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**"Is Delaware's Antitakeover Statute Unconstitutional?
Evidence from 1988-2008"**

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*presenting

Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1988-2008

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ABSTRACT

Delaware's antitakeover statute, codified at Section 203 of the Delaware corporate code, is by far the most important antitakeover statute in the United States. When it was first enacted in 1988, three bidders challenged its constitutionality under the Commerce Clause and the Supremacy Clause of the U.S. Constitution. All three federal district court decisions upheld the constitutionality of Section 203 at the time, relying on empirical evidence indicating that Section 203 gave bidders a "meaningful opportunity for success," but leaving open the possibility that future empirical evidence might change this constitutional conclusion. This Article presents the first systematic empirical evidence since 1988 on whether Section 203 gives bidders a meaningful opportunity for success. The question has become more important in recent years because Section 203's substantive bite has increased, as Exelon's recent hostile bid for NRG illustrates. Using a new sample of all hostile takeover bids against Delaware targets that were announced between 1988 and 2008 that were subject to Section 203 (n=60), we find that no hostile bidder in the past nineteen years has been able to avoid the restrictions imposed by Section 203 by going from less than 15% to more than 85% in its tender offer. At the very least, this finding indicates that the empirical proposition that the federal courts relied upon to uphold Section 203's constitutionality is no longer valid. While it remains possible that courts would nevertheless uphold Section 203's constitutionality on different grounds, the evidence would seem to suggest that the constitutionality of Section 203 is up for grabs. This Article offers specific changes to the Delaware statute that would preempt the constitutional challenge. If instead Section 203 were to fall on constitutional grounds, as Delaware's prior antitakeover statute did in 1986, it would also have implications for similar antitakeover statutes in thirty-two other U.S. states, which along with Delaware collectively cover 92% of all U.S. corporations.

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I. Introduction

Delaware's antitakeover statute, codified at Section 203 of the Delaware General Corporate Law, is by far the most important antitakeover law in the United States. Covering more than half of all U.S. corporations and an even larger fraction of U.S. stock market capitalization,[1] the statute prevents a hostile bidder from completing a back-end merger with the target company for three years after buying more than 15% of the target's shares unless: (1) the bidder gains approval of the target board in advance; (2) the bidder goes from less than 15% ownership of the target to more than 85% ownership in a single tender offer; or (3) the bidder gains approval from two-thirds of the disinterested shares after buying more than 15%.[2] When Section 203 was first enacted in 1988, three hostile bidders for Delaware targets challenged its constitutionality on the grounds that the statute was preempted by the Williams Act, among other things. In all three of these cases, the federal district court upheld the constitutionality of Section 203, concluding from the available empirical evidence that Section 203 gave bidders a "meaningful opportunity for success" and therefore did not disrupt the balance between bidders and targets that Congress envisioned.

After this initial flurry of litigation, the constitutionality of Section 203 has remained unchallenged for twenty years. The omission is puzzling because the hearings on Section 203 made clear that its constitutionality would hinge on bidders' experience under the statute. In addition, the district court opinions relied heavily on the sparse empirical evidence that was available at the time, and explicitly invited the possibility that future empirical evidence could influence, and possibly change, the constitutionality assessment.

This Article seeks to fill the empirical gap. Using a new sample of all hostile takeover bids against Delaware targets that were announced between January 1988 and December 2008 that were subject to Section 203 (n=60), we find that: (1) every bidder in this twenty-one year period required inapplicability of Section 203 as a condition to its offer; (2) no bidder in the past nineteen years has been able to go from less than 15% to more than 85% in a single tender offer, inconsistent with the claims of Section 203 proponents in 1988; and (3) no bidder has "busted through" and suffered the three-year moratorium on a business combination that Section 203 requires. Taken together, this evidence suggests that Section 203 no longer gives bidders a "meaningful opportunity for success." Instead, Section 203 appears to be a "show-stopper" that disrupts the balance

[1] *See* COMPUSTAT DATABASE (downloaded July 16, 2009, on file with authors) (showing that Delaware corporations comprise 51% by number and 61% by market capitalization of all U.S. public companies).
[2] DEL GEN. CORP. L. § 203(a).

between bidders and targets in ways that would seem to frustrate the purposes of the Williams Act.

Those familiar with the evolution of Delaware takeover law might reasonably ask why the constitutionality of Section 203 matters. Until recently, it was not an interesting question because Section 203 was rarely, if ever, the binding constraint on a bidder's ability to buy shares. Instead, the poison pill effectively prevented the frontal assault of a tender offer and channeled bidders through the proxy contest route. Once the bidder gained board control through a proxy contest, it could waive Section 203 and redeem (eliminate) the target's poison pill. So board control was a necessary and sufficient condition for redeeming the pill *and* waiving Section 203. Section 203 provided no additional protection beyond what the pill already provided.

However, recent developments in takeover doctrine and practice have severely weakened the pill. As the pill becomes weaker, Section 203 becomes more important, because boards will be more likely to rely on the statutory authority granted by Section 203 rather than the private law right to maintain a pill. Exelon's recent hostile takeover bid for NRG Energy illustrates the renewed significance of Section 203 as a takeover defense. And so this Article seeks to provide guidance to the federal courts on a question that has become important once again: Is Section 203 constitutional?

The answer, in our opinion, is a perhaps unsatisfying "maybe." This Article provides clear evidence that the empirical propositions that the federal courts have relied upon to uphold Section 203's constitutionality are no longer valid. It remains possible that the federal courts would uphold the constitutionality of Section 203 on different grounds. But at the very least, the constitutionality of Section 203 would seem to be up for grabs, for the first time in twenty years.

While Delaware is of course the most important state in U.S. corporate law, the implications of Section 203's constitutionality extend beyond Delaware. Thirty-two other U.S. states have "business combination statutes" that are similar in design to Section 203, including large states such as Illinois, Michigan, New York, Ohio, and Pennsylvania. Taken together, business combination statutes cover 92% of U.S. corporations by number and 94% by market capitalization. Most of these other statutes are just as or more potent than Section 203. If Section 203 were deemed unconstitutional, it seems possible that these other statutes would fall as well. The result would be a more open market for corporate control in the United States.

II. Background

A. Early Regulation of Takeovers: From the Williams Act to *CTS* (1968-1987)[3]

As state merger statutes in the 1950s and 1960s began to allow the use of cash consideration, the tender offer replaced the proxy contest as the acquisition method of choice for hostile bidders. The typical blueprint was a tender offer for a majority of the voting shares, followed by a "cash-out" merger to exchange the remaining (non-tendering) shares for cash. In 1960, there were eight tender offers involving companies listed on the New York Stock Exchange; in 1966, there were 107.[4] The dramatic growth in tender offers caught state and federal regulators by surprise. As a result, acquirers were completely unregulated in the terms of their tender offer and could operate "in almost complete secrecy."[5] A typical tactic during this era was to gain a toe-hold in a company, thereby gaining access to a shareholder list, and then to make a tender offer for sufficient additional shares to gain control.[6] By leaving the offer open only for a short period of time, and by making only a partial bid, acquirers could force shareholders to decide quickly whether or not to tender. The term "Saturday Night Special" would eventually enter the takeover lexicon as a reference to these types of shotgun tender offers.[7] In addition, an acquirer could accept shares on a first-come, first-served basis. This feature often created a "stampede to tender" before the acquirer gained control and could squeeze out the remaining shareholders at a lower price.

It was in this environment that the federal government made its first and only explicit foray into the regulation of takeovers, with the Williams Act in 1968. Passed by Congress as an amendment to the Securities Exchange Act of 1934, the Act imposes rules on acquirers that are intended to regulate the tender offer process. Congress had two distinct purposes in passing the Williams Act: first, to

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[3] This section draws from Guhan Subramanian, *A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill*, 23 DEL. J. CORP. L. 383-397 (1998) (documenting an era of acquirer power between 1960 and 1990).

[4] *See* 113 Cong. Rec. 24,664 (1967) (statement of Sen. Williams).

[5] S. Rep. No. 90-550, at 2 (1967).

[6] *See, e.g.*, Samuel L. Hayes, III & Russell A. Taussig, *Tactics of Cash Takeover Bids*, HARV. BUS. REV. (Mar/April 1967) at 135, 139. The authors advocate a delay between the toe-hold position and the tender offer: "Knowing when to stop buying . . . is an important element in the bidder's strategy. Investment bankers have suggested to us that at least a month of inactivity should precede a cash tender offer to avoid an undesirable price advance. An even longer period may be warranted to lull the incumbents into a false sense of security." *Id.*

[7] The term was developed as part of a public relations campaign against Colt Industries' hostile tender offer for Garlock in 1975. *See* PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS 40 (1996)

ensure informed decision-making by target shareholders;[8] and second, to achieve neutrality between the acquirer and target shareholders.[9] Section 13(d) of the Act requires that anyone who purchases 5% or more of the outstanding common stock of a company must file a disclosure statement with the SEC.[10] Section 14(d) requires that all shares tendered during a tender offer must be purchased at the same price.[11] If the offer is oversubscribed, the acquirer must purchase shares on a pro rata basis.[12] If the acquirer increases the offer price during the tender offer, all shares tendered previously must receive the higher price.[13] Rules pursuant to Section 14(e) of the Act require that an any-and-all tender offer must stay open for at least seven days, and a partial tender offer must stay open for ten days.[14]

When the Williams Act was passed in July 1968, only one state (Virginia) regulated tender offers, and even the Virginia statute had been passed just four months earlier.[15] Perhaps as a result, there is no evidence from the lengthy hearings and extended debates that Congress considered the extent to which the Williams Act should preempt state antitakeover laws.[16] The Williams Act itself is silent on the question of preemption.[17] The only Congressional guidance comes from the original provision in Section 28(a) of the Securities Exchange Act, which clarifies that the federal securities laws still leave room for state regulation "insofar as it does not conflict with the provisions of this title or the rules or regulations thereunder."[18]

Because Section 28(a) does not clear the field of state regulation, the main constraints on the states' ability to regulate takeovers come from the Supremacy Clause[19] and the Commerce Clause[20] of the U.S. Constitution. Under the

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[8] *See* 133 CONG. REC. 24,664 (1967) (statement of Sen. Williams that the Williams Act "is designed solely to require full and fair disclosure for the benefit of investors").

[9] *See* 133 Cong. Rec. 854 (1967) (statement of Sen. Williams that the objective of the Williams Act is to "balance the scales" between acquirers and shareholders).

[10] *See* Securities Exchange Act of 1934 § 13(d).

[11] *See id.* § 14(d)(7).

[12] *See* Rule 14d-8.

[13] *See* Securities Exchange Act § 14(d)(7).

[14] Rule 14e-1, 17 C.F.R. § 240.14e-1. In 1979, both of these periods were extended to twenty days. *See* Exchange Act Release No. 16,384 (Nov. 29, 1979).

[15] *See* INVESTOR RESPONSIBILITY RESEARCH CENTER, STATE TAKEOVER LAWS (2003), at Appendix B-3.

[16] *See* Edgar v. MITE, 457 U.S. 624, 631 n.6.

[17] In 1987, the U.S. House of Representatives considered a bill that would have given the Securities & Exchange Commission the authority to preempt state takeover laws, but no action was taken. *See* STATE TAKEOVER LAWS, *supra* note 15, at Appendix B-3.

[18] Securities Exchange Act § 28(a).

[19] *See* U.S. CONST. ART. ART. VI, para. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every

Supremacy Clause, federal law implicitly preempts a state statute if (a) compliance with both the federal law and the state law is impossible;[21] or (b) the state statute frustrates the purposes of the federal law.[22] Under the so-called "dormant" Commerce Clause, states may regulate interstate commerce only if the state's interest in regulating the commerce outweighs any adverse impact on interstate commerce.[23]

Between 1968 and 1982, thirty-seven U.S. states passed antitakeover statutes that tested the contours of the Supremacy Clause and dormant Commerce Clause doctrine as applied to the Williams Act.[24] Delaware joined the party in May 1976 with the Delaware Tender Offer Act, codified at Section 203 of the Delaware corporate code.[25] Following a common blueprint among these "first generation" antitakeover statutes, Section 203 imposed waiting periods on the bidder before and after a tender offer was launched. Specifically, the Delaware Act required bidders to file the terms of their tender offer with the target company between 20 and 60 days before beginning its offer, and required bidders to hold their offer open for at least 20 days, longer than what the Williams Act then required.[26]

In November 1978, Dart Industries launched a tender offer for all the shares of P. R. Mallory & Co., a Delaware corporation and maker of the well-known Duracell batteries and Tupperware plastic containers. Dart simultaneously challenged the constitutionality of Section 203 under the Supremacy Clause and the Commerce Clause in Indiana federal district court, where Mallory had its headquarters.[27] On the Commerce Clause claim, the Court applied the balancing test required in *Pike v. Bruce Church*[28] to find that the Delaware Act "fail[ed] . . . to serve any local interest that would justify its impact on interstate commerce."[29] On the Supremacy Clause claim, the district court found that the Delaware Tender Offer Act "clearly contravenes the purpose and spirit of the Williams Act," and

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State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding."

[20] *See* U.S. CONST. ART. I., SEC. 8 ("[Congress shall have power] To regulate commerce with foreign nations, and among the several states, and with the Indian tribes."

[21] *See, e.g.*, Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963).

[22] *See, e.g.*, Hines v. Davidowitz, 312 U.S. 52, 67 (1941); Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978).

[23] *See* Pike v. Bruce Church, 397 U.S. 137 (1970) ("Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.").

[24] *See* STATE TAKEOVER LAWS, *supra* note 15, at B-5 (listing states).

[25] *See* DEL. GEN. CORP. L. § 203 (1976).

[26] *See id.* § 203(a)(1) (1976).

[27] *See* Dart Industries v. Conrad, 462 F. Supp. 1 (1978).

[28] 397 U.S. 137 (1970).

[29] *Dart Industries*, 462 F. Supp. at 13.

"upsets the carefully balanced neutrality of the federal provisions by providing, contrary to the congressional scheme, substantial advantages to incumbent management's efforts to defeat or delay a tender offer."[30] On the basis of these findings the court held that the Delaware Tender Offer Act violated both the Supremacy Clause and the Commerce Clause of the U.S. Constitution, rendering it inapplicable to Dart's offer for Mallory.[31]

One year later, in November 1979, TRE Corp. launched a tender offer against Wylain, a Delaware corporation, and again challenged the constitutionality of Section 203, this time in Delaware Chancery Court. In *Wylain, Inc. v. TRE Corp.*,[32] the Delaware Chancery Court came out in the opposite direction on both the Commerce Clause and the Supremacy Clause claims. On the Commerce Clause analysis, the Court applied the same *Pike v. Bruce Church* balancing test to find that Delaware's interest in providing shareholders in a Delaware company with reasonable notice of a tender offer outweighed the burden imposed on interstate commerce.[33] And on the Supremacy Clause analysis, the Court found that the Act's waiting periods did not disrupt the balance between bidders and targets envisioned by the Williams Act.[34] To the contrary, "[t]he Delaware Tender Offer Act furthers the Congressional policy of investor protection by requiring early public disclosure and by providing the investor reasonably adequate time in which to make a rational business decision concerning his investment."[35] The Court reached this conclusion despite evidence presented by TRE that Congress had explicitly considered, but rejected, a 20-day pre-offer notification requirement in the Williams Act.[36]

The same indeterminacy that plagued the Delaware statute played out in other states as well. As one commentator noted: "Inconsistency reigned as the same law that was upheld by one court was overturned by another. Neither bidder nor target could confidently predict the outcome of any case."[37] In perhaps the most sweeping pronouncement during this era, the Fifth Circuit Court of Appeals struck down the Idaho Tender Offer Act, and in doing so held that all state statutes regulating tender offers were unconstitutional under the Supremacy Clause.[38] Each subsequent case seemed to only muddy, rather than clarify, the contours of the arena that the Williams Act and the dormant Commerce Clause had left to the states.

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[30] *Id.* at 12-13.
[31] *Id.* at 14.
[32] 412 A. 2d 338 (Del. Ch. 1979).
[33] *Id.* at 344-345.
[34] *Id.* at 348.
[35] *Id.*
[36] *Id.* at 347. (noting amendment considered in S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967)).
[37] *See* STATE TAKEOVER LAWS, *supra* note 15, at Appendix B-4.
[38] *See* Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1278 (5th Cir. 1978).

