drawbacks of the NDPTCA).

B. WHO IS THE DESIGNED BENEFICIARY OF NORTH DAKOTA'S CORPORATE GOVERNANCE STATUTE?

As previously discussed, advantages mentioned with the adoption of the NDPTCA were increased revenue through franchise fees, infrastructure growth, and national recognition.<sup>214</sup> Yet the question of benefits also raises the issue of exactly who might benefit from the law.<sup>215</sup> Equally important to explore are some potential drawbacks if the NDPTCA were applied to a corporation.<sup>216</sup>

1. *Who may benefit and who may not?*

“Chapter 10-35 will be the first state corporation law to focus on providing a new model of shareholder rights that builds upon the best thinking of large institutional investors.”<sup>217</sup> Part IV.B.1.a notes that it may indeed be large and institutional investors who benefit from this law, given the significant hurdles an average investor would face with respect to the NDPTCA.<sup>218</sup> Further, Part IV.B.1.b looks at the nature of average public stockholders and their generally apathetic attitude towards the governance process.<sup>219</sup>

a. Significant Hurdles

North Dakota's new law has been touted as the nation's first “shareholder-friendly” law, but to which shareholders this new legislation is “friendly” is an interesting query.<sup>220</sup> A proponent of the NDPTCA stated, “today an investor *with a large position* in a corporation may be essentially locked into its investment and have no choice but to focus on improving the governance of the corporation.”<sup>221</sup> The NDPTCA, even if adopted and used

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214. *See supra* text accompanying note 182 (noting the alleged benefits mentioned in conjunction with adopting the NDPTCA).

215. *See* discussion *infra* Part IV.B.1 (examining the hurdles and other reasons why small or average investors may not benefit from the NDPTCA).

216. *See* discussion *infra* Part IV.B.2 (discussing how the board of directors may serve as a body to protect shareholders from each other).

217. *Hearing, supra* note 103, at 1 (testimony of William H. Clark, Jr.).

218. *See* discussion *infra* Part IV.B.1.a (noting the huge financial hurdles to access some provisions of the NDPTCA).

219. *See* discussion *infra* Part IV.B.1.b (observing the widely accepted notion that most shareholders in a publicly traded company are rationally apathetic).

220. *See* Reid, *supra* note 8, at B1 (stating that the law has been publicized as a progressive infrastructure law for public corporations).

221. *Hearing, supra* note 103, at 2 (testimony of William H. Clark, Jr.) (emphasis added).

by a corporation, would not necessarily benefit the small or even average investor.<sup>222</sup>

Certain portions of the NDPTCA do embrace the idea that all shareholders may participate in the governance process.<sup>223</sup> Yet in other places of the act there remain significant restrictions on who may participate, such as accessing the corporation's proxy statement.<sup>224</sup> If a shareholder is not a "qualified" shareholder, he or she is not entitled to nominate candidates on the proxy.<sup>225</sup> To be considered a "qualified shareholder" the law requires that the person or group own more than five percent of the outstanding shares.<sup>226</sup> Additionally, the law provides that shareholders demanding a special meeting must own at least ten percent of the voting power of all shares entitled to vote.<sup>227</sup>

Though the proxy requirement and the special shareholder meeting in the law contain seemingly insignificant hurdles of five and ten percent, it is important to keep in mind that these provisions pertain specifically to the public corporation.<sup>228</sup> A public corporation's capitalization<sup>229</sup> is likely to be substantial.<sup>230</sup> For example, in 2005 the New York Stock Exchange (NYSE) listed the median market capitalization as \$1.7 billion, with the largest market capitalization as \$371.7 billion and the smallest as \$4.8 million.<sup>231</sup> In 2005, the median market capitalization of the S&P 500 was

