



THE CASE AGAINST DELAWARE.

Rogue State

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Post date: 08.07.02

Issue date: 08.19.02

[Editor's Note: This article erroneously states that Delaware has no gasoline tax. It does.]

Until one day several years ago, I, like most people, harbored no ill feelings toward the state of Delaware. I suppose in some vague sense I thought of it as harmless and even endearing, the way you tend to regard other small things, such as Girl Scouts or squirrels. But all that changed the summer day I moved to Washington, when, making my way down i-95 in a rental truck with all of my worldly belongings, I screeched to a halt in front of what turned out to be a two-hour backup in Delaware. Never having driven down the East Coast, I at first assumed the traffic jam must have been caused by some horrific accident. But as my truck crept forward I saw it was no accident at all but a deliberate obstruction--specifically, a tollboth on the Delaware Turnpike. Slowly the full horror of it sunk in: The State of Delaware had turned the East Coast's main traffic artery into a sweltering parking lot merely so it could exact a tribute from each driver crossing its miserable little stretch of concrete.

The practice of charging road tolls is an archaic holdover blighting much of the Northeast. But Delaware has taken it to a grotesque extreme. Whereas the i-95 tolls amount to less than five cents per mile in New Jersey and four cents per mile in Maryland, in Delaware they cost an exorbitant 18 cents per mile. Which isn't surprising because, in a deeper sense, Delaware's tolls epitomize the state's entire ethos. The organizing principle of Delaware government is to subsidize its people at the rest of the country's expense. While tolls represent the most obvious of the state's nefarious methods, Delaware also utilizes its appallingly lax regulation of banks and corporations to enrich itself while undermining its neighbors. Indeed, Delaware's image as small and inoffensive is not merely a misconception but a purposeful guise. It presents itself as a plucky underdog peopled by a benevolent, public-spirited, entrepreneurial citizenry. In truth, it is a rapacious parasite state with a long history of disloyalty and avarice.



Delaware's status as the initial signatory to the Constitution--reflected in its self-declared and oft-repeated nickname, "the First State"--has bathed it in the soft glow of colonial-era patriotism. But the actual historical record is considerably less edifying. The Delaware delegation to the Constitutional Convention was spearheaded by a bombastic bully named Gunning Bedford Jr. (One delegate called him "impetuous in his temper and precipitate in his judgment.") Bedford fiercely insisted that the national legislature be divided not on the basis of "one man, one vote" but "one state, one vote"--meaning the citizens of tiny Delaware would be massively overrepresented in Congress. In what one delegate described as "the most intemperate speech uttered in the Convention," Bedford blustered, "I do not, gentlemen, trust you." If the large states didn't meet his demands, Bedford threatened, "the small ones will find some foreign ally of more honor and good faith, who will take them by the hand and do them justice."

This initial flourish of anti-patriotic coercion established a Delaware political tradition of self-serving venality. When the nation mobilized for the War of 1812, Delaware manufacturers, led by the du Ponts, demanded that their laborers be exempt from military service. Not only would military service harm Delaware's economy, the factory owners claimed, but it would teach the workers "habits of intemperance and slothfulness," as University of Delaware historian Carol E. Hoffecker writes in *Delaware: A Bicentennial History*. (That the du Ponts thought pitched combat would turn the workers soft gives some sense of the working conditions in Delaware's mills at that time.) Later, when British warships neared the region and the du Ponts feared damage to their holdings, they performed a quick about-face, successfully petitioning the governor to arm their employees and form militias--but only to guard their mills.

Aside from its tradition of self-interestedness, Delaware has historically distinguished itself primarily by its retrograde approaches to race, political reform, and the administration of justice. In 1798 it effectively barred blacks--slave or free--from even entering a county seat on Election Day. As residents of the last Union state to ban slavery, most Delawareans sympathized with the Confederacy, and its senators attacked President Abraham Lincoln as a "monster" (in the words of one) and a "despot" and "weak and imbecile man" (in the words of the other). Despite siding with the Union during the Civil War, the legislature earmarked funds to assist drafted men seeking to buy their way out of military

service--reflecting either its affinity for the Confederacy or its general support for the principle of shirking one's patriotic obligations. Its political parties spent much of the late nineteenth century accusing each other (falsely, alas) of supporting black equality. Delaware voted against the Thirteenth, Fourteenth, and Fifteenth Amendments to the Constitution, which freed the slaves and gave them the vote and equal protection. It retained its Jim Crow laws into the 1960s, yet, perhaps due to its puniness, managed to escape the disrepute given to segregationist contemporaries like Alabama or Mississippi.