In 1982, the U.S. Supreme Court finally intervened. The statute at issue was the Illinois Business Takeover Act, which imposed a 20-day pre-offer notification period like the Delaware Act, but also required the bidder to register its offer with the Illinois secretary of state.[39] During the 20-day waiting period, the secretary of state could call a hearing to adjudicate the substantive fairness of the offer, and was required to deny registration if a tender offer failed to "provide full and fair disclosure" or was "inequitable or would work or tend to work a fraud or deceit upon the offerees."[40]

In *Edgar v. MITE Corp*,[41] the U.S. Supreme Court invalidated the Illinois Act as a violation of the Commerce Clause and (likely) the Supremacy Clause. Writing for a five-Justice majority, Justice White held that the Illinois Act violated the Commerce Clause because it failed the *Pike v. Bruce Church* balancing test.[42] The Court acknowledged that Illinois might have an interest in regulating tender offers, but also noted the substantial burdens that the Act imposed on interstate commerce. "While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders."[43] Writing for a three-Justice plurality,[44] Justice White also found that the Illinois Act violated the Supremacy Clause. "It is . . . crystal clear that a major aspect of the effort to protect the investor [in the Williams Act] was to avoid favoring either management or the takeover bidder."[45] The Illinois Act upset this balance: "[B]y providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers."[46]

Although the Illinois Business Takeover Act went further than first-generation statutes in most other states, state legislatures read the tea leaves of the *MITE* decision and slowly took their pre-bid disclosure laws off the books. By far the most important retrenchment of this kind occurred in Delaware. Even though Section 203 did not include the same registration process and substantive scrutiny

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[39] ILL. REV. STAT., CH. 121 1/2, § 137.54.A (1979).
[40] *Id.* at § 137.57.E (1979).
[41] 457 U.S. 624 (1982).
[42] In addition to Justice White, Chief Justice Burger and Justices Powell, Stevens, and O'Connor joined this part of the opinion.
[43] 457 U.S. at 644.
[44] In addition to Justice White, Chief Justice Burger and Justice Blackmun joined this part of the opinion.
[45] 457 U.S. at 633 (1982)
[46] *Id.* at 635.

as the Illinois Act, the Delaware legislature repealed Section 203 in July 1987 on the "generally accepted" view that Section 203 was unconstitutional.[47]

But because of the lack of explicit preemption in the Williams Act and the fractured opinion in *MITE*, state legislatures cautiously climbed back into the ring. Between 1982 and 1987, twenty-one states, though not Delaware, adopted "second generation" antitakeover statutes.[48] Unlike the first generation statutes, which generally focused on pre-bid disclosure of the offer, the second generation statutes were designed to survive constitutional scrutiny by regulating collateral issues around the tender offer rather than the tender offer itself.

Indiana's Control Share Acquisition Act, signed into law in March 1986, was one such second generation statute. The Indiana Act provided that anyone who acquires 20%, 33.33%, or 50% of an Indiana corporation's shares must win the approval of a majority of the disinterested shares, at the next shareholder's meeting, in order to be able to vote the shares that it owns.[49] In the paradigmatic case where the bidder launched an any-and-all tender offer and acquired more than 50% of the shares, it would then have to obtain majority approval from the remaining shareholders, all of whom by definition did not tender into the offer, before it could take board control. The Act clearly tilted the balance between bidders and targets by making it significantly more difficult for a bidder to acquire voting control. However, unlike the first generation statutes, the Indiana Act and other "control share acquisition" statutes did not impede the tender offer process itself.

Notwithstanding the plausible point of distinction from the first generation statutes, district courts and appellate courts applied the Supreme Court's holding in *MITE* to invalidate the control share acquisition statutes in Hawaii, Minnesota, Missouri, and Ohio between 1982 and 1986.[50] In 1987, the U.S. Supreme Court granted *certiorari* after the federal district court and Seventh Circuit Court of

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[47] *See* THE PROPOSED DELAWARE TAKEOVER STATUTE: A REPORT TO THE DELAWARE GENERAL ASSEMBLY ("Since the decision in *MITE*, it was generally accepted that Section 203 of our General Corporation Law was unconstitutional, and, accordingly, effective July 1, 1987, the statute was repealed."), *reprinted in* LAWRENCE A. HAMERMESH & R. FRANKLIN BALOTTI, THE NEW DELAWARE TAKEOVER STATUTE 66 (1988).

[48] *See* STATE TAKEOVER LAWS, *supra* note 15, at Appendix B-8.

[49] IND. CODE § 23-1-42-9(b) (1986).

[50] *See* Terry ex rel. C. Herman Terry & Mary Virginia Terry Charitable Remainder Unitrust v. Yamashita, 643 F. Supp. 161 (D. Haw. 1986) (holding Hawaii control share acquisition statute to be unconstitutional); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985) (holding Minnesota control share acquisition statute to be unconstitutional); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985) (holding Missouri control share acquisition statute to be unconstitutional); Fleet Aerospace Corp. v. Mark Holderman et al., 769 F.2d 135 (6th Cir. 1986) (holding Ohio control share acquisition statute to be unconstitutional);

Appeals similarly invalidated the Indiana Act.[51] Surprising many commentators,[52] the Supreme Court upheld the Indiana Act against Supremacy Clause and Commerce Clause challenges. In *CTS v. Dynamics Corp. of America*,[53] the Court distinguished the Indiana Act from the Illinois Act that was struck down in *MITE*:

> The overriding concern of the *MITE* plurality was that the Illinois statute considered in that case operated to favor management against offerors, to the detriment of shareholders. By contrast, the statute now before the Court protects the independent shareholder against the contending parties. Thus, the Act furthers a basic purpose of the Williams Act, placing an investors on an equal footing with the takeover bidder.[54]

Writing for a 6-3 majority, Justice Powell concluded that the Indiana Act "furthers the federal policy of investor protection" and therefore did not frustrate the objectives of the Williams Act.[55] The Court also found that the Indiana Act did not discriminate against interstate commerce because it applied equally to both interstate and local businesses,[56] and that any burden on interstate commerce was outweighed by Indiana's compelling interest in defining the voting rights of shares of Indiana corporations.[57] The majority therefore held that the Indiana Act was valid under the Supremacy Clause and the Commerce Clause.

Although the *CTS* majority stated that its holding was consistent with *Edgar v. MITE*, the tenor of the opinion was clearly more receptive to state regulation of takeovers than the Court's reasoning just five years earlier. One likely explanation for this shift, at least in part, was the change in popular sentiment towards hostile takeovers. Stories of "corporate raiders" dismantling healthy companies for enormous personal gain dominated the business press during the mid-1980s. American competitiveness was faltering compared to Japanese and German manufacturers, and many blamed "two-tier, front-end-loaded, boot-strap, bust-up, junk-bond-financed" hostile tender offers.[58] It is no coincidence that 1987, the year that *CTS* was decided, was also the year that Oliver Stone's *Wall*

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[51] CTS Corp. v. Dynamics Corp. of America, 637 F. Supp. 389 (N.D. Ill. 1986); CTS Corp. v. Dynamics Corp. of America, 794 F.2d 250 (7th Cir. 1986).
[52] *See* STATE TAKEOVER LAWS, *supra* note 15, at Appendix B-8 ("It was widely assumed that the Supreme Court [in *CTS*] would invalidate the Indiana law and completely eliminate any further role for states in regulating corporate takeovers.")
[53] 481 U.S. 69 (1987).
[54] *Id.* at 81-82.
[55] *See id.* at 83.
[56] See *id.* at 87.
[57] *See id.* at 93.
[58] This phrase has been credited to Martin Lipton of Wachtell, Lipton, Rosen & Katz.

Street hit movie theaters. The villain was Gordon Gekko, a takeover artist played by Michael Douglas, whose infamous mantra "Greed is Good" became Exhibit A for those who wanted greater regulation of hostile takeovers. Three years later, Richard Gere played a soulless corporate raider in the even bigger Hollywood blockbuster *Pretty Woman*.[59] Rather than going to federal prison for insider trading like Mr. Gekko, Gere found personal salvation in Julia Roberts, and business salvation when he promised her that he would build companies rather than break them apart.[60]

B. Legislative Background and Enactment of Section 203 (June 1987 – Feb. 1988)

But whatever motivations were at play in the Supreme Court's ruling in *CTS*, the Delaware bar wasted no time in accepting the invitation to design an antitakeover statute that would survive constitutional challenge. Delaware's Council on the Corporate Law Section ("the Council") began meeting soon after *CTS* came down to propose an antitakeover statute to the Delaware General Assembly. Initially, the Council considered a control share acquisition statute like Indiana's, which would have been the most straightforward route to avoiding constitutional challenge.[61] In June 1987, however, the Council concluded that an Indiana-style statute would not be in Delaware's best interest.[62]

The Council then turned its attention to the possibility of a business combination (or "freeze-out") statute. A business combination statute deters hostile bidders by delaying their typical gameplan for acquisition. In the absence of any defenses, a hostile bidder would typically launch a tender offer for the target's shares. If a majority of the target's shares were tendered, the bidder would close the tender offer and then execute a statutory merger between itself and the target company, thereby eliminating the remaining (non-tendering) shares of the target company. A business combination statute delays the bidder's ability

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[59] *See* PRETTY WOMAN at 53:45 (Mr. Morse, Jr: "Mr. Lewis, if you were to get control, and I don't think you will, but if you did, what do you plan to do with the company?" Mr. Lewis [Gere]: "Break it up and sell off the pieces." Mr. Morse, Sr.: "I'm sure you'll understand I'm not thrilled at the idea of your turning forty years of my work into your garage sale." Mr. Lewis: "At the price I'm paying for this stock, Mr. Morse, you are going to be a very rich man." Mr. Morse, Sr.: "I'm rich enough. I just want to run my shipyard.")

[60] Even though the academic thinking on hostile takeovers has changed considerably over the past twenty years, *see infra* Part IV.D., and the public's perception has correspondingly softened, Hollywood's disfavor of hostile bidders continues to this day. For example, Chick Hicks, the bad guy (actually, bad race car) in Pixar's *Cars*, was sponsored by "Hostile Takeover Bank." We thank Samuel James Subramanian for this important insight.

[61] *See* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-2

[62] *See id.*

to execute this "back-end" merger, for (e.g.) three or five years. The result is that the bidder is unable to eliminate the non-tendering shareholders in the target for that period of time.

Business combination statutes have an antitakeover effect for at least three reasons. First, the bidder will be subject to reporting requirements for the target company, and vulnerable to shareholder litigation from the non-tendering minority shareholders, until it can close out the back-end merger. Second, the bidder will be unable to use the target's assets to service the debt incurred in the acquisition, which can be necessary if the acquirer is relying heavily on debt financing. And third, the bidder will have to share any operational benefits and synergies with the non-tendering shareholders, *pro rata*.[63]

One state already had a business combination statute in place by the time Delaware began contemplating the possibility in 1987. In December 1985, even before *CTS*, New York adopted a statute that prevented a hostile bidder from executing a back-end merger with the target company for five years after acquiring 20% of the outstanding shares, unless the bidder gained approval from the target board in advance.[64] After five years, the bidder could execute a back-end merger only if one of two conditions were met: (1) the bidder gained approval from a majority of the disinterested shares; or (2) the bidder paid a "fair price," which was defined as the price paid for the largest block of shares.[65]

On November 19, 1987, just six months after *CTS* was handed down, Delaware's Council on Corporate Law published a draft business combination statute that took New York's basic approach, but with important points of departure.[66] The proposed statute required an "interested shareholder" (defined as a 10% or more holder) to wait three years before executing a back-end merger, unless one of three conditions was met: (1) the interested shareholder received board approval in advance of crossing the 10% threshold; (2) the bidder went from less than 10% ownership of the target to more than 90% of the target in a single tender offer; or (3) after crossing the 10% threshold, the interested shareholder gained approval from two-thirds of the disinterested shareholders.[67] Although it followed the same basic template as the New York statute, the proposed business combination statute was milder than New York's, with a three-year moratorium rather than five years; a 90% hurdle that provided an immediate

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[63] *See, e.g.*, Cede & Co. v. Technicolor, Inc., 684 A.2d 289 (Del. 1996).
[64] N.Y. BUS. CORP. L. § 912(b) (1985).
[65] *Id.* at § 912(c).
[66] NOTICE OF MEETING FROM COUNCIL OF THE CORPORATION LAW SECTION (Nov. 19, 1987), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 41.
[67] PROPOSED BUSINESS COMBINATION LEGISLATION (Nov. 19, 1987), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 41-51.

out for a sufficiently determined bidder; and no "fair price" requirement or other restrictions on the back-end merger once the three years had expired.

Reflecting Delaware's importance in the regulation of takeovers, policymakers and commentators quickly lined up on both sides of the debate over the proposed antitakeover statute. Reagan Administration officials,[68] SEC commissioners,[69] and policy analysts[70] generally opposed the legislation, preferring instead an unfettered market for corporate control. Delaware legislators and corporate representatives generally favored the legislation, on the view that the legislation would help deter corporate raiders from "bust-up, boot-strap, junk-bond-financed" hostile takeovers that were destroying corporate America.

Two issues emerged as the most important battlegrounds in the debate. First, there was the question as to whether companies would have to affirmatively opt-in to the statute, through board and shareholder approval, or whether the statute would presumptively apply but companies could opt-out. Section 102(b)(7), which had been added to the Delaware corporate code just one year earlier in order to permit waiver of director liability for duty of care violations, followed an opt-in model.[71] Under Section 102(b)(7)'s opt-in approach, a board needed to affirmatively propose a liability waiver, and the shareholders had to then approve it. Opponents of the proposed Section 203 favored a similar opt-in model, to the extent that an antitakeover statute was adopted at all, on the expectation that shareholders of Delaware companies would be unlikely to agree to opt-in. Proponents of the statute argued in response that "it would be unfair to . . . make shareholders vote for protection to which they are entitled,"[72] and warned that an opt-in approach would prompt Delaware companies to reincorporate out of the state.

The Council's proposal took an opt-out approach. In the Delaware House of Representatives, William A. Oberle Jr. proposed an opt-in amendment that was resoundingly defeated by voice vote.[73] And in the Delaware Senate, Majority Leader and Judiciary Committee Chairman Thomas B. Sharp similarly proposed

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[68] *See, e.g.*, Letter from Beryl Sprinkle, Chairman of the President's Council of Economic Advisors (representing Reagan Administration on this issue), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 142-143.

[69] *See, e.g.*, Letter from SEC Commissioner Joe Grundfest, representing himself and one other commissioner, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 79-113.

[70] *See, e.g.*, JAMES E. HEARD & JOHN POUND, DELAWARE GENERAL CORPORATION LAW SECTION 203: AN ECONOMIC ANALYSIS (April 1989) (arguing that Section 203 will reduce overall societal value).

[71] *See* DEL. GEN. CORP. L. § 102(b)(7).

[72] Comments of A. Gilchrist Sparks III, chairman of the Corporation Law Section, *cited in* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-4.

[73] *See* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-2.

an opt-in version of the bill, but backed down after witnessing the results from the House.[74] And so in sharp contrast to Section 102(b)(7), passed just one year earlier, Section 203 in final form took an opt-out approach.

A second, and more contested, battleground for debate was the tender needed for a bidder to escape the three-year moratorium on a back-end merger.[75] The Council's proposal required a bidder to go from less than 10% to more than 90% in its tender offer, with no exclusion of shares held by officers or directors for purposes of this calculation. Even among those who favored strong antitakeover protection for Delaware companies, there was concern that setting the bar too high would increase the risk of unconstitutionality. Accordingly, both sides of the Section 203 debate had an interest in setting a bar that hostile bidders could realistically achieve.

As might be expected, wide disagreement emerged on this fundamentally empirical question. On one hand, some asserted that any serious, non-coercive tender offer should easily get to 90%. Well-known attorney Martin Lipton, for example, called the 90% threshold a "barn door size exemption" to the antitakeover effects of the statute,[76] and later declared, after the proposed threshold had been reduced to 85%, that "[i]t will be a rare situation where a tender offer will not attract 85% of the target's non-management stock."[77] A practitioner commentary at the time similarly noted that "the available data suggests that the 85% mark is not an unattainable figure," though it cited no particular data.[78]

On the other hand, some believed the 90% threshold to be an illusory "out" from the statute's antitakeover effects. In a letter to the Corporate Law Section of the Delaware Bar, SEC Commissioner Joe Grundfest observed: "I am aware of no case in which a tender offer obtained more than 90 percent of the target's shares despite management opposition."[79] Beryl Sprinkle, Chairman of the President's Council of Economic Advisors, similarly wrote that "the proposed Section 203 would virtually close down the market for corporate control for more than half of

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[74] *See id.* at Delaware-6.

[75] *See, e.g.*, In re Digex, Inc. Shareholders Litigation, 789 A.2d 1176, 1201 ("[T]he 85% shareholder exemption was one of the most disputed provisions in the entire statute and received a tremendous amount of scrutiny.").

[76] WACHTELL, LIPTON, ROSEN & KATZ memorandum to clients (Nov. 23, 1987).

[77] Quoted in affidavit of Michael Houghton, exh. 9, BNS v. Koppers, 683 F. Supp. 458, 471 (D. Del. 1988). *See also* Comments of Raymond Groth, First Boston ("the vast majority of tender offers which are not abandoned have resulted in the acquisition of more than 85% of the shares of the target."). Affidavit of Raymond C. Groth, para. 8, BNS v. Koppers, 683 F. Supp. 458, 471 (D. Del. 1988).

