

# A 'Delaware Trap' for Companies

*The Wall Street Journal*

By: Daisy Maxey

May 7, 2017

What incorporates in Delaware stays in Delaware.

More than half of publicly traded U.S. companies incorporate in the small state, regardless of their headquarters location, and once there they rarely leave. That is generally because once incorporated, it is difficult to get shareholders and management to agree on a new state of incorporation, says Robert Anderson IV, an associate professor of law at Pepperdine University School of Law.

In a new [study](#), Dr. Anderson examines why so many companies land in what he dubs “the Delaware Trap.”

There have long been two competing theories on what motivates companies' incorporation decisions. The “race to the bottom” theory holds that states compete by making rules that favor company insiders at the expense of corporations and their shareholders.

The “race to the top” theory, in contrast, suggests that market constraints prevent such favoritism, and that states instead compete to provide efficient legal rules that enhance shareholder value.

But Dr. Anderson examined regulatory filings related to raising private capital, and concluded that it is all about the company's choice of law firm near the time of founding.

He found that some larger, elite law firms may steer businesses toward a Delaware incorporation with their own needs in mind, rather than because of any superior quality of the state's legal system or the companies' needs. Perhaps, he speculates, it is easier and less expensive for them to focus on Delaware, rather than having to master the laws of many states.

In contrast, other firms—such as smaller, regional firms—are likely inherently focused on their state's law, and therefore might be expected to disproportionately recommend in-state incorporation, he says.

Because it is difficult for companies to reincorporate, there is little incentive for states to compete for incorporation business and the franchise fees it generates by offering robust alternatives to Delaware law, Dr. Anderson says.

“The consequence is a stagnant menu of relatively homogeneous state corporate law with little innovation, even though innovation might benefit shareholders,” he says.

Dr. Anderson's research doesn't take into account various factors that prior research has shown to influence incorporation decisions, such as the antitakeover statutes of a business's state of headquarters, says Lucian Bebchuk, the James Barr professor of law, economics and finance at Harvard Law School and the director of its program on corporate governance.

A study by Dr. Bebchuk and Alma Cohen, a professor of empirical practice at Harvard Law School, found that companies are more likely to incorporate in Delaware rather than their state of headquarters when they have more employees or sales, when they're based in the Northeast or South or when their state of headquarters has fewer antitakeover statutes.

But Dr. Anderson says he's confident that weighing states' antitakeover statutes wouldn't undermine his results.