While its record on race put Delaware in a league with the Deep South, it had no peers when it came to political corruption. The small number of voters needed to buy one's way to power has tempted generations of Delaware tycoons. Electoral fraud established itself in Delaware as early as the eighteenth century, and 100 years later it grew endemic. In 1899 a gas magnate running for Senate offered voters as much as \$50 each--an astronomical sum at the time. One late-nineteenth-century magazine story called Delaware the only state that "maintains so composedly and so contentedly the usages and ideas of the medieval period of American politics." Republicans outside the state, writes Hoffecker, were "acutely embarrassed by the bad publicity emanating from little Delaware, where journalists reported votes being sold as if at auction."

Delaware also set itself apart through its fondness for medieval forms of punishment. It was not until the early 1900s that Delaware became the last state in the Union to abolish the pillory, a twelfth-century torture device. (The pillory resembled the stocks, but it was even crueler in that it forced the convict to stand, with his neck craned at what drawings indicate to be a highly uncomfortable angle.) In addition, Delaware achieved minor notoriety as the last state to ban public whipping. Connecticut renounced the practice in 1828, Pennsylvania in 1790. Delaware, by contrast, flogged its last convict in 1952.

But Delaware's greatest specialty is finding ways to siphon money out of nonresidents. The most irritating of these is its toll system. If a state wants to charge drivers for the cost of maintaining roads, tolls are a dubious way to do it--the traffic congestion they produce can be more costly than the toll itself. (You could reduce this congestion by charging double fare on the southbound turnpike and eliminating the northbound toll, as Maryland does; but Delaware concluded this would prompt motorists to drive around the state altogether.) The more efficient way to maintain roads is by taxing gasoline, which nearly all states do. But Delaware has no gas tax, presumably because if it did it would force Delawareans themselves to pay for most of the upkeep of their roads. Instead, the state uses its tiny stretch of i-95 to make out-of-staters foot the bill.

The reason Delaware charges a full \$2 for the privilege of driving the scant eleven miles of the Delaware Turnpike--four times more per mile than the Maryland or New Jersey turnpikes--is straightforward. Casual observation of license plates shows that many, perhaps most, of the drivers on the Maryland and New Jersey turnpikes hail from those states. Since those states have no interest in gouging their own citizens, tolls are low on a per-mile basis. But on the Delaware Turnpike, native license plates adorn just a tiny fraction of the cars. (Delaware transportation officials say they've never tried to calculate how many.) So why not take the outsiders for all they're worth? Every dollar in tolls paid by New Yorkers or Washingtonians means one fewer dollar in revenue that must be raised from Delawareans.

And even after you've crawled through their turnpike and handed them your toll, the citizens of Delaware still haven't finished with you. There's still a \$3 fare for the Delaware Memorial Bridge, which is run jointly by Delaware and New Jersey and whose proceeds--which far outstrip the bridge's maintenance costs--benefit both states about equally. (The *News Journal* in Wilmington reported that in recent years the bridge managers--political cronies from Delaware and Jersey--diverted \$1 million in toll revenues for trips to Europe, five-star resorts, golf outings, and strip clubs.) Altogether Delaware collects some \$120 million--around 6 percent of its budget--from tolls, most of it extracted from non-Delawareans. (Maryland, by contrast, collects a mere 1.5 percent of its budget from tolls, a far higher share of which comes from its own citizens.) Delaware transportation officials make a point of insisting that the revenue from these tolls--minus the cost of the odd lap dance--goes into Delaware's transportation trust fund. To nonresidents, of course, it makes not a whit of difference that our tolls finance Delaware's airports rather than its schools. The point is that Delawareans are forcing the rest of us to pay for their public infrastructure.