[78] BNA CORPORATE PRACTICE SERIES – THE TAKEOVER LAW OF DELAWARE 8 (1989).

[79] Letter from SEC Commission Joseph Grundfest to David B. Brown, Esq., Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 106.

the country's largest corporations."[80] These commentators generally urged a 75% threshold, with shares held by directors and officers excluded for purposes of this calculation. Charles Richards, a senior partner at Richards, Layton & Finger, proposed an amendment to the Corporate Law Council that would have lowered the out to 75%, but this amendment failed by a vote of 30-101.[81]

Despite the empirical nature of the question, empirical evidence was notably lacking in the debate. In hearings before the Delaware House and Senate Judiciary Committee, Commissioner Grundfest noted: "There are objective data that can help the Legislature determine the appropriate parameters of such an exemption, but to the best of my knowledge these data have not as yet been gathered and analyzed in a forum that is directly responsive to issues posed [in] the pending legislation."[82] Grundfest offered that the SEC could collect the relevant data within two months,[83] but in the rush to pass something this offer was never taken up by the Delaware legislature.

In the end, the threshold for interested shareholders was increased from 10% to 15%, the required tender was reduced from 90% to 85%, and shares held by "directors who are also officers" were excluded for purposes of calculating the percentage tendered into the bidder's offer. In a report to the Delaware General Assembly, the Corporate Law Section of the Delaware bar recommended against lowering the threshold any further:

> If an offer is a good one, it should obtain 85% of the stock of the company. This is particularly so where the proposed statute eliminates from the 85% figure stock owned by director-officers and by employee stock plans. The Corporate Law Council and section of the Bar Association believe that 80% is too easy to attain. . . . The votes required by Section 203 have been carefully calculated to provide the least intrusive measure possible that will still allow the statute to limit the abusive takeover tactics to which it is directed. . . . The 85% threshold is set at that level because there is evidence that less-than-full-price,

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[80] Letter from Beryl Sprinkle, Chairman of the President's Council of Economic Advisors, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 142.

[81] *See* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-3. The back story on this vote is interesting. Richards, Layton & Finger, which represented Carl Icahn at the time, got all of its lawyers admitted to the Council in an effort to increase the number of opponents to strong antitakeover protections for Delaware companies. In response, Skadden, Arps and the other Wilmington firms had all of their attorneys admitted to the Council in order to counterbalance Richards' move, so the end result had little effect on the outcome of the debate. We thank Professor Randall Thomas for this account.

[82] Testimony of Joseph Grundfest, SEC Commissioner, before Delaware General Assembly House and Senate Judiciary Committees (Jan. 20-21, 1988), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 144.

[83] *See* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-6.

> coercive tender offers are frequently able to obtain stock tenders of 80% or more. [citing *Moran v. Household International*] Thus, unless Section 203 set a greater than 80% threshold requirement, it would not preclude the very evil it seeks to prevent. . . . On the other hand, the 85% level is sufficiently low and flexible so as not to preclude legitimate proposals."[84]

On the question of whether the Delaware assembly should move quickly or wait to consider the statute further, the Corporate Law Section urged haste:

> This statute has been under study for 7 months. As even Commissioner Grundfest admits, no more data is *readily available* [emphasis added] for further study. To delay legislation now is to jeopardize Delaware's hard-earned position as a leader in corporate law. . . . We are about to enter the annual proxy season for most Delaware corporations. They are now preparing their 1988 proxy solicitation materials. We want to avoid the situation of these corporations placing on the ballot the issue of moving to another state to take advantage of that state's takeover law.[85]

The Delaware House of Representatives approved the bill on January 26, 1988, by a vote of 39-0.[86] Two days later the Delaware Senate approved it as well, by a vote of 19-1.[87] (The lone dissenter was Senator Sharp, who had proposed the opt-in approach described above.[88]) Governor Michael Castle signed the bill into law on February 2, 1988, though it applied retroactively to persons who were "interested shareholders" as of December 23, 1987.[89] This

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[84] MICHAEL D. GOLDMAN & EDWARD M. MCNALLY, THE PROPOSED DELAWARE TAKEOVER STATUTE: A REPORT TO THE DELAWARE GENERAL ASSEMBLY, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 62.

[85] GOLDMAN & MCNALLY, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 65. Other commentary from Delaware practitioners and politicians makes clear that many were motivated by the fear of losing Delaware companies to other states. For example, Secretary of State Mike Harkins told the House and Senate Judiciary Committees: "The argument to go home to the state of their actual corporate headquarters where there is already existing legal protection is strong and our failure to act strengthens that pressure. Delay would force some companies to seriously look at leaving. I distributed to you today the correspondence I have received from 170 corporations, all of whom pay the maximum tax of $130,000. All but three support this statute. . . and at least half a dozen have stated in their letters that they would have to look seriously at the question of changing their Delaware incorporation. Is that a prudent risk? I believe it is not." Testimony of Mike Harkins, Delaware Secretary of State, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 139-140.

[86] See STATE TAKEOVER LAWS, *supra* note 15, at Delaware-2.

[87] *See id.*

[88] *See id.* at Delaware-6.

[89] Statement of Governor Michael Castle regarding House Bill 396 (Feb. 2, 1988), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 257, 258

retroactivity protected Texaco, a Delaware corporation, which was then under pressure from (then) notorious corporate raider and (now) shareholder activist Carl Icahn.[90] In the signing ceremony, Governor Castle noted that Section 203 "is the product of the most intense debate that I can remember in twenty years in government."[91]

The statute has remained virtually unchanged since then. The centerpiece is Section 203(a), which prevents a shareholder from executing a back-end merger for three years after buying more than 15% of the target's stock, unless one of three exceptions is met. Section 203(a)(1) provides the most frequently used "out," board approval in advance. This exemption facilitates friendly deals and offers where the hostile bidder has obtained board control. Section 203(a)(2) provides the second out, moving from less than 15% to more than 85% in a single tender offer, excluding for the purposes of this calculation shares that are held by "directors who are also officers" and shares held by "employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer."[92]

Section 203(a)(3) provides the final out: approval from two-thirds of the disinterested shares after the bidder crosses 15%. It is widely understood that Section 203(a)(3) is dominated by Section 203(a)(2) in the hostile takeover context, because gaining approval from two-thirds of the shares that did not sell into the tender offer is a difficult hurdle to meet. Consider the typical case where a bidder obtains 51% of the shares in a first-step tender offer. If the bidder closes this offer without obtaining a Section 203 waiver first, it will then need approval from two-thirds of the remaining 49% (=33% of the outstanding) in order to be able to execute a back-end merger. In total, the bidder would need support from 84% of shares outstanding (=51%+33%), which is virtually the same hurdle that Section 203(a)(2) requires.

A bidder who was determined to overcome Section 203 through the (a)(3) route would do better by buying just 15%, thereby triggering Section 203, and then seeking approval from two-thirds of the remaining 85% (=57%). This strategy would reduce the total support required from the target's shareholders to 72%. The break-even occurs at approximately 54%:[93] if a bidder closed a tender offer for more than this percentage of the target's shares, it would need more

[90] *See* STATE TAKEOVER LAWS, *supra* note 15, at Delaware-2.

[91] Statement of Governor Michael Castle regarding House Bill 396 (Feb. 2, 1988), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 258.

[92] *See* DEL. GEN. CORP. L. § 203(a)(2).

[93] Solving (x) + (100 – x) * 2/3 = 85%, where x is the percent of shares bought in the initial tender offer.

overall shareholder support under 203(a)(3) than it would have needed under 203(a)(2).

Even below the 54% threshold, the simple math masks other barriers that make the (a)(3) route unattractive relative to 203(a)(2). First, a bidder who follows the Section 203(a)(3) route faces a serious problem if it is not able to get the requisite two-thirds approval from the remaining shares in order to close the deal. If the bidder decides to back out at that point, flooding the market with the target's shares would likely depress the price and lead to losses for the bidder. And if the bidder actually made a profit on its foray into the target's stock, short-swing profit rules would require the bidder to disgorge that profit back to the target company if the bidder "crept up" to more than 10% before triggering Section 203.[94]

A second unattractive feature of (a)(3) relative to (a)(2) is that it provides no relief for shares held by directors who are also officers, which means that the effective hurdle is almost always higher than what the simple math would show. For example, if directors who are also officers hold 10% of the target's shares, then a bidder who pursues the "optimal" (a)(3) strategy of buying a 15% stake first would need approval from 80% of the outstanding shares that are "in play" (=72/90) rather than the 72% calculated above.

For these reasons, Section 203(a)(3) is thought to be dominated in the hostile takeover context by 203(a)(2). The (a)(3) route is designed to provide an out for a long-time (but less than three-year) interested shareholder that wants to freeze out the minority, but it is a non-viable route for traditional arms-length hostile bidders. This leaves just two outs: board approval in advance, and achieving 85% in a single tender offer. As a formal matter, a bidder who gains target board approval is no longer a hostile bidder, though we return to this question in Part IV.B below. This leaves Section 203(a)(2) as the sole out that a "hostile-to-the-end" bidder can pursue. Consistent with this conclusion, the viability of the Section 203(a)(2) out became the focus of the constitutional challenge to Section 203 overall.

C. A Trilogy of Constitutional Challenges (March – Sept. 1988)

Three constitutional challenges to Section 203 came in rapid-fire succession. As in *CTS*, the question in all three cases was whether Delaware's antitakeover statute was preempted by the Williams Act under the Supremacy Clause, and/or whether the state statute violated the dormant Commerce Clause by unduly restricting interstate commerce. In all three cases, the court held that Section 203 survived both the preemption challenge and the Commerce Clause challenge. In

[94] *See* SECURITIES AND EXCHANGE ACT §16(b); Rule 16a-2(c).

our discussion of these cases below, we focus on the courts' treatment of the preemption challenge, because this analysis relied heavily on empirical propositions that we re-examine in Part III. In contrast, the Commerce Clause analysis relied on standard doctrinal analysis that is unlikely to be re-considered today for reasons of *stare decisis*.

The first constitutional challenge occurred just one month after Section 203 was signed into law. On March 3rd, 1988, a consortium between two British companies and Shearson Lehman Brothers announced a tender offer for Koppers, Inc., a Delaware corporation headquartered in Pittsburgh, Pennsylvania. After the Koppers board rejected the offer, the consortium filed a claim in the federal district court for the district of Delaware alleging, among other things, that Section 203 was preempted by the Williams Act.[95] In *BNS v. Koppers*, the court began its Supremacy Clause analysis by articulating a test for determining preemption in view of the U.S. Supreme Court's pronouncements in *MITE* and *CTS*:

> Section 203 alters the balance between target management and the offeror, perhaps significantly. Yet the section will be constitutional notwithstanding its pro-management slant, so long as it does not prevent an appreciable number of hostile bidders from navigating the statutory exceptions. . . . [E]ven statutes with substantial deterrent effects on tender offers do not circumvent Williams Act goals, so long as hostile offers which are beneficial to target shareholders have a meaningful opportunity for success.[96]

The court then went on to determine whether the three "outs" provided in Section 203 provide bidders with "a meaningful opportunity for success." The court ignored the first out, board approval in advance, because that possibility "will necessarily be absent in the hostile takeover context."[97] On the out of board approval followed by approval of two-thirds of the non-tendering shares, the court concluded that "[s]tanding alone, this exception might well be illusory."[98] But on the 85% out, the court noted the significant difference of opinion regarding the viability of this route and concluded, without elaboration, that the 85% threshold "must be viewed as giving hostile offerors an opportunity to consummate their offers."[99] On balance, the court concluded that the Delaware legislature's judgment on the viability of the 85% should be respected,[100] and as a result

[95] BNS v. Koppers, 683 F. Supp. 458, 470 (D. Del. 1988).
[96] *Id.* at 470.
[97] *Id.*
[98] *Id.* at 471-472.
[99] *Id.* at 473.
[100] *Id.* at 473.

Section 203 "in all likelihood [is] constitutional and not preempted."[101] One commentator read that the tone of *BNS* to "impl[y] that Section 203 barely falls within the bounds of what the Williams Act allows."[102] Perhaps reflecting this sentiment, the *BNS* court concluded with an invitation for further review: "If the method Delaware has chosen to protect stockholders in fact on balance harms them, then at that time reconsideration of the statute's congruence with the Williams Act will be warranted."[103]

On April 8, 1988, just seven days after the federal district court issued its opinion in *BNS*, Tate & Lyle PLC, a British corporation, launched a tender offer for Staley Continental, a Delaware corporation headquartered in Illinois. After Staley rejected the bid, Tate & Lyle again brought suit challenging the constitutionality of Section 203 in the federal district court for the district of Delaware.[104] Noting the "meager evidentiary record" in *BNS*, Judge Jane Roth agreed to re-examine the question of Section 203's constitutionality.[105]

In *RP Acquisition Corp. v. Staley Continental, Inc.*, the court began its analysis by endorsing the preemption test articulated in *BNS*: "The crucial inquiry . . . is whether hostile offers still have a meaningful opportunity for success despite the operation of Section 203."[106] To answer this question, the plaintiffs offered an affidavit from Professor Gregg Jarrell, former Chief Economist of the SEC, which provided evidence on 29 hostile tender offers over the prior seven years.[107] The analysis revealed that 55% (16 out of 29) of hostile bidders reached 85% ownership in the target.[108] In an *amicus curiae* submission, the SEC defined hostility somewhat differently and found that 50% (13 out of 26) of the hostile offers reached 85% ownership in the target.[109]

Quite reasonably, the court concluded that "[t]hese percentages undercut plaintiff's own argument and indicate that hostile offers will have a 'meaningful opportunity for success' under the 85 percent exception."[110] The court concluded from this straightforward analysis that Section 203 did not frustrate the purposes of the Williams Act and therefore survived constitutional scrutiny, but, as in *BNS*, left open the possibility that future empirical evidence might change the constitutional conclusion: "[U]ntil an accurate, rather than hypothetical, record

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[101] *Id.* at 472.
[102] Elliott J. Weiss, *What Lawyers Do When the Emperor Has No Clothes: Evaluating CTS Corp. v. Dynamics Corp. of America and Its Progeny – Part II*, 79 GEO. L. J. 211, 253 (1990).
[103] BNS v. Koppers, 683 F. Supp. at 473.
[104] RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988).
[105] *Id.* at 477.
[106] *Id.* at 482.
[107] *See id.*
[108] *See id.*
[109] *See id.* (citing Brief of SEC as Amicus Curiae at 29-30).
[110] *Id.* at 482-83.

can be assembled, whether the 85 percent exception will permit a sufficient number of hostile-to-the-end offers . . . is an issue which remains to be seen."[111]

City Capital Associates v. Interco[112] is the third and final case in the trilogy of federal district court opinions examining the constitutionality of Section 203. In July 1988, City Capital, an investment vehicle controlled by the well-known Rales brothers, launched a tender offer for Interco (formerly the International Shoe Company), a Delaware corporation headquartered in St. Louis, Missouri. After the Interco board repeatedly rejected City Capital's offers, City Capital brought suit in the federal district court for the district of Delaware challenging the constitutionality of Section 203, among other things.[113] In its briefs City Capital submitted an updated version of the statistical data and affidavits that the plaintiffs had submitted in *Staley*.[114] Nevertheless, the federal district court relied heavily on *BNS* and *Staley* to dispose of the constitutional challenge:

> In *BNS*, Chief Judge Schwartz suggested that reconsideration of § 203's constitutionality might be warranted if evidence could be developed showing that application of the statute harms shareholders by preventing a sufficient number of 'hostile to the end' tender offers, because such a result may thwart the purposes of the Williams Act and require a finding that although § 203 is constitutional on its face it is unconstitutional in its application. . . . [The Court] concludes that the data submitted to this Court has not changed significantly from the data submitted to the court in *Staley*. The limited opportunity which *BNS* left for future constitutional challenges of § 203 requires a much greater evidentiary showing than that which has been presented here.[115]

And so the *Interco* court, following *BNS* and *Staley*, had little trouble concluding that Section 203 survived constitutional scrutiny.

D. Twenty Years of Unexamined Experience (1989-2008)

Since the trilogy of *BNS*, *Staley*, and *Interco*, no court has reviewed the constitutionality of Section 203, and, perhaps related, no further empirical analysis has been done on the antitakeover impact of Section 203. These omissions are puzzling for at least three reasons. First, commentators noted the absence of relevant empirical evidence in the initial hearings on Section 203. Second, all three district court opinions relied heavily on the empirical assertion

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[111] *Id.* at 483.
[112] 696 F. Supp. 1551 (D. Del. 1988).
[113] *See id.* at 1553.
[114] *See id.* at 1555.
[115] *Id.* at 1554-55.

that Section 203 provided bidders a meaningful opportunity for success. And third, significant changes in takeover law, bidder tactics, and takeover defense suggest that the answer to the empirical question might have changed in the 1990s and today.