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222. See Cheryl Nichols, *The Importance of Selective Federal Preemption in the U.S. Securities Regulatory Framework: A Lesson From Canada, Our Neighbor to the North*, 10 CHAP. L. REV. 391, 394 n.2 (2006) (defining small investors as individuals who invest relatively small amounts of money in the U.S. securities markets); INV. CO. INST. & THE SEC. INDUS. ASS'N, EQUITY OWNERSHIP IN AMERICA 10 (2005), available at [http://www.ici.org/pdf/rpt\\_05\\_equity\\_owners.pdf](http://www.ici.org/pdf/rpt_05_equity_owners.pdf) (noting that median household financial assets in equities was \$65,000 and that equity owners, on average, held fifty-five percent of their household financial assets in individual stock or stock mutual funds in 2005). See also Antony Page, *Taking Stock of the First Amendment's Application to Securities Regulation*, 58 S.C. L. REV. 789, 816 (2007) (noting that private investors directly own a small percentage of securities).

223. See, e.g., N.D. CENT. CODE § 10-35-05(1) (2007) ("Any shareholder of a publicly traded corporation may propose the adoption, amendment, or repeal of a bylaw." (emphasis added)).

224. See *id.* § 10-35-08(2) (restricting access to only "qualified shareholders"). In public corporations, voting occurs before the shareholder meeting, since most shareholders do not attend. PINTO & BRANSON, *supra* note 9, at 110. The use of proxies allows shareholders to vote on certain matters or to delegate their vote to another who will be present at the meeting. *Id.*

225. N.D. CENT. CODE § 10-35-08(3) (2007).

226. *Id.* § 10-35-02(8).

227. *Id.* § 10-35-13(1).

228. *Id.* § 10-35-02(6).

229. BLACK'S LAW DICTIONARY 223 (8th ed. 2004) (defining capitalization as "the total par value or stated value of the authorized or outstanding stock of a corporation").

230. See Wilshire Assoc., *Fundamental Characteristics of the Wilshire 5000*, <http://www.wilshire.com/Indexes/Broad/Wilshire5000/Characteristics.html> (noting that public corporations command a total market capitalization of more than \$16 trillion).

231. NYSE COMPOSITE INDEX (2006) [http://www.nyse.com/pdfs/key\\_benefits\\_nya.pdf](http://www.nyse.com/pdfs/key_benefits_nya.pdf).



around \$9.8 billion.<sup>232</sup> The average investor's portfolio,<sup>233</sup> coupled with the fact that many investors these days are diversified among companies, makes it even less likely that a small or average investor would have the requisite five or ten percent required amount in a single public corporation to trigger certain provisions.<sup>234</sup> For example, taking the median capitalization of a corporation on the NYSE of \$1.7 billion, the five or ten percent triggers would require a shareholder to have \$85 million or \$170 million, respectively.<sup>235</sup>

This section does not intend to argue that certain triggers or hurdles should not be established with respect to shareholder access and the governance process, because there are many thresholds in corporate law today.<sup>236</sup> However, thresholds should be carefully considered.<sup>237</sup> For example, section 10-35-08 of the North Dakota Century Code (requiring only a five percent trigger to access the company's proxy) is patterned after an SEC proposal from 2003.<sup>238</sup> Some critics have suggested that a more appropriate threshold for this type of provision would be a twenty-five percent trigger, because it would establish a more substantial shareholder interest and would be a more trustworthy indicator that the costs and disruption of contested elections is reasonable.<sup>239</sup> An elevated threshold would also lessen the probability of a corporation receiving a director contest proposal from a

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232. Stephen Biggar & Robert Gold, *These 40 Stocks—the Power Picks 2005 Portfolio—Represents S&P Analysts' Top Choices From Among the 1,500 That They Cover*, BUS. WK. ONLINE, Jan. 3, 2005, available at 2005 WLNR 170351 (Westlaw).