Not all the instruments of Delaware's rapacity take the form of meddlesome, high-handed government exacting inflated costs on out-of-state visitors. When need be, the state's avarice can also be fed by the exact opposite. An example of this latter technique is Delaware's enticement of much of the banking industry to relocate within its borders. It did so in 1981 not only by offering special tax breaks--the standard formula that states and localities use to woo industry--but by eviscerating its usury laws, which limit the interest a bank can charge for loans or credit cards. Seizing the opportunity to exploit unwary consumers across the country, eight of the ten largest credit-card firms in the country now operate within Delaware. In the meantime, personal bankruptcy nationwide has risen sevenfold over the last two decades, and tens of millions of Americans send checks to Delaware every month.

Undoubtedly this has spurred Delaware's economy, providing tens of thousands of jobs, which in turn have produced enough tax revenue to allow the state to slash its other taxes. But it has also made it nearly impossible for other states to regulate even the most predatory kinds of loan-sharking. Last year, for instance, Pennsylvania barred one of its banks from engaging in "payday lending." This practice entails lending to poor, financially unsophisticated consumers for two weeks. When they can't repay the loan, they typically take out another, repeating the cycle and paying interest rates that can exceed 700 percent. But just after the Pennsylvania bank ceased its payday lending, a bank based out of Delaware opened up shop in its place.

Etill, perhaps the prime example of what Louis D. Brandeis called the regulatory "race to the bottom" is Delaware's

biggest scam: incorporation fees. It so happens that in excess of 300,000 corporations--including half of the Fortune 500-- incorporate in wee Delaware. And unlike the banks that have moved to Delaware, companies that incorporate in the state needn't actually locate there. All the process entails, really, is that they hand over an annual fee, as low as \$50. Delaware collects so many of these fees that they, along with some associated revenues, account for a whopping one-quarter of total state revenues. The revenue stream is so large (relative to Delaware's budget) that the state needs no sales tax. Its tax-free shopping, in turn, allows its merchants to lure big-ticket shoppers from surrounding states--yet another way for Delaware to suck money from its neighbors.

Why do so many businesses incorporate in the First State? Delaware propaganda suggests it is primarily a function of the state's efficient bureaucracy and legal system, which includes a chancery court (a chamber specializing in business disputes). This is partly true, but it ignores the overriding factor: Incorporating in Delaware allows companies to operate under its laws and courts, which are the most promanagement in the nation. Corporations based there are held to the laxest possible standards of disclosure, shareholder rights, and fiduciary responsibility. Indeed, as the state has admitted in the past, its laws are specifically crafted to appeal to the interests of corporate executives. In the '60s Delaware formed a law revision committee to, as one member put it, "ascertain what other states have to attract corporations that we do not have."

All of this is deliberate state policy. A hundred years ago, in fact, the great trusts preferred to incorporate in New Jersey, not Delaware. It was only when New Jersey, under the progressive-era governorship of Woodrow Wilson, altered its laws to take account of interests (other than management) that corporations began to flee across the Delaware River. In the intervening years other states have tried to loosen their regulations and win for themselves the easy money that accompanies Delaware's avalanche of incorporation fees. (A Michigan corporation law from 30 years ago was described by its sponsor as an effort to "out-Delaware Delaware.") But at every juncture Delaware has underbid its competitors.

Hence much of American corporate law is driven not by any rational consideration of the public good but by Delaware's desire to fund its government with the tiniest possible contribution from its own citizens. A seminal 1974 *Yale Law Review* article by William Cary of Columbia Law School observed that "a pygmy among the 50 states prescribes, interprets, and indeed denigrates national corporate policy as an incentive to encourage incorporation within its borders, thereby increasing its revenue."