Nevertheless, the absence of subsequent empirical investigation is perhaps explainable by a parallel development in corporate takeover defense, involving the creation and solidification of the poison pill. The pill was introduced in 1983 and was validated by the Delaware Supreme Court in 1985.[116] Technically, the pill is simply a warrant to buy additional shares of the target company (a "flip-in" pill) or the acquiring company (a "flip-over" pill) at a deep discount to market price, in the event that a hostile bidder crosses a certain trigger threshold, typically between 10-20% of the target's shares. In the event that the pill is triggered, all target shareholders except the triggering shareholder can (and, likely, will) exercise their warrants, which severely dilutes the bidder's stake in the target. Until very recently, no bidder had ever "busted through" a pill and suffered the resulting dilution.[117] Instead, all hostile bidders either negotiated a deal with the target board or ran a proxy contest to replace the target board. In either case, the target board would then redeem (eliminate) the pill to let the offer proceed.

In 1987, when the Delaware legislature was considering Section 203, it was not clear whether, and how, state antitakeover statutes such as Section 203 would interact with the pill. Pill cases in the Delaware Chancery Court from the late 1980s suggested that the ability for a target board to maintain a poison pill would be meaningfully constrained by the board's fiduciary duty to shareholders.[118] In these situations, Section 203's "backstop" provided an additional layer of substantive defense against a hostile bidder.[119]

However, by the mid-1990s, a series of Delaware Supreme Court cases made clear that the ability to maintain a pill was subject only to the board's ability to stay in office.[120] In practitioner parlance, target boards could use a poison pill to "Just Say No" to a hostile bidder. This doctrinal shift meant that Section 203 was no longer a binding constraint in most hostile takeover contests. Even if a bidder got to 85% and Section 203's restrictions disappeared, the pill would still prevent a buyer from buying a control stake. Because a target board could maintain a pill

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[116] *See* Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985).

[117] WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 544 (3d ed. 2009)

[118] *See, e.g.*, City Capital Associates Ltd. Partnership v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); Grand Metropolitan Public Ltd. Co. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988).

[119] *See* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice*: Evidence on the "Race" Debate and Antitakeover Overreaching, 150 U. PENN. L. REV. 1795 (2002).

[120] *See* Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J. L. ECON. & ORG. 32 (2004).

indefinitely, most hostile bidders sought board control in order to redeem the pill and to waive Section 203. That is, the pill made board control a prerequisite for a hostile bid, but with board control a bidder would naturally waive Section 203.[121] As a result the pill, not Section 203, became the binding constraint, and the importance of getting to 85% disappeared.[122]

E. Why It Matters

Why, then, does it matter whether Section 203 provides bidders with a meaningful opportunity for success, or, by extension, whether Section 203 is constitutional? The answer is that the pill has been weakened in recent years by rising shareholder activism, strengthened fiduciary duty constraints on the pill, and the willingness of bidders to contemplate deliberate pill triggers. As the pill becomes weaker, Section 203 gains substantive bite in hostile takeover contests. We explain these points in more detail below.

First, shareholder activists are increasingly bringing "precatory" (non-binding) resolutions urging boards to eliminate their poison pills.[123] Even though boards have the legal ability to resist such demands, the growth of "majority vote" requirements in director elections,[124] the SEC's new rule on proxy access for shareholders,[125] and the elimination of broker voting of discretionary shares[126] have conspired to give shareholders unprecedented ability to replace directors. As a result, directors are listening to shareholder requests, and pill incidence is declining in corporate America.[127]

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[121] *See* John C. Coates IV, *The Contestability of Corporate Control: A Critique of the Scientific Evidence on Takeover Defenses*, 79 TEX. L. REV. 271 (2000).

[122] *See id.*

[123] The number of such resolutions more than tripled from 2001 to 2003, but has declined from its high of 76 in the 2003 proxy season as more companies have removed their poison pills. GEORGESON, ANNUAL CORPORATE GOVERNANCE REVIEW (2008), *available at* http://www.georgeson.com/usa/resources_research.php.

[124] From February 2006 to November 2007, the percentage of S&P 500 companies with majority voting provisions rose from 16% to 66%. *See* Claudia H. Allen, *Study of Majority Voting in Director Elections* (Nov. 12, 2007), *available at* http://www.ngelaw.com/files/upload/majoritystudy111207.pdf.

[125] *See* Proposed Rule 14a-11, SEC Release Nos. 33-9046; 34-60089 (May 20, 2009), *available at* http://www.sec.gov/rules/proposed/2009/33-9046.pdf.

[126] *See* SEC Release No. 34-60215 (July 1, 2009), *available at* http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

[127] From 2005 to 2007, the percentage of S&P 1500 companies with active pills declined from 54% to 37.5%. *See* RISKMETRICS 2008 POSTSEASON REPORT SUMMARY at 7 (Oct. 16, 2008), *available at* http://www.riskmetrics.com/system/files/private/PSR_2008_Short_final.pdf. *See also* John Laide, *Rethinking the Role of the Poison Pill?*, FACTSET (Sept. 17, 2008), *available at* www.sharkrepellent.net (finding that the net number of companies with poison pills declined by 640 between 2005 and 2008).

Second, as a doctrinal matter, Delaware courts have not yet squarely addressed the ability of a target board to "Just Say No" behind a poison pill,[128] but collateral attacks on the pill have been successful. In 2006, for example, the Delaware Chancery Court declined to bar a shareholder proposal at CA (formerly Computer Associates) that would have limited the ability of the CA board to use a pill.[129] Although the proposal was not approved by the CA shareholders, the very fact that the company was, in effect, forced by the court to place the proposal in its proxy materials represented a victory for pill opponents. In another recent pill decision, the Delaware Chancery Court allowed plaintiffs to proceed against the News Corp. board for reneging on a "board policy" that limited its use of a poison pill.[130] In language that, if read literally, would seem to alter the fundamental balance between the board and shareholders, the court held that "the board's power – which is that of an agent's with regard to its principal – derives from the shareholders, who are the ultimate holders of power under Delaware law."[131]

Finally, in the latest and most dramatic salvo against the pill, practitioners have begun to contemplate "busting through" the pill rather than treating it as a show-stopper. In a 2007 commentary, one of us documented the dilutive effect of PeopleSoft's poison pill, and argued that busting through may have been a better route for Oracle than the negotiated acquisition route that it chose.[132] In response a prominent Delaware practitioner noted:

> [S]ome bidders do analyze the economics of buying through pills, although not in every deal. We have asked for the bankers to run the dilution analysis on several occasions when it was not otherwise done. Generally, when raised, the idea of buying through is discarded for the simple reason that no one's ever done it. The road map in your article

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[128] The closest we have come to gaining guidance on the fundamental "Just Say No" question arose in Oracle v. PeopleSoft, when Oracle and PeopleSoft reached a negotiated deal just days before Vice Chancellor Strine would have issued his opinion on PeopleSoft's ability to maintain its pill after an 18-month defense against Oracle's all-cash, fully-financed offer. *See, e.g.*, Andrew Ross Sorkin, *Saying No to the 'Just Say No' Defense*, NEW YORK TIMES (July 8, 2009) ("[I]n Oracle's bid for PeopleSoft, there was a rumor (gut feeling?) that Vice Chancellor Strine was going to order the PeopleSoft pill to be redeemed and invalidate the change-of-control provisions PeopleSoft had negotiated in its customer contracts. Since that time, there has been some talk among practitioners that the just-say-no defense was under attack. . . "). *See also* David Millstone & Guhan Subramanian, *Oracle v. PeopleSoft: A Case Study*, 12 HARV. NEG. L. REV. 1, 25 (2007) (noting that one legal advisor to a major PeopleSoft shareholder estimated a 70% chance that Vice Chancellor Strine would require PeopleSoft to redeem its poison pill).

[129] Bebchuk v. CA, Inc., 902 A.2d 737, 738-39 (Del. Ch. 2006).

[130] UniSuper Ltd. V. News Corp., 2005 WL 3529313, at *1.

[131] *Id.* at *6.

[132] *See* Guhan Subramanian, *Bargaining in the Shadow of PeopleSoft's (Defective) Poison Pill*, 12 HARV. NEG. L. REV. 41 (2007).

> will be a great help in pushing back on this knee jerk response next time the issue arises.[133]

In November 2008, Versata Capital intentionally triggered the poison pill at Selectica, a "microcap" software company incorporated in Delaware.[134] Versata then challenged the validity of Selectica's pill in Delaware Chancery Court.[135] As of October 2009 the Delaware Chancery Court action is still pending, but Versata's move highlights the willingness of bidders today to contemplate a frontal assault on the pill.

In short, increased shareholder activism, emerging fiduciary duty constraints, and bidders' willingness to contemplate a deliberate pill trigger have conspired to weaken the pill in recent years. And as the pill becomes weaker, Section 203 gains substantive bite in hostile takeover contests. To take the simplest example, even if a bidder busts through a pill it still must grapple with the restrictions imposed by Section 203.

Twenty years of unexamined experience, then, might be explained by a historical context in which the pill, not Section 203, was the binding constraint on a bidder's strategy. But today Section 203 is becoming important once again. As it does, it seems worthwhile, if not essential, to examine this past experience.

F. Case Study: NRG Energy v. Exelon Energy

The recent case of Exelon Energy's hostile takeover bid for NRG Energy illustrates these points.[136] Exelon and NRG are competitors in the power generation and supply business. Both companies are incorporated in Delaware. On September 26th, 2008, John Rowe, Chairman and CEO of Exelon, telephoned David Crane, President and CEO of NRG, to "express interest in exploring a possible transaction and meeting to discuss the strategic direction of their companies."[137] On September 30th, Rowe, Crane, and other top managers from both sides met in New York City to discuss the terms of a potential combination, but the negotiations broke down over price and other issues.[138]

On October 20th, Exelon launched a hostile exchange offer for NRG at an exchange ratio of 0.485 Exelon shares for each NRG share.[139] The offer represented $6.2 billion in total value and a 37% premium over NRG's share price

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[133] E-mail from Delaware practitioner (August 12, 2007) (on file with authors).
[134] *See* Steven M. Davidoff, *Two Interesting Moves in a Quiet Week*, DealBook, NEW YORK T. (Jan. 7, 2009).
[135] *Id.*
[136] This bid is also the last (i.e., most recent) offer in the sample we construct in Part III.
[137] Exelon Corp. S-4/A (filed May 20, 2009) at 22.
[138] *See id.*
[139] *See id.*

the previous trading day,[140] though NRG claimed that the offer was "vastly below the price range [Exelon] had mentioned in setting up the September 30th meeting."[141] On November 9th, the NRG board unanimously rejected the offer and recommended that shareholders not tender their shares.[142]

Reflecting the weakening of the pill documented in the previous Part, NRG did not have a poison pill when Exelon announced its offer, nor did NRG make any effort to put in a pill afterwards, as targets historically have done.[143] Instead, NRG relied on two defenses against Exelon's offer. First, NRG had approximately $8.6 billion of debt on its balance sheet, of which $4.6 billion would have to be refinanced in the event of a "change of control," defined as either a new controlling shareholder in NRG or replacement of a majority of the NRG incumbent directors.[144] This kind of change-of-control clause (a.k.a. "poison put" or "proxy put") is not unusual in debt agreements,[145] but it can prevent a takeover if the cost of refinancing the debt at the time of the takeover becomes too large.[146]

This is exactly what happened at NRG. With the credit markets in freefall at the time of Exelon's bid, NRG estimated that refinancing the $4.6 billion of NRG debt would add $500 million to the cost of the acquisition.[147] Exelon agreed that the refinancing cost would be "substantial,"[148] and its own estimates in its *pro forma* financial statements suggested a similar, if not larger, refinancing cost.[149] Exelon would trigger the change of control clause and suffer the refinancing cost if it closed its tender offer for a majority of NRG's shares or gained a majority of NRG's board seats, but it would *not* trigger the change of control provisions if the parties restructured the deal as a merger of Exelon in to NRG, because such a deal

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[140] Exelon Corp. S-4/A (filed November 12, 2008) at i.

[141] Exelon Corp. S-4/A (filed November 12, 2008) at 29 (letter from NRG rejecting Exelon bid on Nov. 9, 2008) .

[142] NRG ENERGY PRESS RELEASE (November 10, 2008), contained in Form 8-K (filed November 10, 2008).

[143] *See, e.g.*, BRIAN HALL, CHRISTOPHER ROSE & GUHAN SUBRAMANIAN, CIRCON (A), Harvard Business School Case Study No. 9-801-403 (Mar. 2001) (documenting how Circon put in a so-called "morning after" poison pill after U.S. Surgical launched its tender offer).

[144] NRG ENERGY PRESS RELEASE (Mar. 26, 2009).

[145] *See, e.g.*, AMYLIN PRESS RELEASE (April 12, 2009) (indicating that 15 out of 26 comparable biotechnology companies have similar change-of-control clauses in their convertible securities).

[146] Ronald Grover, *A Hot Weapon in Proxy Battles*, BUS. WEEK (April 20, 2009). In prior work, one of us has proposed an approach for how courts should review the antitakeover effect of so-called "embedded" defenses, such as change-of-control clauses in debt agreements. *See* Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from Air Line Pilots Ass'n International v. UAL Corp.*, 120 HARV. L. REV. 1239 (2006).

[147] Complaint for Declaratory and Injunctive Relief in *NRG Energy, Inc., v. Exelon Corporation and Exelon Xchange Corporation* (U.S. District Court, S.D.N.Y 09CV2448) at para. 3.

[148] *See* Exelon S-4 (Nov. 12, 2008) at 48.

[149] *See* Exelon S-4 (filed Nov. 12, 2008) at 74.

structure would not constitute a "change of control" for NRG.[150] Of course, this kind of deal structure could only be achieved pursuant to a merger agreement with the NRG board.[151]

The second impediment to Exelon's offer was Section 203. Interestingly, Exelon conditioned its exchange offer on gaining a waiver of Section 203, but it did not condition its offer on restructuring the deal in a way that would avoid the refinancing cost. This choice implicitly suggested that Exelon viewed Section 203 as a more onerous obstacle than a $500 million refinancing cost.

Exelon's exchange offer expired on January 6th, 2009, with 46% of NRG shares tendered.[152] Exelon then extended its exchange offer to February 25th and got to approximately 51% of shares tendered.[153] On July 2nd, Exelon raised its offer to 0.545 Exelon shares for each NRG share, representing a 12% increase over its initial offer and $8.0 billion in total value for the NRG shareholders.[154] The NRG board again rejected the offer,[155] and all four leading proxy advisory firms recommended that shareholders not vote for Exelon's proposed board expansion that would have facilitated the offer.[156] In conjunction with its July 2nd increase, Exelon disclosed that NRG shareholder support for its prior offer had dwindled to 12%.[157]

With such tepid shareholder support making it highly unlikely that Exelon would get to 85%, Exelon brought suit in the Delaware Chancery Court. Unlike the bidders in *BNS*, *Staley*, and *Interco*, Exelon did not challenge the constitutionality of Section 203. For reasons described in Part IV, this may have been a mistake in Exelon's litigation strategy. Instead, Exelon brought a general fiduciary duty claim against the NRG board, seeking an injunction against NRG's use of Section 203:

> The NRG Board's decision to defend against the Tender Offer by relying on § 203 is coercive, preclusive, and unreasonable. Unless Exelon acquires more than 85% of NRG's stock in the Tender Offer . . . Exelon cannot consummate the second-step transaction contemplated by the transaction without a three-year delay. Up to three years of the substantial benefits of the Proposed Acquisition would be lost to the

[150] *See* Exelon S-4 (Nov. 12, 2008) at 48
[151] *See* DEL. GEN. CORP. L. § 251 (requiring target board approval of statutory merger).
[152] EXELON PRESS RELEASE (Jan. 7, 2009), contained in Form 8-K (Jan. 7, 2009) at 1.
[153] EXELON PRESS RELEASE (Feb. 26, 2009), contained in Form 8-K (Feb. 26, 2009) at 1.
[154] Mark Peters, *Exelon Lifts NRG Offer in Bid to Form Power Giant*, WALL ST. J. (July 3, 2009).
[155] NRG ENERGY PRESS RELEASE (July 8, 2009), contained in Form 8-K (July 8, 2009), at 1.
[156] *All Four Leading Proxy Advisory Firms Support NRG and Recommend NRG Stockholders Vote "FOR" All Four NRG Director Nominees on the White Proxy Card ; Stockholders Recommended to Vote "Against" Exelon's Board Expansion Proposal*, BUSINESSWIRE (July 13, 2009)
[157] *See* NRG Energy Inc., Form 425 (July 8, 2009).