233. INV. CO. INST. & THE SEC. INDUS. ASS'N, *supra* note 222, at 10.

234. See Larry E. Ribstein, *The Constitutional Conception of the Corporation*, 4 SUP. CT. ECON. REV. 95, 134 (1995) ("Most individuals either hold diversified portfolios of investments or invest in corporations indirectly through institutions such as mutual funds. Accordingly, they care little about the internal affairs of individual companies"); Page, *supra* note 222, at 816 (noting that vast majority of securities are institutionally owned and not directly held). Equities these days are much less likely to be selected by individuals and more likely to be held as part of a "large portfolio of stocks weighted by their market capitalization." *Id.* (quoting Utpal Bhattacharya & Neal Galpin, *The Global Rise of the Value-Weighted Portfolio* 1, AFA Chicago Meetings Paper (Mar. 2007), available at <http://ssrn.com/abstract=849627>).

235. NYSE COMPOSITE INDEX, *supra* note 231; N.D. CENT. CODE §§ 10-35-02(8), (13) (2007).

236. See, e.g., N.D. CENT. CODE § 10-35-17 (requiring shareholder consent before a firm issues shares having more than twenty percent of the outstanding votes); MODEL BUS. CORP. ACT § 6.21(f)(1) (2002) (establishing a similar twenty percent requirement for the issuance of shares).

237. See John J. Castellani & Amy L. Goodman, *The Case against the SEC Director Election Proposal*, in *Shareholder Access to the Corporate Ballot*, 21 (2004), available at [http://www.law.harvard.edu/faculty/hjackson/alumnipapers/SEC\\_Director\\_Election.Castellani.and.Goodman.pdf](http://www.law.harvard.edu/faculty/hjackson/alumnipapers/SEC_Director_Election.Castellani.and.Goodman.pdf) (urging caution in that a specific voting trigger would be available to shareholders of all public companies, not only those with an ineffective proxy process).

238. Security Holder Director Nominations, Exchange Act Release No. 48, 626, 68 Fed. Reg. 60, 784 (Oct. 23, 2003) (proposing Rule 14a-11); N.D. CENT. CODE § 10-35-08; *Hearing*, *supra* note 103, at 3 (testimony of William H. Clark, Jr.).

239. Castellani & Goodman, *supra* note 237, at 21.

single large shareholder with a personal grievance against the company or its board.<sup>240</sup> Whether the threshold is five or twenty-five percent, they both likely mean the average or small shareholder will not to be able to achieve these financial hurdles, nor as discussed below, will they likely make the effort to aggregate their shares due to rational apathy of shareholders in public firms.<sup>241</sup>

#### b. Shareholder Apathy

It is not simply the amount of money it takes to access some provisions of the NDPTCA that shows the law assists large shareholders; it is also the nature of shareholders that make up a public firm.<sup>242</sup> A single shareholder need not possess the entire five percent, ten percent, or whatever trigger level is required, because they may collectively pool their resources with other shareholders.<sup>243</sup> However, the likelihood of a small or average shareholder initiating this action is unlikely, since “shareholders face well-known collective action and rational apathy problems.”<sup>244</sup> The shareholders of a publicly traded company are generally considered passive and would rather sell their shares than challenge the management of the corporation.<sup>245</sup>

An example of rational apathy is given where, in the case of a director challenge from activist shareholders, smaller or average shareholders frequently lack incentives to become informed about the competing candidates for whom they are voting.<sup>246</sup> “This is the classic problem of rational apathy: for the average shareholder, collecting and absorbing the necessary information will entail a much higher opportunity cost than the expected benefit, which is low because most shareholder votes will have little individual impact on the outcome.”<sup>247</sup> Since shareholders lack the incentives and information to make a decision, it is more cost effective to convey the information to a central place to have the board make the collective

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240. *Id.*

241. See discussion *supra* note 231 (noting that the median capitalization of the NYSE is \$1.7 billion); see also discussion *infra* Part IV.B.1.b (discussing the potential millions of dollars it may take shareholders to access certain provisions of the NDPTCA and the apathetic nature of shareholders in a public corporation).

242. See PINTO & BRANSON, *supra* note 9, at 87 (noting that shareholders of public companies are by and large widely dispersed).