Conservatives argue that Delaware's loose regulations could not be harming shareholder interests, because, if they did, the stock prices of firms incorporating there would drop. This may be true in theory, but, as recent scandals show, even blatant infringements by corporate management--monstrous compensation packages, obtuse accounting--can go unpunished by investors for a very long time. In actual practice Delaware's loose rules amount to an invitation to engage in chicanery. Indeed, it is no coincidence that Enron chose to incorporate many of its fraudulent subsidiaries in Delaware. Nor was the collapsed energy giant the only shady entity recently tempted by Delaware's sycophantic approach to corporate regulation. Last year the Senate Subcommittee on Investigations found that the Russian mob laundered more than one billion dollars through a series of Delaware front corporations. Who needs the Cayman Islands when there's a tiny, secretive corporate haven on U.S. soil?

Of course plenty of states have some commercial cash cow to power their economies--Wall Street in New York or the entertainment industry in California. But those enterprises enrich their home states by creating products and services of value to consumers. Delaware, on the other hand, has come to its lucre at the direct expense of other states. It is simply a game of beggar-thy-neighbor. And the very act of draining money away from its fellow states usually carries massive repercussions--whether traffic jams on I-95 or the national emasculation of corporate governance.

Most Delawareans seem to regard the consequences of their state's parasitism with blithe indifference. In part this is because the state, like most cultures seeking to justify aggressive practices, has instilled in its people a deep sense of grievance. The state currently distributes a civics lesson, which instructs Delaware schoolchildren that, in the eighteenth century, merchants "charged the people of Delaware higher prices" than other states and which prods them with leading questions like: "Was Delaware being pushed around because of its small size? How could the situation be fixed?" Viewing their history through the lens of persecution and inferiority allows Delawareans to justify their state's reprehensible conduct.

The purest distillation of pro-Delaware propaganda can be found at the Delaware History Museum, a bright, cheerful storefront in downtown Wilmington. In the lobby sits a small amphitheater playing a film titled *Distinctly Delaware*. After dwelling on the state's tiny size--1/108 of Texas and so on--the narrator sounds a defiant note: "Smallness united [Delaware's] citizens in the 1780s to stand their ground at the Constitutional Convention and demand equal representation in the Senate." Of course, what Delaware's citizens demanded was not equal representation but **vastly disproportionate** representation--today one out of every 400,000 Delawareans has a vote in the Senate, as opposed to one in 17 million Californians.

Befitting their exalted place in the state's culture, toll roads have their own exhibit in the museum. A placard explains to visitors Delaware's first attempt to construct roads in the colonial era: "The government levied taxes to maintain the roads but rarely collected enough to keep them in good repair. Bumps, ruts, dust and mud challenged travelers and strained horses." Then to the rescue came investors with their more advanced toll roads. Suddenly, Delawareans "hoped to rival Philadelphia merchants by connecting local ports with farmers as far away as Lancaster." You see, little Susie, if not for tolls the state couldn't afford decent roads and travelers' horses would go lame!

The museum also devotes an exhibit to Delaware's innumerable banks and legally incorporated entities. "Many banks moved to Delaware, employing thousands and providing a major stimulus to the economy," reads one

placard. "People all over the world now use credit cards issued in Delaware." Another placard explains that "businesses from all over the country have incorporated in the state. Corporation fees and taxes provide a major source of state revenue." Next to the placard sits a mock judge's chamber intended to explain the state's chancery court system. Visitors can sit behind the bench and play a video game titled, **You Be the Judge**, where they decide cases with titles such as "Who's Cooking the Books?" and "What's an Insider Trader?" On the wall behind the bench hangs the robe that, a card informs us, belonged to William Marvel, a judge who once presided over Delaware's chancery court. The robe is encased in glass, as if it were the jersey of a baseball star. All this is designed to inculcate in Delaware's children the sense that it's normal--indeed praiseworthy--to have an inordinate proportion of corporate America legally based in one tiny state. Who knows? Perhaps one day they too might grow up to issue a favorable ruling for the board of directors.

In an apparent effort to hammer home the connection--friendly court equals incorporation!--the wall adjacent to the judge's bench carries an electronic ticker on which the names of companies incorporated in Delaware whiz by in endless succession. And indeed it's hard not to be impressed by the sheer volume of the state's achievement. To hell with the national interest. Delaware is looking out for number one.

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