> NRG stockholders, and any number of events could occur within this time period that could derail the Proposed Acquisition altogether.[158]

The Exelon-NRG deal highlights how, in the absence of the pill, Section 203 had become a binding and significant constraint on Exelon's ability to acquire NRG. In its brief, Exelon went on to argue that the typical proxy contest route around Section 203 was not available to Exelon because a successful proxy contest would trigger the $500 million refinancing cost.[159] Because of this "unique context,"[160] Exelon sought declaratory and injunctive relief to "compel the Defendants to approve the Tender Offer for purposes of § 203 and enjoin Defendants . . . from taking any action to enforce or apply § 203 that would impede, thwart, frustrate, or interfere with the Tender Offer."[161]

In response, NRG's lawyers argued simply that "[t]he Board has no affirmative obligation to waive § 203."[162] NRG also noted that a court injunction mandating a § 203 waiver would be inconsistent with the plain language of Section 203(a)(1), which vests the power to waive Section 203 with the board.[163]

On July 21st, 2009, the NRG shareholders declined to elect an Exelon partial slate (which would not have triggered the debt refinancing) to the NRG board.[164] Exelon abandoned its exchange offer, which meant that the Delaware Chancery Court was not required to rule on the injunctive relief that Exelon sought. While predictions about hypothetical court decisions are of course always dangerous, existing Delaware precedent,[165] the plain language of Section 203(a)(1), and fundamental principles of corporate law suggest to us that Exelon would have been unsuccessful in gaining a Section 203 waiver through court injunction.

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[158] Complaint for Declaratory and Injunctive Relief in *NRG Energy, Inc., v. Exelon Corporation and Exelon Xchange Corporation* (U.S. District Court, S.D.N.Y 09CV2448) at para. 102.
[159] *Id.* at para. 104-106.
[160] *Id.* at para. 106.
[161] *Id.* at para. 107.
[162] DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS THE AMENDED COMPLAINT OF EXELON CORP. AND EXELON XCHANGE CORP., C.A. No. 4155-VCL (June 12, 2009) at 3.
[163] *Id.* at 31.
[164] *See* EXELON PRESS RELEASE: EXELON TERMINATES OFFER TO ACQUIRE NRG (July 21, 2009) (quoting Exelon CEO John Rowe: "The NRG shareholders have spoken, and Exelon will move on. We wish NRG and its owners well.").
[165] *See* Nomad Acquisition Corp. v. Damon Corp., 1988 WL 383667 at * 829 (Del. Ch.) ("Nomad makes the novel request that the Court enter a mandatory injunction compelling the Board to take action to exempt the Nomad Offer from the provisions of 8 Del. C. § 203. . . . If Nomad's request were granted, this Court would usurp the managerial powers of the Board by forcing it to approve a Nomad Offer which the Board has found to be inadequate. This application is without merit and must be denied.").

To the extent that this prediction is correct, it highlights the potency of Section 203 compared to the poison pill. The pill is a private law innovation and requires affirmative board action. As such, it is subject to, and constrained by, the board's fiduciary duty to the corporation. Although this fiduciary duty constraint has been dormant for many years, it appears to have gained new substantive bite over the past few years, for reasons discussed in the previous Part. In contrast, Section 203 is a statutory law innovation and does not require affirmative board action. It would seem unusual, and unprecedented, for a Delaware court to rule that a board's fiduciary duty prevented it from doing something that the Delaware legislature had explicitly authorized.[166] Put differently, fiduciary duty trumps a board's use of a pill, but it is unlikely to trump a board's use of Section 203.[167]

The implication of this point is that we may be entering an era where the decline of a constrained antitakeover device (the pill) causes the emergence of an unconstrained antitakeover device (Section 203). It highlights the futility of shareholder activists' campaign against the pill for the past decade: because the pill and Section 203 provide a belt-and-suspenders defense, Delaware companies' defensive postures remain virtually unchanged if they redeem the pill. As the pill begins to get stripped away, it becomes important to assess the strength of Section

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[166] In *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003), a rare 3-2 majority of the Delaware Supreme Court reversed a Chancery Court decision and held that the NCS board violated its fiduciary duty when it included a "force the vote" provision in its merger agreement with Genesis, even though Section 251(c) of the Delaware corporate code explicitly permitted NCS to include such a provision. Although it has not been explicitly overruled, *Omnicare* is of questionable continued vitality. *See, e.g.*, Orman v. Cullman, 2004 WL 2348395 (Del. Ch.) (distinguishing *Omnicare* on the grounds that the controlling shareholders entered into their voting agreements as shareholders rather than as directors, even though the controlling shareholders in Omnicare also entered into the voting agreements as shareholders). In any case, *Omnicare* does not contradict the point in the text because the *Omnicare* majority was bothered by the interaction of the force-the-vote provision and a controlling shareholder lockup, with the latter not explicitly endorsed by the Delaware legislature and therefore subject to a board's fiduciary duties under *Unocal* and *Unitrin*.

[167] In a recent memorandum to clients, Eric Robinson and Ryan McLeod of Wachtell, Lipton, Rosen & Katz challenge this conclusion. *See* WACHTELL, LIPTON, ROSEN & KATZ MEMORANDUM TO CLIENTS, FLAWED ACADEMIC CHALLENGE TO CONSTITUTIONALITY OF DELAWARE'S ANTI-TAKEOVER LAW (Sept. 29, 2009) at 1 ("In any situation where fiduciary duties might compel a board to redeem a rights plan [a.k.a., poison pill], they would also likely compel a board to waive Section 203's waiting period."). In order to reach their conclusion, Robinson & McLeod must assume that a Delaware court would apply enhanced (*Unocal*) scrutiny to the decision not to waive Section 203, because enhanced scrutiny would clearly apply to the decision to not redeem a pill. To our knowledge, no Delaware court has ever done so. In the one known case in which a Delaware court was asked to enjoin the use of Section 203 by a target board, the court summarily rejected this "novel request." *See supra* note 165. In any case, the question of what standard of review should attach to a board's decision not to waive Section 203 is not relevant for the constitutionality of Section 203, because no court has suggested that the "meaningful opportunity for success" test could be satisfied through the possibility of a court-ordered board waiver.

203, as a stand-alone instrument, with the available empirical evidence. The next Part does so.

III. Evidence on Tender Offers Under Section 203

In this Part we examine bidder strategy and shareholder tender decisions in context of Section 203 since January 1988, when the statute became effective. As described in Part II, all prior empirical work on Section 203 was done in 1988, just after Section 203 became law. To our knowledge, this Part presents the only systematic empirical evidence on Section 203 from deals in which Section 203 actually applied.

A. Methodology

We use the Thomson One Banker database to identify all "Unsolicited" and "Hostile" tender offers made against Delaware targets between January 1st, 1988 and December 31st, 2008. Our initial filter yielded 145 transactions from Thomson One Banker. We then excluded five kinds of bids for which Section 203 was not relevant: (1) bids in which the acquirer held more than 15% of the target's shares at the time of the offer, because such acquirers are already "interested" shareholders for purposes of Section 203; (2) bids against targets that have a merger agreement in place with a friendly buyer, because such bids are not subject to Section 203;[168] (3) deals that were withdrawn prior to a tender offer being launched; (4) bids for less than 85% of the target; and (5) deals in which the target had opted out of Section 203.[169]

In addition, we excluded bids in which the target agreed to the offer before the expiration of the initial tender offer. This exclusion introduces the possibility of sample selection bias (specifically, truncation), if target boards negotiated friendly deals *because* the board believed that the bidder was about to get to 85%. One straightforward reason that we exclude such bids is that there are no data available on the number of shares that were tendered while the bid was still hostile. Because bidders are not required to report the number of shares that were tendered along the way, all we have is the number of shares that were tendered into the friendly tender offer.

Putting aside the data availability issue, in our opinion this exclusion is warranted for two reasons. First, on the continuum between friendly and hostile bids, deals that go friendly very quickly, before the expiration of the initial tender

[168] *See* DEL. GEN. CORP. L. § 203(b)(6).

[169] Engelhard Corporation and Georgia Gulf Corporation opted out in 1988 when Section 203 was passed, and Spreckels Industries waived Section 203 before American Enterprises launched its hostile bid for Spreckels.

offer, are more like friendly bids than hostile bids. We therefore exclude these bids because the question that we are trying to examine is the viability of the 85% threshold in pure hostile bids.

Second, we believe that the hypothesized sample selection bias did not exist during the time period under examination because, as discussed in Part II.D, Section 203 was rarely if ever the binding constraint against a hostile tender offer. To illustrate this point, consider IBM's unsolicited tender offer for Lotus Development Corp. In June 1995, IBM launched a tender offer for Lotus, a Delaware company, at $60 per share in cash. If IBM had gotten to 85% in its hostile tender offer, Lotus's poison pill would have still thwarted an acquisition. Lotus nevertheless capitulated almost immediately because IBM could have called a special meeting of shareholders, replaced the Lotus board, redeemed the poison pill, and waived Section 203, all within a month.[170] Because Section 203 was not the binding constraint in IBM's bid for Lotus, it seems unlikely that the Lotus board agreed to be bought because IBM was about to achieve 85% in its hostile tender offer. The example illustrates why our exclusion of deals that turned friendly before the expiration of the initial tender offer is unlikely to create truncation bias in our sample.

The final sample includes 60 hostile bids. **Table 1** presents the list of these transactions, in chronological order. For each of these bids, we examined SEC filings (primarily 10-K, 14A, TO-T, and 14D-1) and press reports to collect data on the bidder's offer and the fraction of target shares that were conditionally tendered into the offer.

B. Bidder Strategy Against Section 203

As a starting point, we find that every bidder in our sample conditioned its offer on the inapplicability of Section 203. While this finding is consistent with practitioner wisdom that Section 203 is a "show stopper" against a hostile bidder, it is generally inconsistent with claims that Section 203 would be a mild deterrent to a hostile bidder, because some bidders might simply wait the three years before executing a back-end freeze-out merger.

Case law developments after Section 203 was enacted might explain why the three-year moratorium has become more onerous than was originally foreseen. On November 30th, 1982, Ron Perelman closed a $23 per share all-cash tender offer to gain control of Technicolor, a Delaware corporation with several distinct businesses in the film industry.[171] Perelman immediately began implementing his

[170] *See* John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CAL. L. REV. 1301 (2001).
[171] Cede v. Technicolor, 684 A.2d 289, 293 (Del. 1996).

operating plan, which included the sale of several underperforming businesses.[172] On January 24th, 1983, nearly two months after acquiring control, Perelman executed the back-end freeze-out that eliminated the remaining 18% of Technicolor shares.[173] Litigation ensued over whether the minority (non-tendering) shareholders were entitled to the additional value created by the Perelman divestment strategy in an appraisal of their shares.[174] The Delaware Court of Chancery held that the answer was no.[175] But in 1996, after more than a decade of litigation, the Delaware Supreme Court reversed, holding that the minority shareholders were entitled to the benefits of the Perelman plan that were implemented in the interim between the front-end tender offer and the back-end merger.[176]

To the extent that it was unclear beforehand, *Technicolor* clarified the substantive bite of Section 203's three-year moratorium. A bidder who closes a front-end tender offer without gaining a Section 203 waiver in advance will need to wait three years before executing a back-end merger. During those three years, the non-tendering shareholders will share *pro rata* in any operational improvements. When the back-end merger finally occurs, *Technicolor* tells us that this transaction is not the second step of a two-step acquisition; rather, it is a plain vanilla freeze-out merger by a controlling shareholder.

Kahn v. Lynch Communications,[177] a Delaware Supreme Court decision that also occurred in the aftermath of Section 203, further tells us that a controlling shareholder cannot escape "entire fairness" review in freeze-out mergers, even if the deal process is pristine. In prior work, one of us finds that the presence of a special committee with veto power and the specter of entire fairness review in freeze-out mergers permit minority shareholders to extract even more than their *pro rata* share of going concern value.[178]

The result of *Technicolor* and *Lynch* is a challenging gauntlet for a hostile bidder to run in the absence of a Section 203 waiver. The overall cost of an acquisition becomes uncertain; in fact, the more successful the bidder's business plan, the more the acquisition will cost. All bidders in our sample felt compelled to avoid this uncertainty and perverse incentive by making their offer conditional on the inapplicability of Section 203.

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[172] *See id.* at 293.
[173] *See id.*
[174] *See id.* at 293-294.
[175] Cinerama Inc., v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994).
[176] Cede v. Technicolor, 684 A.2d 289 (Del. 1996).
[177] 638 A.2d 1210 (Del. 1994).
[178] *See* Guhan Subramanian, *Post-Siliconix Freeze-outs: Theory & Evidence*, 36 J. LEG. STUD. 1 (2007). For an alternative approach to freeze-outs that reduces some of these barriers, *see* Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L. J. 2 (2005).

C. Feasibility of 85% Hurdle

We now examine target shareholders' response to the bidder's tender offer. Specifically, we examine the fraction of shares that were conditionally tendered into the offer in order to assess the feasibility of the 85% "out." For purposes of calculating the 85% hurdle, Section 203 requires exclusion of shares held "by persons who are directors and also officers" and shares held by "employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer."[179] We therefore examined SEC filings to exclude these shares for purposes of calculating the percent tendered.

Table 2 provides the detailed results by bid. These results are summarized in the following histogram:

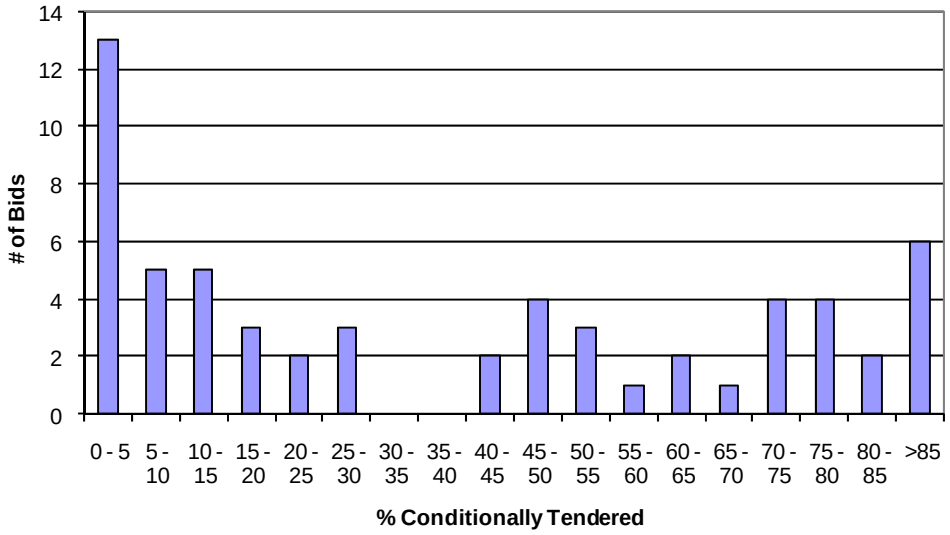


Table 2 shows that six out of 60 bidders (10%) achieved more than 85%, and two more bidders came close to achieving 85% (i.e., 80-85%). Of the six bids that were able to reach the 85% out required by Section 203, four occurred in 1988 and two occurred in 1989. The two bidders that came close to reaching 85% occurred in 1989. These findings indicate a significant decline in the likelihood of getting to 85%, compared to the data reported by Professor Jarrell in his 1988 study. Jarrell examined hostile bids between 1981 and 1988 to find that 55% (16 out of 29) reached 85% ownership in the target. The data reported in Table 2 indicates that 4 out of 18 hostile bids (22%) achieved 85% ownership in 1988, and another 2 out of 8 (25%) achieved 85% ownership in 1989. Even if the two

[179] *See* DEL. GEN. CORP. L. § 203(a)(2)(i).

bidders who came close to 85% are included, the overall success rate for bidders seeking the 85% out would be 31% (8 out of 26) between 1988-89, which is significantly lower than the 55% in Professor Jarrell's sample.

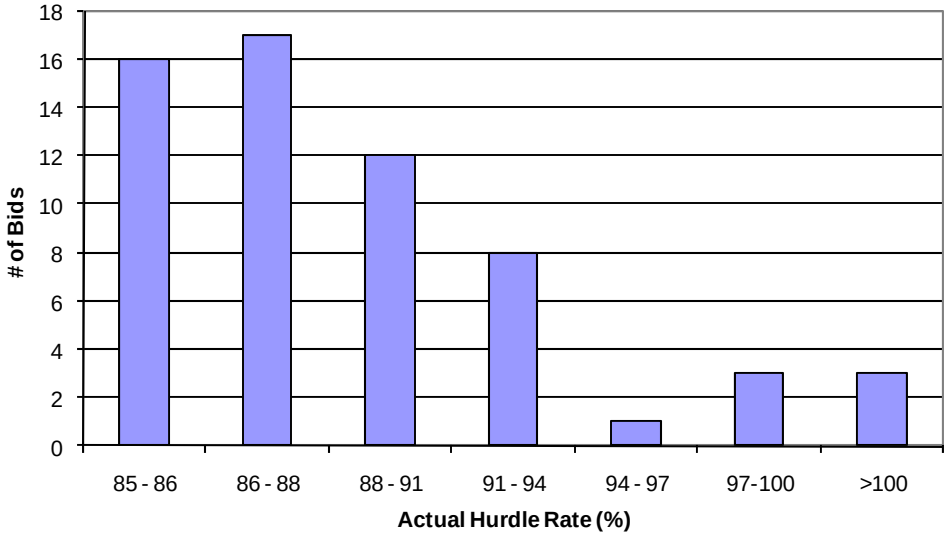
Perhaps more striking is the further decline in likelihood of getting to 85% since 1989: Table 2 shows that no bidder in the last nineteen years (1990-2008) has achieved the 85% out required by Section 203, or has even come close. In unreported analyses, we examined the 31 hostile bids against targets incorporated in states other than Delaware over the past fifteen years (1995-2009). The results are the same: no bidder achieved more than 85%; in fact, only one bidder achieved more than 70%.[180] We return to the implications of these finding in Part IV below.