243. N.D. CENT. CODE § 10-35-02(8) (2007). “‘Qualified shareholder’ means a person or group of persons acting together.” *Id.*

244. Choi & Guzman, *supra* note 170, at 987.

245. PINTO & BRANSON, *supra* note 9, at 111.

246. John F. Olson, *Professor Bebchuk’s Brave New World: A Reply to “The Myth of the Shareholder Franchise,”* 93 VA. L. REV. 773, 784 (2007).

247. *Id.*

decision.<sup>248</sup> Consequently, shareholders would rather entrust decision-making authority to the board of directors because in the long run, this efficient system will maximize shareholder wealth.<sup>249</sup>

Shareholder activism sometimes wins support from smaller shareholders, but it is spearheaded in each case by large shareholders.<sup>250</sup> Large shareholders have more at stake and are more inclined to battle than small shareholders.<sup>251</sup> Herein lies the issue with a statute like the NDPTCA: larger shareholders will simply have a larger voice.<sup>252</sup> A fair question to ask is whether this “greater voice” of large shareholders could place smaller shareholders at risk of becoming disadvantaged if large stockholders are given a more active role in the governance process.<sup>253</sup> The following section discusses several examples where large shareholders use their influence at the expense of other shareholders.<sup>254</sup>

## 2. *Potential Drawbacks: Shareholder Opportunism*

Corporate management has been criticized for opportunism, yet shareholders are not excluded from this type of action, either.<sup>255</sup> Directors are certainly capable of making opportunistic threats.<sup>256</sup> However, the difference between director and shareholder opportunism is that, “unlike shareholders, directors do not benefit financially from making threats, at least not in their positions as directors.”<sup>257</sup> One way to look at the power given to the board of directors is that it serves shareholders by protecting them from one another.<sup>258</sup> The director primacy model can help referee the deep divisions between shareholders, especially large shareholders, who may have private interests in conflict with maximizing overall shareholder value and who are most likely to exercise their shareholder power.<sup>259</sup>

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248. Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 60, at 624 (citing KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 68 (1974)).

249. *Id.*

250. Rodrigues, *supra* note 152, at 1404.

251. *Id.*

252. *See id.* (“It is true that in shareholder democracy larger shareholders have a greater voice.”).

253. *See* Anabtawi, *supra* note 55, at 575 (explaining that certain shareholders in public firms may have private interests that can actually work to disadvantage some shareholders).

254. *See* discussion *infra* Part IV.B.2 (discussing the role that opportunism may play among various shareholders).

255. *See* Anabtawi, *supra* note 55, at 575 (stating that shareholders in public firms may have private interests that can lead to opportunistic behavior).

256. Stout, *supra* note 60, at 797.

257. *Id.* (emphasis omitted).

258. *Id.* at 794.

259. Anabtawi, *supra* note 55, at 564.

Shareholders may use persuasion not only to enhance shareholder values, but also to attain private benefits.<sup>260</sup> In theory, one shareholder, or several shareholders holding the same preferences, would be able to specify with one voice an objective for running the corporation.<sup>261</sup> Nonetheless, if shareholders have private interests, they may have a preference that the company pursue certain interests differently and possibly at the expense of other shareholders.<sup>262</sup> These existing private interests no longer make it appropriate to think of shareholder action “as a collective good.”<sup>263</sup> Shareholders could use their own interests, for example, to pursue labor interests, push forward a “social” agenda, or obtain “greenmail” benefits.<sup>264</sup>

In addition, “rent-seeking” activities by shareholders are a concern that may result in reduced shareholder value.<sup>265</sup> The costs of rent-seeking are manifested in distorted decision-making and resources spent in transferring wealth.<sup>266</sup> A classic example of how a shareholder can create costs within a corporation is the du Pont investment in General Motors (GM).<sup>267</sup> Du Pont substantially increased its equity interest within GM in order to obtain a large portion of GM’s leather, paint and varnish business.<sup>268</sup> After buying a large amount of stock, du Pont used its influence as a large shareholder and became the major supplier to GM of those foregoing products.<sup>269</sup> The GM case illustrates a large investor using influence to further its private interests, even though the transaction increased production costs for GM.<sup>270</sup> The deal generated an interest cost for GM shareholders because GM had entered into a less than favorable agreement with du Pont.<sup>271</sup>

The Perry Capital example is a more modern instance of “rent-seeking” where a large investor used their power to push for strategies that increased the worth of another security held by the investor.<sup>272</sup> Perry Capital, a hedge

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260. *Id.* at 574.