D. Actual Hurdle to Get to 85%

As noted above, Section 203 excludes shares held by officer-directors and ESOP's for purposes of calculating the 85% out. Section 203 does not exclude shares held by directors who are not officers or shares held by officers who are not directors. If these individuals are unlikely to tender their shares into the offer, then bidders would need to get more than 85% of shares that are actually "in play" in order to reach the 85% hurdle. For example, if directors who are not officers and officers who are not directors collectively own 5% of the target's shares, and if these shares are not realistically "in play" for a hostile bidder, then in order for the acquirer to achieve 85% of shares outstanding for purposes of Section 203, it must acquire 89.5% of shares held by the remaining shareholders (=85% / 95%).

Table 3 documents the percentage of shares held by shareholders *other* than officers or directors that bidders would need to control in order to reach 85%. To the extent that officer and director shares are not in play, the results in Table 3 can be viewed as being the actual hurdle that a bidder needs to achieve in order to get to the stated hurdle of 85%. The Table 3 results are summarized in the following histogram:

[180] The one bidder that achieved more than a 70% tender outside of Delaware was an anomalous situation. On January 15, 2003, Simon Property Group made a hostile offer for Taubman Centers, a company headquartered and incorporated in Michigan. On February 14, 2003, Simon announced that 44.1 million shares had been tendered, and that number amounted to 84.5% of the 52.2 million total outstanding shares. However, Taubman claimed that there were 85 million shares outstanding, which included 32.8 million shares owned by the Taubman family. Simon Properties brought suit in the Eastern District of Michigan to enjoin the Taubman family from voting its shares. Simon won in District Court and Taubman appealed to the Sixth Circuit. Simon then withdrew before the Sixth Circuit ruled, thereby leaving the question unresolved.



The histogram shows that only 16 out of 60 targets (27%) had an actual hurdle that was approximately 85%. The remaining targets had actual hurdles that went well beyond 85% of the actual shares that were in play. Six targets had actual hurdles that were greater than 97%, and of these, three had hurdles over 100%.

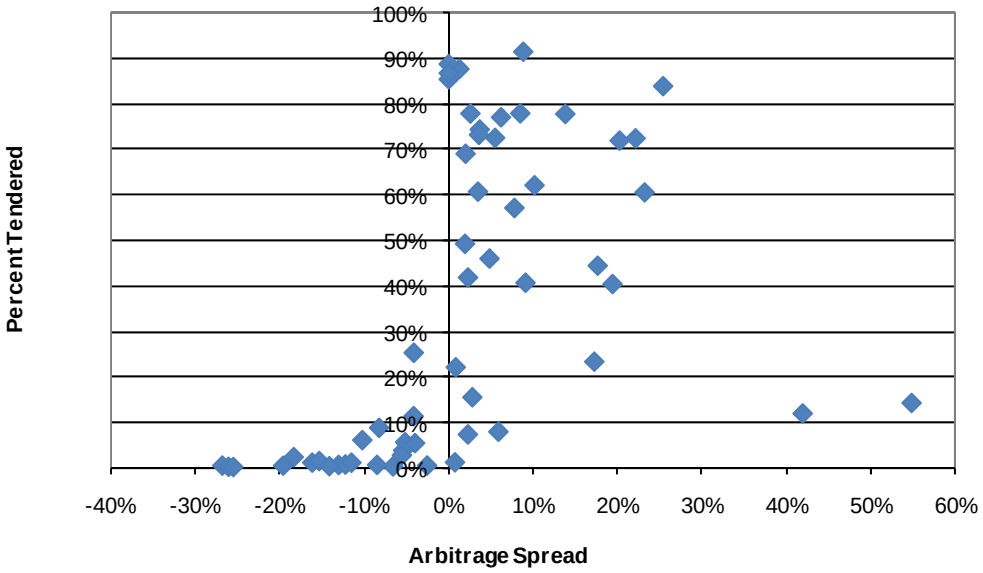
A natural question is whether, and to what extent, shares held by non-director officers and non-officer directors are in play. We do not have direct evidence on this question because non-director officers and non-officer directors only need to report under Section 16(b) of the Securities Exchange Act when they actually sell their shares.[181] Importantly, for our purposes, these individuals do not need to report under Section 16(b) when they have conditionally tendered their shares into a tender offer. However, we can compile indirect evidence on the question by examining director recommendations on the tender offer, on the reasonable assumption that directors would be unlikely to tender shares themselves after voting against recommending the offer to shareholders.

Table 3 shows the composition of the board vote in response to the tender offer. 51 out of 60 target boards (85%) unanimously opposed to the offer; another seven boards (12%) were against the offer but the board vote was not disclosed; and the remaining two boards (3%) took no position on the offer. These results provide indirect evidence that non-officer director shares are not, in fact, in play. The findings support the analysis above that the actual hurdle for most bidders is higher than the 85% bar would suggest.

[181] *See* Securities Exchange Act § 16(b). *See also* Allis-Chalmers Mfg. Co. v. Gulf & Western Industries, Inc., 309 F. Supp. 75, 80 (E.D. Wis. 1970) ("Until a contract is a firm commitment, i.e., until both parties are bound, there is no 'purchase' or 'sale' under § 16(b) of the Act.").

E. Arbitrage Spreads

In order to shed further light on the target shareholder tender decision, we examine arbitrage spreads, which we define as the percentage difference between the bidder's offer price and the target's share price on the expiration date of the offer.[182] If the arbitrage spread is negative on the expiration date of the offer, then shareholders would have little incentive to tender their shares because they can get a higher price (immediately) by selling their shares on the market. To calculate the percentage of shares tendered we divide the number of shares tendered by the number of shares available for tender, defined as the number of shares outstanding less shares owned by officer directors, shares owned by non-officer directors, shares owned by non-director officers, and shares already owned by the bidder.[183] The following chart graphs the percent tendered against the arbitrage spread for each of the deals in our sample.



We find that 22 out of 57 targets (39%) had negative arbitrage spreads at the tender offer expiration date. In those 22 deals, the chart shows that the shareholder tender percentage is very low, never exceeding 30%, which is

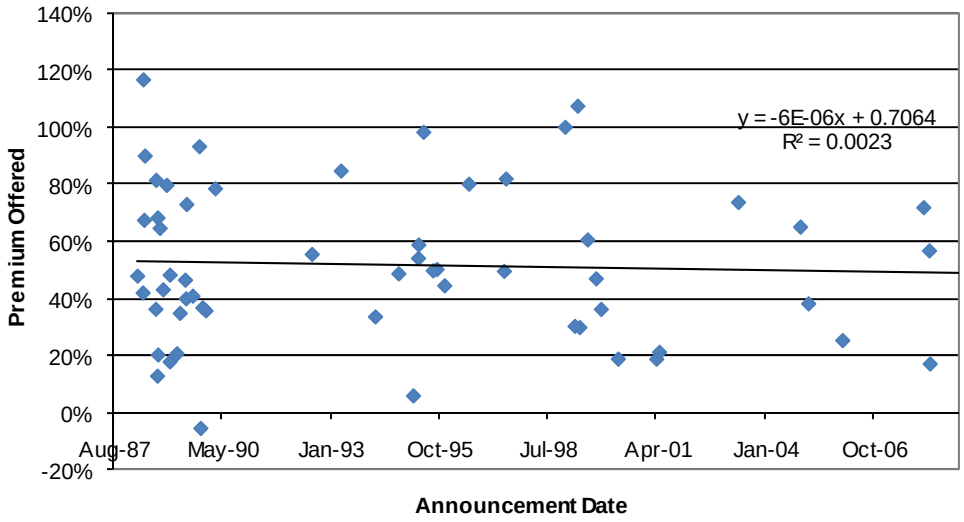
[182] Specifically: Offer Price / Trading Price – 1. Stock price data come from the Center for Research in Security Prices ("CRSP") database. The bids for Nostalgia Networks, Net Perceptions, and Whitehall Jewelers are not included because stock price data were not available in CRSP. Using the target's share price 1 to 5 days before the expiration date of the tender offer does not change our findings.

[183] *See* Parts III.D and IV.C for the rationale behind this methodology.

consistent with the intuition that many shareholders will not tender when they can sell their shares on the market for a higher price. Also consistent with intuition, all of the more successful tender offers (i.e., tender percentages > 30%) occurred in offers where the arbitrage spread was positive at the expiration of the tender offer. We return to the implications of these findings in the next Part.

F. Offer Premiums

The finding that 6 out of the 26 bidders in 1988 and 1989 achieved 85% and no bidder has since done so raises the question of why bidders after 1989 have been less successful than earlier bidders. One potential explanation is that bidders have made less attractive offers since 1989. To test this possibility, we examine premiums in hostile bids during the timeframe of our analysis. The following chart shows the premium offered in each of the deals in our sample, calculated as the price offered in each tender offer relative to the target's closing price twenty days prior to the announcement of the offer.[184]

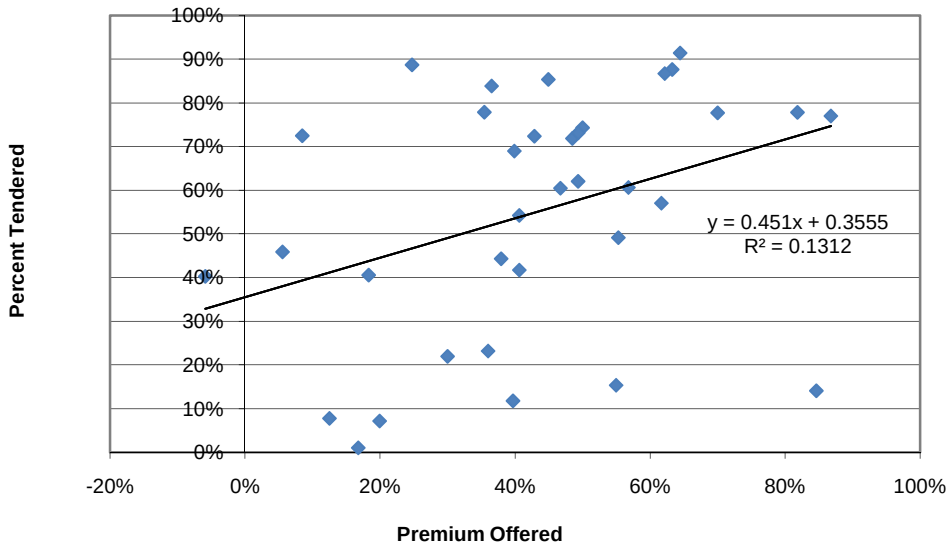


The chart shows no significant drop in premiums after 1989. Although a simple trend line is downward sloping, the time trend coefficient is very close to zero and the trend line does not predict meaningfully lower premiums at the end of the sample period: an average premium of approximately 53% in January 1988 declines to approximately 50% by December 2008. Taken as a whole the

[184] We also calculated premiums relative to the closing price five and ten days prior to the announcement of the offer, which produced similar results.

evidence would not seem to support the hypothesis that the inability to get to 85% after 1989 was due to lower premiums being offered.

We also examine the correlation between premiums offered and shares tendered. Although the theoretical correlation will be positive as long as the supply curve for the target's shares is upward sloping, the empirical correlation provides further insights on the feasibility of the 85% out. For reasons described in Part III.E, the tender decision is likely to be distorted when the arbitrage spread is negative. We therefore focus our analysis on the 35 deals (61% of the available sample) in which the arbitrage spread was positive at the time the tender offer expired. The following chart shows the correlation between premiums offered and the maximum percentage of shares tendered into the offer.



As basic economic theory would predict, the chart shows a positive and statistically significant (at 95% confidence) correlation between premiums offered and percent tendered among the offers in our sample with a positive arbitrage spread. Because of the reasonable fit (R-sq = 13%) the analysis allows us to extrapolate what a bidder would need to offer, on average, in order to expect an 85% tender. Solving for Percent Tendered=85% reveals that a bidder would need to offer a premium of approximately 110% over the existing market price in order to expect to achieve an 85% tender. This estimate incorporates the 1988/1989 data, in which some bidders actually did achieve 85%. If we focus only on the past nineteen years, the premium that would be needed in order to expect to achieve 85% would be even higher than 110%.

The results from this simple model should of course be interpreted with caution. Nevertheless, they are broadly consistent with the overall conclusion that achieving 85% is an exceedingly high bar.

IV. Implications

A. Revisiting the Constitutionality of Section 203

Stepping back from the details, the data in Part III presents a striking fact. Over the past nineteen years, *no hostile bidder* has been able to avoid the restrictions imposed by Section 203 by going from less than 15% to more than 85% in a single tender offer. In our informal conversations with New York City and Wilmington practitioners, this fact does not surprise them. To the contrary, our impression is that experienced practitioners would have been surprised if we *were* able to find a hostile bidder who was able to make use of the 85% out.

Despite the congruence between the empirical finding and conventional wisdom among practitioners, the core finding presented in Part III paints a significantly different picture about the viability of the 85% out than the data that the federal courts relied upon in 1988 to uphold the constitutionality of Section 203. Back then, Professor Jarrell's data showed that approximately half of all bidders were able to get to 85%. Our evidence from 1988-1989 is roughly consistent with this prior analysis. But then something changed. Since 1990, no bidder has been able to achieve 85% in a hostile tender offer. Over the past nineteen years, then, Section 203 has been a show-stopper against a hostile bidder.

We find no evidence that bidders began offering less, measured by premiums over pre-announcement share prices, after 1989. The reason for the stark difference before and after 1989 therefore remains something of a puzzle. What is nevertheless clear, in our opinion, is that that Section 203 no longer gives hostile bidders a "meaningful opportunity for success," as the federal district courts have held that the Williams Act requires. In view of this new evidence, it would seem to us that the question of Section 203's constitutionality is very much back in play.

B. The Possibility of Strategic Behavior

One important concern is the possibility of strategic behavior that would distort the tender offer data in our sample. Virtually all of the tender offers in our sample were conditioned upon redemption of the pill, which means that shareholders could not tender into the bidder's offer because this condition was not met while the offer was still hostile. This introduces the possibility of

strategic behavior by shareholders, i.e., shareholders not revealing their true preferences in the tender offer because they could not actually tender their shares to the bidder until the conditions were met.

As a starting point in assessing this possibility, all of the bids in our sample were any-and-all offers, which means that the tender decision was a non-coercive and therefore non-distorted choice.[185] Shareholders who wanted the offer should tender their shares, in order to pressure the target board to sell, which would also increased the likelihood of achieving 85%. Shareholders who did not want the offer should not tender their shares, which would reduce the likelihood of achieving 85%. At first pass, then, the shareholder tender decision would seem to be aligned with the likelihood of achieving 85%.

However, larger shareholders might play a more complex game by not tendering, even if they would be willing to accept the offer, in order to induce the bidder to pay more. Before exploring this possibility empirically, we note a few assumptions and caveats that underlie the "strategic behavior" hypothesis. First, the signal can only have an effect if the bidder does not know that shareholders are playing such a game. If bidders know that target shareholders are engaging in strategic behavior, they will discount the tender data, which in turn will discourage shareholders from strategic behavior. Second, target shareholders must assume that the bidder's willingness to pay more is influenced by the fraction of shares that are tendered. This must be true even at tender levels higher than 50%, where the bidder has the legal ability to close the deal, because above 50% is the only arena in which strategic behavior can influence the bidder's ability to achieve 85%.

Even if strategic behavior exists, the directional effect is not clear because target shareholders are negotiating with the bidder and with their own board. Shareholders might withhold shares, even if they would be willing to sell at the offer price, in order to induce the bidder to pay more. Shareholders might also tender their shares, even if they would be unwilling to sell at the offer price, in order to put pressure on their own board to come to the table to negotiate a deal.

In addition to these assumptions and qualifications, there is a practical consideration. Strategic behavior is a risky game because Sections 14(a) and 13(d) of the Securities Exchange Act effectively prevent shareholders from communicating with each other. Each shareholder must make an individual tender decision not knowing what other shareholders will do. Because shareholders can revoke their shares at any point during a tender offer, all shareholders in effect make a simultaneous decision at the close of the tender

[185] *See* Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985).

offer.[186] If a large shareholder behaves strategically but guesses wrong about what the other shareholders will do, the tender result might be artificially low and the bidder might go away.