261. *Id.* at 575.

262. *Id.*

263. *Id.*

264. Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 720 (2007). “Greenmail” is the buying back of stock by a corporation from a transient, threatening investor at a preferential price to end the threat of a takeover. David Manry & David Stangeland, *Greenmail: A Brief History*, 6 STAN. J.L. BUS. & FIN. 217, 224 (2001).

265. Anabtawi, *supra* note 55, at 575. “‘Rent seeking’ is the socially costly attempt to obtain wealth transfers.” *Id.*

266. *Id.*

267. *Id.* at 576.

268. *Id.*

269. *Id.*

270. *Id.*

271. *Id.*

272. Stout, *supra* note 60, at 794.

fund, acquired a block of Mylan Laboratories common stock.<sup>273</sup> Simultaneously, Perry Capital entered into a derivatives contract with a brokerage firm that allowed Perry Capital to keep its Mylan Laboratories votes while hedging away its financial interest in the stock.<sup>274</sup> Perry then used its status as a large shareholder to pressure Mylan's board of directors to acquire another company, King Pharmaceuticals.<sup>275</sup> This acquisition took place at a hefty premium over market price.<sup>276</sup> Why would Perry, as such a large shareholder in Mylan, want Mylan to overpay for King Pharmaceuticals?<sup>277</sup> Likely because Perry Capital was also a large shareholder of King stock and had not hedged away its economic interest in King.<sup>278</sup> In other words, Perry had retained the voting rights as a Mylan shareholder without any of the financial risk.<sup>279</sup>

Indeed, deep divisions exist between shareholders of a corporation.<sup>280</sup> Some shareholders have long-term interests, and generally have little regard for short-term developments.<sup>281</sup> However, a short-term investor sells and buys shares frequently and is concerned with short-term values of stock.<sup>282</sup> These two interests can lead to a divergence in preferences as to how a corporation makes decisions.<sup>283</sup> For example, short-term investors would prefer short-term inflation of stock, while long-term shareholders would be willing to forego the short-term gains for future appreciation.<sup>284</sup> Certain shareholders are primarily interested in a big profit in a short time and keep a "laser-beam focus on quarter-to-quarter earnings."<sup>285</sup> Other examples of divergent shareholders' interests include diversified versus undiversified shareholders<sup>286</sup> and inside versus outside shareholders.<sup>287</sup>

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273. *Id.*

274. *Id.*

275. *Id.*

276. *Id.*

277. *Id.*

278. *Id.* at 794-95. Perry set up a complicated trade so that it had practically no exposure to changes in Mylan's stock price, which likely would have dropped if it purchased King. Posting of Justin Hibbard to Deal Flow [hereinafter Posting of Hibbard], [http://www.businessweek.com/the\\_thread/dealflow/archives/2006/01/the\\_not\\_so-divi.html](http://www.businessweek.com/the_thread/dealflow/archives/2006/01/the_not_so-divi.html) (Jan. 11, 2006, 13:20 EST).

279. Posting of Hibbard, *supra* note 278.

280. Anabtawi, *supra* note 55, at 577.

281. *Id.* at 579.

282. *Id.*

283. *Id.* at 581.