This leads to a quantitative point. Even if a target shareholder makes the assumptions above and overcomes the practical challenges to strategic behavior, the shareholder implicitly engages in the following calculation: Pr(bidder pays more because of the incremental non-tender) * (Incremental premium likely to be offered) >? Pr(bidder goes away because of the incremental non-tender) * (Premium currently offered). Of course, we do not know the probabilities on either side of this equation, beyond knowing that they are both small. On the other terms, however, empirical evidence tells us that the typical "bump" from first offer to final offer in a hostile takeover contest is approximately 10%; and the typical initial premium in a hostile takeover contest is approximately 40%.[187] Therefore, the probability that the bidder pays more must be roughly four times as large as the probability that the bidder goes away in order to justify strategic behavior. And once a bidder has bumped its offer once, the cost-benefit calculation moves even further away from strategic behavior. This admittedly rough analysis suggests that the economics of strategic behavior are unlikely to pay off in many situations, because the downside risk is substantially larger than the upside gain.

As a final (doctrinal) point before turning to the data, it is important to note that the Delaware courts never intended the "meaningful opportunity for success" test to be assessed in a vacuum. Strategic behavior exists even without a pill, which means that strategic behavior existed in the 1980s. For example, a target shareholder in 1989 might withhold shares from a tender offer in order to reduce the likelihood that the bidder would achieve 50%, thereby forcing the bidder to pay more. Not only did strategic bidder exist when *BNS*, *Staley*, and *Interco* were decided, the pill existed too – it was validated by the Delaware Supreme Court four years earlier, in *Moran v. Household International*.[188] Nowhere did the federal district courts state that the "meaningful opportunity for success" must be considered in a vacuum, without the possibility of strategic behavior, or in the absence of the pill.

Nevertheless, assuming that some strategic behavior exists and that we should account for it in our analysis, the question becomes whether strategic behavior would change the core finding regarding the viability of the 85% out. The data presented in Part III.E indicates that approximately two-thirds of the offers in our sample had positive arbitrage spreads at the time the offer expired. In effect, the

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[186] *See, e.g.*, Lucian Arye Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 922-23 (1987).
[187] *See* BEBCHUK, COATES & SUBRAMANIAN HOSTILE BIDS DATABASE (on file with authors).
[188] 500 A.2d 1346 (Del. 1985).

market was predicting that target shareholders were unlikely to get more money in these offers, either from the current bidder or from a third-party bidder. It would seem difficult for an individual target shareholder to put pressure on the bidder to pay more when the market was predicting otherwise. In addition, strategic behavior when the arbitrage spread is positive entails some risk, because shareholders do not have the ability to sell into the market for a higher price.

In the one-third of cases where the arbitrage spread was negative, Part III.E tells us that the tender percentage never exceeded 30%. Target shareholders may have been engaging in strategic behavior in these cases, or just selling their shares into the market rather than tendering into the offer, but the bidder was unlikely to get to 85% because of the negative arbitrage spread, not because of strategic behavior. In effect, negative arbitrage spreads are another obstacle that a bidder has to contend with in trying to get to 85%.

In an effort to dig more deeply on the question of strategic behavior, we examined the four bids in our sample after 1989 that achieved more than a 70% tender: Puritan-Bennett (77.4%), Wallace Computer (74.3%), Circon Corp. (79.7%), and PeopleSoft (73.1%). In all four of these deals, the arbitrage spread was positive, in two cases very positive.[189] For reasons described above, the positive arbitrage spreads suggest that strategic behavior would be minimal. Among all other post-1989 deals in our sample, it would take a very large amount of strategic behavior by target shareholders, amounting to more than 15% of the shares outstanding, in order to change our core finding that no hostile bidder has achieved 85%.

In three of the four bids that achieved more than 70% (all but Oracle-PeopleSoft), the bidder eventually withdrew, suggesting that any strategic behavior by target shareholders in order to induce a higher price was a miscalculation. At least in the end-game, as the bidder was about to go away, strategic behavior should be "flushed out" in these bids, as target shareholders tried to keep the bidder at the table.

In Oracle-PeopleSoft, our analysis in Table 3 indicates that the actual hurdle for Oracle to meet the 85% out was 94.9% -- a virtually impossible hurdle regardless of the amount of strategic behavior. To see the point a different way, consider the following calculation: Taking the 73.1% of shares already tendered to or owned by Oracle and the 10.3% of shares held by director non-officers and officer non-directors off the table leaves 16.6% of shares outstanding. Among these shares, Oracle would have needed to get 11.9% of the outstanding, or 72% of the available shares, in order to achieve the 85% out. Therefore, unless 72% of the available shares were playing a strategic game, Oracle would not have achieved the 85% out.

[189] Puritan-Bennett (20% arbitrage spread), Wallace Computer (4%), Circon (14%), PeopleSoft (4%).

In short, it seems unlikely that strategic behavior among the targets in our sample would have changed our conclusion that no bidder in the past nineteen years has achieved 85% in a hostile tender offer. It is also worth mentioning that the closest case, Oracle's hostile bid against PeopleSoft, was the product of an all-cash, 18-month tender offer, in which Oracle's final hostile offer represented a 65% premium over PeopleSoft's trading price 20 trading days prior to the offer. If this is what it takes for a hostile bidder to achieve (close to) the 85% out, it is not clear that the case illustrates how Section 203 provides a meaningful opportunity for success.

C. Potential Reconciliations of the Doctrine and the Data

There are, of course, some potential ways in which federal courts might reconcile the doctrine with the data. One simple possibility would be to re-interpret the district courts' test so that a "meaningful opportunity" only requires a "theoretical possibility" of success.[190] This approach would seem to do violence not only to the plain meaning of the words, but also to the district courts' reasoning in applying the test. Specifically, this re-articulation would be difficult to square with the courts' heavy reliance on Professor Jarrell's findings, as well as its invitation for further empirical evidence, since no data could ever fail a "theoretical possibility" test.

A more plausible variation would be to conclude from the evidence not that hostile bidders have no meaningful opportunity for success, but rather that hostile bidders simply have not been paying sufficiently high premiums over the past twenty years. In any deal, there is (almost always) some price that, if offered, would get the bidder to 85% of the target's shares. Bidders would have a "meaningful opportunity for success" if they simply paid this amount. This argument is conceptually plausible, because all it requires is that the supply-curve for shares is upward-sloping. However, the argument is inconsistent with the evidence presented in Part III, showing that premiums have not noticeably declined since 1989. In addition, our analysis in Part III.F shows that bidders would have to offer premiums of approximately 110% in order to expect to achieve an 85% tender. In our opinion, an antitakeover statute that requires

[190] One well-known financial economist proposed a version of this argument to us, which he called the "Black Swan" argument after Nassim Nicholas Taleb's well-known book of the same name: just because we have not seen a bidder achieve 85% in a tender offer against a Delaware target in the past 19 years does not mean it will not happen in the future. We cannot refute this argument, nor is it refutable. But if achieving 85% is in fact a "Black Swan," i.e., an extreme outlier event, then it would seem to prove the point that Section 203 does not provide bidders a meaningful opportunity for success.

bidders to pay such large premiums in order to succeed does not really give bidders a meaningful opportunity for success.

A further variation would be to conclude that an assessment of a "meaningful opportunity for success" should include deals that started hostile but went friendly, or deals in which the hostile bidder replaced the target board and then waived Section 203. These two routes are related in that both get around Section 203 through board approval,[191] either by the incumbent board (negotiated deal) or by the new board (proxy contest). Table 1 shows that the board approval route is the only way in which a hostile bidder has been successful against a Delaware target during the past twenty years. And so the argument might be that Section 203 did not shut down hostile takeovers, but merely channeled them into negotiated acquisitions or proxy contests.

Although this argument has some intuitive appeal, there are some problems. First, as a doctrinal matter, all three opinions in the Delaware district court trilogy rejected the possibility that the friendly deal route under Section 203(a)(1) should be considered in determining whether Section 203 provides bidders with a meaningful opportunity for success.[192] Indeed, because the hostile-turned-friendly pathway always provides an opportunity for success under Section 203(a)(1), it would be illogical to consider these deals, and then also investigate the viability of the 85% out. If the federal district courts were to endorse the argument that the feasibility of hostile-turned-friendly deals satisfied the meaningful opportunity test, then, it would be a shift away from existing doctrine.

Even if the federal courts were to make such a shift, the argument raises the further empirical question as to the viability of the proxy contest route against a Delaware target. In prior work with Lucian Bebchuk and John Coates, one of us finds that no hostile bidder since 1995 has been successful in obtaining board control of a target with a staggered board, because the bidder must win two proxy contests that can be as long as thirteen months apart.[193] This evidence suggests that the board approval out does not provide bidders with a "meaningful

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[191] *See* DEL. GEN. CORP. L. § 203(a)(1).

[192] *See* BNS v. Koppers, 683 F. Supp. 458, 470 ("[T]here are three major 'outs' or escapes of subjection (a). The first, board approval, however, will necessarily be absent in the hostile takeover context, leaving the bidder with just two escape routes.") (footnotes omitted); RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476, 483 ("[U]ntil an accurate, rather than hypothetical, record can be assembled, whether the 85 percent exception will permit a sufficient number of hostile-to-the-end offers . . . is an issue which remains to be seen."); City Capital Associates v. Interco, 696 F. Supp. 1551 (D. Del. 1988) (Section 203 unconstitutional if it will prevent "a sufficient number of 'hostile to the end' tender offers")

[193] *See* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 STAN. L. REV. 887 (2002); Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2003).

opportunity for success" against targets with a staggered board, which constitute approximately half of all U.S. public corporations.[194] A federal district court might accordingly split the baby to find that Section 203 gives a bidder a meaningful opportunity for success against a unitary board but not against a staggered board.

Another possible route would be for federal courts to downplay (or dismiss) the evidence from the past nineteen years because it has been muddied by the concurrent existence of the poison pill. In a critique of this Article, Eric Robinson and Ryan McLeod of the law firm Wachtell, Lipton, Rosen & Katz focus on this possible reconciliation of the doctrine with the data.[195] Robinson and McLeod argue that the evidence presented in this Article is "meaningless" because the existence of the pill has made the tender offer decision simply a "straw poll."[196] According to Robinson and McLeod, the evidence over the past 20 years does not reflect what would happen in the absence of the pill because "[s]ome shareholders who want a takeover may withhold tendering . . . to encourage the bidder to increase its price," (i.e., strategic behavior) and "some shareholders may choose not to participate in straw polls altogether."[197] For reasons described in the previous Part, we believe that the possibility of strategic behavior is unlikely to change the overall conclusion on the viability of the 85% out. To use the election metaphor, straw polls might be questionable if the election is close, but straw polls are typically accurate in predicting the winner when the election is a landslide.

On the possibility that shareholders ignore the signaling function of the tender offer and simply adopt a "wait and see" approach to hostile tender offers, this effect would also have to be large in order for it to change our core empirical finding. In addition, a wait-and-see approach would be risky because typically the bidder can waive conditions just before the expiration of the offer, and the target can fulfill some conditions at a moment's notice (e.g., pill inapplicability condition), so the offer might become unconditional and the bidder might close its offer before the wait-and-see shareholder could tender shares.[198] Wait-and-see

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[194] *See* S&P 1500 CLASSIFIED BOARD TREND ANALYSIS (Jan. 13, 2009) (on file with authors).

[195] *See* WACHTELL, LIPTON, ROSEN & KATZ MEMORANDUM TO CLIENTS, FLAWED ACADEMIC CHALLENGE TO CONSTITUTIONALITY OF DELAWARE'S ANTI-TAKEOVER LAW (Sept. 29, 2009) at 1.

[196] *See id.*

[197] *Id.* at 2.

[198] Whether a waiver of a condition constitutes a material change in the terms of a tender offer that triggers an extension of the offer period under Rule 14d-4(d)(2) is a murky area. *See* LOU KLING & EILEEN NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS (2000 & supplements) at §5.03(3). Shareholders at least act as if there is a risk of being "left behind." For example, one senior practitioner noted to us that a common hedge fund strategy is to always tender shares on the day before the expiration date if the arbitrage spread is positive, in order to avoid losing the offer price.

becomes particularly risky in the two-thirds of cases where the arbitrage spread is positive. Consistent with these observations, we are aware of no institutional investor or other shareholder that has announced a wait-and-see strategy with respect to hostile takeovers. One would think that a shareholder with such a strategy would publicly disclose it so that no negative signal was inferred from its non-tender.

It is also important to note that Robinson and McLeod's argument has no limits. If the data from the past twenty years are "meaningless," then a 95% out too could not be challenged under a "meaningful opportunity for success" test, even though no bidder has come close to achieving that bar either. Surely, at some point the data must present a compelling enough picture that it has some meaning. We also note that meaningless data would be unlikely to produce the statistically significant correlation between premiums and shares tendered that we find in Part III.F.

What it might boil down to is this: are the effects, if any, of strategic behavior and a wait-and-see approach large enough to change our core empirical finding on the viability of the 85% out? For the reasons described above we believe that the answer to this question is no, but we acknowledge that a definitive answer is currently unavailable. For Robinson and McLeod to deny that the constitutionality of Section 203 is potentially vulnerable without knowing the answer to this question seems puzzling.

Of course, rather than trying to reconcile the data to the doctrine, the federal district courts could simply change the doctrine. Specifically, a future federal court could decline to apply the "meaningful opportunity for success" test in assessing the constitutionality of Section 203. While most other courts have endorsed the test for purposes of reviewing business combination statutes,[199] the Seventh Circuit Court of Appeals explicitly rejected the test in *Amanda Acquisition v. Universal Food Corp*.[200] The statute at issue was Wisconsin's business combination statute, which was similar to Delaware's Section 203 in all material respects (three-year moratorium, board approval "out," etc.) except that it provided no "out" from acquiring a high percentage of the target's stock.[201] The bidder, Amanda Acquisition, focused its efforts on demonstrating that the Wisconsin statute did not provide bidders with a meaningful opportunity for success.[202] A district court in a separate case had accepted this argument to invalidate Wisconsin's business combination statute under the Supremacy

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[199] *See* Weiss, *supra* note 102, at 259 (1990) (reviewing eight post-*CTS* cases assessing the constitutionality of business combination statutes).
[200] 877 F.2d 496 (7th Cir. 1989).
[201] *See id.* at 498.
[202] *See id.* at 499.

Clause.[203] On appeal to the Seventh Circuit, however, Chief Judge Frank Easterbrook categorically rejected the premise of the argument:

> The three district judges who have considered and sustained Delaware's law delaying mergers did so in large measure because they believed that the law left hostile offers "a meaningful opportunity for success." Delaware allows a merger to occur forthwith if the bidder obtains 85% of the shares other than those held by management and employee stock option plans. . . . Wisconsin offers no such opportunity, which Amanda believes is fatal. . . . [However,] the Commerce Clause does not demand that states leave bidders a "meaningful opportunity for success."[204]

Curiously, Judge Easterbrook mis-read the Delaware trilogy to be applying the "meaningful opportunity for success" test in their Commerce Clause assessment, when in fact all three cases clearly applied the test in their Supremacy Clause assessment.[205] But putting aside these doctrinal nuances, Judge Easterbrook's sweeping language in upholding the Wisconsin business combination statute suggested that he did not think highly of the "meaningful opportunity for success" test. A like-minded judge in Delaware might similarly re-articulate the test for determining whether Section 203 is preempted by the Williams Act.

All of these are legitimate possibilities for reconciling the available empirical evidence with the conclusion that Section 203 is constitutional. In the end, all we

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[203] *See* RTE Corp. v. Mark IV Holdings, Inc., Civ. A. No. 88-C-378 (E.D. Wis. May 6, 1988), *vacated* Fed. Sec. L. Rep. (CCH) 93,789 (E.D. Wis. June 22, 1988) ("[T]he Wisconsin law, by vesting existing management with the power to block a tender offer, frustrates the purposes of the Williams Act, which is to ensure investor choice with respect to acceptance of tender offers. Thus, the area sought to be regulated by the Wisconsin law has been preempted by federal law.").

[204] Amanda Acquisition v. Universal Foods, 877 F.2d 496, 508 (7th Cir. 1989) (citations omitted).

[205] *See also* Weiss, *supra* note 102, at 262 (noting that Amanda made its argument regarding "meaningful opportunity for success" as part of its Supremacy Clause claim, not its Commerce Clause claim). Judge Easterbrook's opinion includes other misunderstandings about takeover practice. For example, he states that a bidder could simply nullify the dilutive effect of a flip-in pill by issuing the same rights itself. *See* Amanda Acquisition, 877 F.2d at 496 n. 11. In fact this would be impossible because the bidder, unlike the target, would have to buy the target's stock in order to issue that stock at a severely discounted price (and of course, such buying would itself trigger the pill). Judge Easterbrook also states: "Poison pills are less fatal in practice than in name (some have been swallowed willingly)." *Id.* at 508. In fact only one bidder (Sir James Goldsmith at Crown Zellerbach) had deliberately triggered a pill as of 1989, and a second deliberate pill trigger would not occur until 2008. Contrary to Judge Easterbrook's assertion, practitioners at least acted as if poison pills were quite fatal in practice. *See also* Weiss, *supra* note 102, at 258 ("Judge Easterbrook misrepresented the plaintiffs' claims [in *Amanda Acquisition*], imputing to the plaintiffs arguments that it had not advanced, and addressing in inappropriate contexts arguments on which the plaintiff had relied.").

can say is this: the empirical claim that the federal courts have relied upon to uphold Section 203's constitutionality is no longer valid. It seems possible that the federal courts would uphold the constitutionality of Section 203 on different grounds. But at the very least the constitutionality of Section 203 would seem to be up for grabs.