284. *Id.*

285. Strine, *supra* note 106, at 1764. "[Short-termism] helped create managerial incentives that contributed to the debacles at corporations like Enron, WorldCom, HealthSouth, and Adelphia." *Id.*

286. Anabtawi, *supra* note 55, at 583.

Whatever the different interests of shareholders may be, du Pont and Perry Capital serve as cautionary tales and illustrate the danger inherent in changing corporate laws in a way that gives opportunistic shareholders in public firms greater leverage over boards.<sup>288</sup> Indeed, transferring more authority to shareholders will likely only aggravate rent-seeking behavior.<sup>289</sup> Certainly providing shareholders with more rights can create risks to other shareholders, but the following section addresses an equally important issue: Whether the NDPTCA actually works to address the scandals and frauds that have beleaguered some corporations.<sup>290</sup>

### C. THE NDPTCA DOES LITTLE TO ADDRESS RECENT CORPORATE SCANDALS

In the wake of apparent executive malfeasance and director negligence of recent corporate scandals, there have been renewed calls for increased shareholder participation.<sup>291</sup> In fact, testimony by a proponent of the NDPTCA stated that the scandals of Enron and WorldCom law have not ended.<sup>292</sup> While the NDPTCA modestly addresses the recent anger caused over CEO compensation,<sup>293</sup> there is likely little or nothing in the rest of the Act that would have prevented or minimized the damage caused by the scandals of Enron, WorldCom, Adelphia, and others.<sup>294</sup>

In these recent scandals, federal disclosure rules were violated and fraud was committed.<sup>295</sup> Yet, the frauds perpetrated in those cases bear little relationship or remedy to the main thrusts of the NDPTCA, which applies restrictions on antitakeover defenses and enhances shareholders' power to adopt bylaws and vote, among others.<sup>296</sup> Keep in mind that current reform efforts, as embodied in the NDPTCA, are aimed to some extent at "reunifying" ownership and control in the modern public

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287. *Id.* at 586. Inside shareholders are shareholders who are firm employees as opposed to outside investors who invest externally. *Id.*

288. Stout, *supra* note 60, at 795.

289. Anabtawi, *supra* note 55, at 577.

290. See discussion *infra* Part IV.C (explaining that there is little or nothing in the NDPTCA to protect shareholders from the frauds of recent corporate scandals).

291. Stout, *supra* note 60, at 806.

292. *Hearing, supra* note 103, at 2 (testimony of William H. Clark, Jr.).

293. N.D. CENT. CODE § 10-35-12(5) (2007). The statute obliges the compensation committee of the board of directors to report to the shareholders at each regular meeting of shareholders. *Id.* Shareholders are able to vote as to whether they accept the report, but only on an advisory basis. *Id.*

294. See Stout, *supra* note 60, at 806 ("Enron did not collapse because its shareholders did not have enough power.").

295. PINTO & BRANSON, *supra* note 9, at 129.

296. N.D. CENT. CODE §§ 10-35-05, 10-35-22 to -25 (2007).

company.<sup>297</sup> Reunifying ownership and control is very different from the frauds committed in the last few years, and none of the provisions in the NDPTCA address disclosure or strengthen criminal penalties for fraud.<sup>298</sup> In addition, if directors or officers within a publicly traded corporation commit fraud by withholding or falsifying information, shareholders are helpless to protect themselves in any case.<sup>299</sup> Simply stated, the provisions of the NDPTCA do not address any further measures that would protect shareholders from these fraudulent actions.<sup>300</sup>

Aside from failing to deal with real issues in corporate governance, there are some provisions in the NDPTCA that use unique language with respect to business statutory schemes.<sup>301</sup> That is, certain provisions appear to have no corresponding counterpart in any other business statute.<sup>302</sup> Section D compares the enabling shareholder rights language to other business statutory schemes.<sup>303</sup>

#### D. PROVISION PROVIDING UNIQUE LANGUAGE COMPARED WITH CONTEMPORARY CORPORATE LAW

The NDPTCA creates a rule of construction mandating that the “provisions of this chapter and of chapter 10-19.1 must be liberally construed to protect and enhance the rights of shareholders in publicly traded corporations.”<sup>304</sup> The statutory directive to liberally construe the Act has no counterpart in either the 1984 Model Business Corporation Act (MBCA), the current version of the MBCA, the BCA, or in any other of North Dakota’s corporate statutes.<sup>305</sup> Its requirement of “liberal construction,” which is sometimes found in remedial<sup>306</sup> or consumer<sup>307</sup> legislation is

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297. Anabtawi, *supra* note 55, at 569.

298. N.D. CENT. CODE ch. 10-35; *see* Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT’L L.J. 31, 39 (2007) (stating that many of the recent corporate fraud cases involved incorrect and deceptive disclosures that broke existing laws).

299. Interview with Jason Kilborn, Visiting Professor of Law, University of North Dakota, Grand Forks, N.D. (Feb. 3, 2007).

300. *Id.*

301. *See* § 10-35-27 (calling for the statute to be interpreted liberally to protect and increase shareholder rights).

302. *See* discussion *infra* Part IV.D (discussing the unique language placed in the NDPTCA compared with contemporary corporate law).

303. *See* discussion *infra* Part IV.D (contrasting and comparing the NDPTCA with other corporate statutes).

304. § 10-35-27.

305. N.D. CENT. CODE tit. 10 (2007); *id.* § 10-19.1; MODEL BUS. CORP. ACT (2002); MODEL BUS. CORP. ACT (1984).

306. *See* AM. JUR. 2D *Statutes* § 185 (2007) (explaining that the purpose of liberal interpretation of remedial statutes should be to give them a fair construction and promote justice).

applied here in the context of corporate law.<sup>308</sup> Business entity law differs from consumer or remedial legislation in that it largely deals with individuals who freely choose to invest financial resources and are aware of the rules and risks up front.<sup>309</sup>

Further, the directive to construe the Act to “enhance” shareholder rights finds no similar provision in any version of the MBCA, or any other North Dakota corporate statutes.<sup>310</sup> The language singling out shareholders as the group whose rights are to be protected and enhanced is interesting in light of *all* the constituencies a corporation serves.<sup>311</sup> While this language of favoring shareholders is consistent with the overall concept of the NDPTCA, its inclusion in a business law statute is an unusual step to be sure.<sup>312</sup>

## V. CONCLUSION

Regardless of whether North Dakota’s new corporate governance statute is ever realized in actual application, the central message behind this new law is that the balance between shareholders and directors is in need of a massive overhaul.<sup>313</sup> Even Sarbanes-Oxley, the federal response to recent corporate scandals, which presented a marked departure in the federal government’s role of corporate regulation, certainly did not mandate or even suggest a fundamental structural overhaul between shareholders, managers, and directors.<sup>314</sup> After hundreds of years of American corporate law, a delicate but important balance has been achieved within our distinctive

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307. See 21 C.J.S. *Credit Reporting Agencies* § 36 (2007) (“Generally, consumer protection statutes are to be construed liberally and broadly in favor of consumers.”).

308. § 10-35-27.

309. See Stout, *supra* note 60, at 801 (explaining that an often-overlooked fact of business is that investors are not forced to purchase shares in public corporations). Alternatively, investors have the option of investing in closely held corporations, sole proprietorships, partnerships, and limited partnerships. *Id.*

310. N.D. CENT. CODE tit. 10 (2007); *id.* § 10-19.1; MODEL BUS. CORP. ACT (2002); MODEL BUS. CORP. ACT (1984).

311. See Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 60, at 626 (noting all the constituencies affected by corporate governance).

312. See Fershee, *supra* note 190 (noting that the language enhancing shareholder rights is a nod to the overall notion of the entire statute).

313. See Veasey, *supra* note 135, at 816 (replying to several major proposed reforms of Lucian Bebchuk with respect to increasing the authority of shareholders).

314. See PINTO & BRANSON, *supra* note 9, at 130 (stating that Sarbanes-Oxley tried to regulate corporate governance by increasing the monitoring of corporations and managers); Romano, *supra* note 4, at 1523 (noting that Sarbanes-Oxley altered the traditional authority of the state and federal government by providing specific legislative directives for SEC regulation, something formerly perceived as the states’ exclusive jurisdiction).



federalist system, and a fundamental overhaul is unnecessary.<sup>315</sup> The system in place (apart from the NDPTCA) is an arrangement that balances the relationships and responsibilities of directors, shareholders and officers along with what is generally the appropriate role of the state and federal governments to manage the internal affairs and regulate the markets.<sup>316</sup>

Bearing in mind the rational apathy and financial hurdles shareholders face in accessing some provisions of the NDPTCA, this new law is clearly not about “corporate democracy,” but rather provides tools for the large investor.<sup>317</sup> Recent shareholder activism certainly demonstrates that large shareholders can find it worthwhile to agitate for changes within corporations.<sup>318</sup> For example, Kirk Kerkorian, with his almost ten percent stake in GM, was able to place an ally on the board of directors and pressure for overall strategic changes.<sup>319</sup> Carl Icahn successfully used his status as a large shareholder of Time Warner to have the company buy back twenty billion dollars worth of stock and was able to place two directors on its board.<sup>320</sup> An investor with a significant share of stock at Six Flags effectively replaced the CEO,<sup>321</sup> and an individual shareholder resisting Novartis AG’s acquisition of Chiron Corporation brought the deal into doubt.<sup>322</sup> Individual shareholders are not the only activist shareholders, as evidenced by the institutional activities of California Public Employees’ Retirement System (CalPERS) and the American Federation of State, County, and Municipal Employees.<sup>323</sup>

Protecting shareholders is and always should be a priority, but increasing some shareholders’ power via the NDPTCA is not the way to protect shareholders from fraud.<sup>324</sup> Rather, the concept of a shareholder democracy appears to be driven by emotion and an assumption that greater shareholder control must be a good thing, “like Mom and apple pie.”<sup>325</sup> Even if corporate management and directors respond to activist shareholders and adopt

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315. See Veasey, *supra* note 135, at 817 (noting that American corporate law has achieved a delicate balance not only based upon federalism, but also including the balance of the rights and responsibilities of the shareholders, directors, and managers).

316. *Id.*

317. Fershee, *supra* note 190.

318. Rodrigues, *supra* note 152, at 1403.

319. *Id.*

320. *Id.*

321. *Id.* at 1403-04.

322. *Id.* at 1404.

323. *Id.*; Chad Terhune & Joann S. Lublin, *At Home Depot, CEO “Pay Rage” Boils Over in Vote*, WALL. ST. J., June 2, 2006, at A3 (describing shareholders’ voting power).

324. See Stout, *supra* note 60, at 806-07 (noting that the recent corporate scandals transpired at a time when shareholders had more power than ever before).

325. *Id.* at 809.

different codes of practice, these are not signs that individual shareholders are gaining a more meaningful voice in the corporate decision-making processes.<sup>326</sup>

Additionally, not only do the foregoing examples show that large shareholders find it worthwhile to “agitate for change,” but that they are capable of accomplishing their objectives without the help of North Dakota’s new law.<sup>327</sup> North Dakota’s novel approach to corporate governance will likely face challenges with respect to corporations that will actually incorporate under this law—and it may be the overall impact of this law is little to nothing.<sup>328</sup> Yet, with the premise of this law looking to assist large stockholders, perhaps whether one thinks North Dakota’s new law is a good idea depends on how much they trust those large shareholders.<sup>329</sup>

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326. Tsuk Mitchell, *supra* note 6, at 1575.

327. See William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1428 (2007) (entertaining the idea that in some way activist shareholders’ record of governance success is impressive to the point that they may have “shifted the balance of corporate power in the direction of outside shareholders and their financial agendas”).

328. See discussion *supra* Part IV.A.1-3 (discussing three scenarios where a corporation might incorporate under the NDPTCA and reasons the company would be unable to do so or would choose not to do so).

329. See Rodrigues, *supra* note 152, at 1404 (referring to voting proposals within a public corporation, but also noting that in a shareholder democracy, large shareholders have a larger say in the affairs of a corporation).

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