D. Delaware's Self-Help Remedy

Delaware could of course wait for the constitutional challenge. Commenting on this Article to the *Wall Street Journal*, former SEC Commissioner and Stanford Law School professor Joe Grundfest noted: "Lawyers now have the data they need to renew a constitutional battle over these sorts of state takeover laws."[206] In a challenge against the 85% out, the outcome would likely be all-or-nothing for Section 203 because Section 203 does not include a severability clause.[207] A bidder might instead challenge the 85% out as applied to its particular bid, if the actual bar (as calculated in Part III.D) were 90% or 95% or (most clearly) greater than 100%.[208]

Instead of waiting for the constitutional challenge, Delaware could engage in self-help by amending Section 203 in ways that would put the statute on firmer constitutional footing. The first, and most obvious, amendment would lower the 85% threshold to something that provides a "meaningful opportunity for success." In view of the historical data presented in Part III, our opinion is that a 70%

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[206] Peter Lattman, *New Hostility for an Old Delaware Antitakeover Law*, WALL ST. J. DEALS BLOG (Sept. 24, 2009), *available at* http://blogs.wsj.com/deals/2009/09/24/with-hostiles-on-the-rise-a-delaware-antitakeover-law-comes-under-scrutiny/.

[207] A House amendment inserted a Section 2 to the Act that introduced severability: "The provisions of this Act are severable and any provision held invalid shall not affect or impair any of the remaining provisions of this Act." *See* House Amendment No. 3 (Jan. 26, 1988), *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 37. Curiously, the fate of this amendment is unclear. Early versions of the final Act included this amendment as Section 203(f), *see, e.g.*, BNS v. Koppers, 683 F. Supp. 458 at Appendix A, yet Section 203(f) seems to have disappeared in the statute today, and there is no mention of such an amendment in the legislative history on Section 203. Conversations with Delaware practitioners who were "there at the creation" of Section 203 reveal no clear answer as to how Section 203(f) met its demise. One prominent Delaware practitioner speculated to us that "code revisors," whose job is to "clean up" the Delaware corporate code in non-substantive ways, may have deleted Section 203(f) after its constitutionality was upheld in the 1988 Delaware district court trilogy. If correct, the data provided in this Article suggests that such "cleaning up" was premature. In any case, severability is not terribly important for present purposes because in the event that the 85% out were found to be unconstitutional, deleting just Section 203(a)(3) would of course go in the wrong direction.

[208] *Cf.* SWT Acquisition Corp. v. TW Services, Inc., 700 F. Supp. 1323 (D. Del. 1988) (as-applied challenge to constitutionality of Section 203 because two-thirds requirement under §203(a)(3) allegedly did not provide a meaningful opportunity for success).

threshold would satisfy this test, since 4 out of 34 post-1989 bidders (12%) were able to achieve a 70% tender.[209]

A further refinement to Section 203 involves the denominator for calculating the 85% hurdle (or, as proposed above, a 70% hurdle). The statute currently excludes shares held by "persons who are directors and also officers" for purposes of the 85% calculation,[210] on the view that this group might have an entrenchment interest and might reap private benefits of control. Therefore, these shares are "out of play" since virtually no price would induce them to sell their shares to a hostile bidder. In our opinion, this exclusion is too narrow: *all* officers and directors should be excluded for purposes of the 85% calculation, because the same entrenchment interest and private benefits of control make it highly unlikely that this broader group would sell. That is, the same argument that justifies the current exclusion of directors who are also officers equally justifies the exclusion of all officers and directors.

On the specific category of directors who are not officers, Table 3 shows that 51 out of 60 target boards in our sample (85%) voted unanimously against the offer, and among the remaining nine boards there is no evidence that any director voted in favor of the hostile offer. This finding is not surprising: because collegiality and consensus are valued in the board room (some would say, too valued), board votes are typically unanimous. This empirical finding nevertheless has important implications for whether non-officer director shares are realistically "in play" for the hostile bidder. It would be bizarre (and potentially liability-inducing) for independent directors to recommend that other shareholders *not* tender their shares, but then tender their own shares to the hostile bidder. For this reason non-officer director shares are not "in play" and should be excluded for purposes of the 85% calculation.[211]

This precise refinement was considered, but rejected, by the Corporate Law Section of the Delaware bar in 1988. In response to the question "Should the stock owned by directors who are not officers be eliminated from the 85% figure?" the Section's representatives responded:

> Directors who are not officers are independent of management under Delaware law. We should not enact a statute which changes this

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[209] Our proposal is directionally consistent with the 75% threshold advocated by SEC Commissioner (now Stanford Law School professor) Joe Grundfest and others in the original hearings on Section 203. *See* Testimony of Joseph A. Grundfest before the Delaware House and Senate Judiciary Committee (Jan. 20, 1988), *cited in* HAMERMESH & BALOTTI, *supra* note 47, at 185.

[210] *See* DEL. GEN. CORP. L. § 203(a)(2)(i).

[211] *See also* Chesapeake Corp. v. Shore, 771 A.2d 293, 341 (Del. Ch. 2000) ("The board also ignored the fact that each one of its members had already committed to oppose the Consent Solicitation, thus rendering their votes out of Chesapeake's reach.").

> significant aspect of our law and which brands them as insiders. This would be viewed as an extremely negative sign by corporate America.[212]

Whatever validity this statement might have had in 1988, it does not accurately characterize the Delaware corporate law of today. It is true that certain aspects of Delaware law give special weight to the decision of a committee of independent directors. To offer a few examples: approval by the independent directors can cleanse the "taint" of a conflict transaction in the ordinary course of business, thereby subjecting the transaction to deferential business judgment review by the Delaware Chancery Court;[213] independent directors constituted as a special litigation committee can recommend dismissal of litigation against the corporation,[214] as long as these directors are truly independent;[215] and independent directors can approve the price that minority shareholder receive from the controlling shareholder in a freeze-out transaction, thereby yielding more deference (though not business judgment review) from a court.[216]

But there is nothing in the Delaware law of hostile takeovers that cleanses a board decision because it was made by the independent directors. To the contrary, Delaware law implicitly assumes that the independent directors are subject to the same entrenchment motivations and private benefits of control as the management directors.[217] To take the simplest example, the Delaware Chancery Court will continue to apply *Unocal*-style "intermediate" scrutiny of takeover defenses even if these defenses were approved unanimously by the independent directors on the board.[218]

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[212] GOLDMAN & MCNALLY, *reprinted in* HAMERMESH & BALOTTI, *supra* note 47, at 65.

[213] *See* DEL. GEN. CORP. L. § 144; *see, e.g.*, Cooke v. Oolie, 2000 Del. Ch. LEXIS 89 (May 2000).

[214] *See* Zapata Corp. v. Maldano, 430 A.2d 779 (Del. 1981).

[215] *See* In re Oracle Corp. Derivative Litigation, 824 A.2d 917 (Del. Ch. 2003).

[216] *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Kahn v. Lynch Communication Systems, 669 A.2d 79 (Del. 1995).

[217] *See, e.g.*, Unocal Corp. v. Mesa Petroleum, 493 A.2d 946, 954 (Del. 1985) ("Because of the omnipresent specter that *a board* may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred. . . .") (emphasis added)

[218] In Oracle's hostile takeover bid for PeopleSoft, for example, PeopleSoft established a "Transaction Committee," comprised solely of the independent directors of the board, that would be responsible for "evaluating the Oracle tender offer," and "advising the Board or making recommendations to stockholders and any other actions the Board make [sic] take in response to Oracle's offer." PEOPLESOFT INC., PROXY STATEMENT FOR THE 2004 ANNUAL MEETING OF STOCKHOLDERS (FORM PRE14A) 7 (Feb. 23, 2004). Nevertheless, there was never any doubt that PeopleSoft's defensive measures would be evaluated under Unocal's "enhanced" or "intermediate" scrutiny. *See* Millstone & Subramanian, *supra* note 128, at 13.

There is a second, more subtle, way in which Section 203's distinction between officer and non-officer directors is problematic. The statutory language draws a bright line between these two groups, even though best-practice corporate governance principles[219] and stock exchange listing guidelines[220] acknowledge the reality that a bright line is unwise. Consider the example of David Duffield, founder and 7.6% owner of PeopleSoft.[221] At the time Oracle made its hostile bid for PeopleSoft in 2003, Duffield was a director of PeopleSoft but no longer an officer. (Four years earlier, Duffield had retired and turned over the CEO job to Craig Conway.[222]) Section 203 therefore included Duffield's shares as part of the denominator for calculating the 85% threshold, but Duffield's public comments at the time, as well as documents revealed during the litigation, made it clear that his shares were unavailable to Oracle at virtually any price.[223] As a result of just Duffield's shares, Oracle would have needed to get 92.0% of the available shares (= 85% / (100%-7.6%)) in order to meet the 85% out. When other director non-officer and officer non-director shares are considered, Oracle would have needed 94.9% of the available shares in order to meet the 85% out – a virtually impossible hurdle.[224] Section 203's unduly narrow exclusion made the hurdle higher than it was supposed to be. In order to give bidders a cleaner, more

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[219] *See* BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE (Nov. 2005), *available at* http://www.businessroundtable.org/sites/default/files/CorporateGovPrinciples.pdf. ("An independent director should not have any relationships with the corporation or its management — whether business, employment, charitable or personal — that may impair, or appear to impair, the director's ability to exercise independent judgment. . . . When considering whether a director is independent, the board should consider not only whether the director has any of the relationships covered by the board's independence standards but also whether the director has any other relationships, either directly or indirectly, with the corporation, senior management or other board members that could affect the director's actual or perceived independence.").

[220] *See* NEW YORK STOCK EXCHANGE LISTING MANUAL § 303A.02 (2009) ("It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company. . . . Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others.").

[221] *See* Millstone & Subramanian, *supra* note 128, at 8.

[222] *See id.* at 4-5.

[223] *See, e.g.*, *id.* at 20-21 (quoting David Duffield's e-mail to CEO Craig Conway after hearing the news that the Department of Justice had filed suit to block Oracle's acquisition of PeopleSoft on antitrust grounds: "I'd personally like to do something special for the independent directors. . . . It could be lavish like a really good watch (better than Rolex) or a trip to a resort. . . ."); Joseph Menn, *Oracle Wins Battle to Buy PeopleSoft*, L. A. TIMES (Dec. 14, 2004) (quoting David Duffield's e-mail to all 12,000 PeopleSoft employees after approving the sale to Oracle at $26.50 per share: "You should know, and I hope you would expect, that I am deeply saddened by this outcome. We have come so far under such trying circumstances over the past 18 months . . . I offer my sincere apologies for not figuring out a different conclusion.").

[224] *See* Table 3.

realistic, and uniform target to shoot for, the denominator of the 85% calculation should exclude shares held by all directors.[225]

Officers who are not directors do not have to publicly recommend against the offer to the target company's shareholders, so these people would not be publicly inconsistent if they tendered their own shares. However, other factors typically make officers' shares even less available to a hostile bidder than the directors' shares. First, the entrenchment interest is typically larger for officers than for non-officer directors. Officers have their human capital tied up in the company, and a hostile takeover bid typically puts their job at risk.[226] In contrast, a non-officer director's entrenchment interest arises solely from the perks of being a director, which is a part-time job. Unlike an officer, a director's compensation from the corporation is typically a small fraction of his or her overall income. Second, officers who are not currently on the board typically aspire to be on the board. This possibility of course disappears if the company is taken over in a hostile acquisition. In short, the arguments that justify excluding the shares of officers who are also directors apply equally, if not more so, for officers who are not on the board.

To summarize, the empirical evidence from the past nineteen years indicates that the 85% bar is too high. This raises the possibility that the statute is unconstitutional. One way to mitigate the constitutional issue is by lowering the bar explicitly. We believe that a reduction from 85% to 70% would be appropriate. Another way to mitigate the constitutional issue is by providing bidders with a cleaner shot at the bar, whether that bar is 85% or a lower number. In our opinion, this is best achieved by excluding for purposes of the calculation all shares held by directors and officers of the target company, rather than only the shares held by directors who are also officers. These two changes, if implemented, would go a long way toward giving bidders a "meaningful opportunity of success," as the federal district courts have held that the Williams Act requires.

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[225] Section 203 excludes shares held by officer directors from the denominator but not the numerator for purposes of the 85% calculation. *See* DEL. GEN. CORP. L. § 203(a)(2). In the unlikely event that officers who were also directors tendered their shares, this would give the bidder an actual threshold that was lower than 85%. To fix this problem, and potentially as a *quid pro quo* for the change proposed in the text, shares held by directors and officers could be taken out of the numerator *and* the denominator for purposes of the 85% calculation. The following text reflects the complete set of proposed revisions, and would replace the last clause of Section 203(a)(2): "excluding for purposes of this calculation those shares owned (i) by persons who are directors or officers and (ii) employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer."

[226] *See* Chesapeake Corp. v. Shore, 771 A.2d 293, 341 (Del. Ch. 2000) (court endorses the assumption that "management holders are not disinterested and will stick with their announced opposition to the Chesapeake Consent Solicitation").

Delaware has a well-known interest in maximizing its share of the corporate charter marketplace.[227] Delaware could meet this interest by proactively making the two changes proposed here, rather than risking constitutional invalidation of Section 203 and being left with no antitakeover statute whatsoever. Political and popular sentiment have shifted considerably since 1988, toward far greater acceptance of hostile tender officers as an important "disciplinary" mechanism that improves allocational efficiency in the marketplace.[228] If Delaware lost Section 203 to constitutional challenge, it would be far more difficult than it was in 1988 for the Delaware legislature to replace it with a new antitakeover statute. Because amending the existing statute is more politically viable than installing a new one, the Delaware legislature should be proactive rather than reactive on Section 203.

E. Implications for Other States

Thirty-two other U.S. states have business combination (freeze-out) statutes like Delaware's, including large states such as Connecticut, Illinois, Michigan, New York, Ohio, Pennsylvania, and Virginia.[229] Taken together, business combination statutes cover 92% of U.S. corporations by number and 94% by market capitalization.[230] As with Delaware's statute, freeze-out statutes have been upheld against constitutional challenges in Georgia,[231] New York,[232] and Wisconsin.[233] However, all of these challenges, like Delaware's, occurred in the late 1980s, in a substantially different takeover environment and without the

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[227] *See, e.g.*, Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491 (2005); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003).

[228] *See generally* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 117, at Chapter 13.

[229] *See* STATE TAKEOVER LAWS, *supra* note 15, at Appendix A-1. The full list of 33 states with business combination statutes is here (with number of years for delay of business combination in parentheses): Arizona (3), Connecticut (5), Delaware (3), Georgia (5), Idaho (3), Illinois (3), Indiana (5), Iowa (3), Kansas (3), Kentucky (5), Maine (5), Maryland (5), Massachusetts (3), Michigan (5), Minnesota (4), Missouri (5), Nebraska (5), Nevada (3), New Jersey (5), New York (5), Ohio (3), Oklahoma (3), Oregon (3), Pennsylvania (5), Rhode Island (5), South Carolina (2), South Dakota (4), Tennessee (5), Texas (3), Virginia (3), Washington (5), Wisconsin (3), Wyoming (3).

[230] *See* COMPUSTAT DATABASE, *supra* note 1.

[231] *See* West Point-Pepperrell Inc. v. Farley Inc., 711 F. Supp. 1096 (N.D. Ga. 1989) (applying meaningful opportunity test).

[232] *See* Vernitron Corp. v. Kollmorgen Corp., 89 Civ. 241 (JES) (S.D.N.Y. Feb. 9, 1989).

[233] *See* Amanda Acquisition v. Universal Foods, 877 F.2d 496 (7th Cir. 1989). *But see* RTE Corp. v. Mark IV Holdings, Inc., Civ. A. No. 88-C-378 (E.D. Wis. May 6, 1988), *vacated* Fed. Sec. L. Rep. (CCH) 93,789 (E.D. Wis. June 22, 1988) ("[T]he Wisconsin law, by vesting existing management with the power to block a tender offer, frustrates the purposes of the Williams Act, which is to ensure investor choice with respect to acceptance of tender offers. Thus, the area sought to be regulated by the Wisconsin law has been preempted by federal law.").

benefit of the systematic data that we have today. In addition, the Georgia opinion, though not New York or Wisconsin, invited the possibility of further review:

> [T]here is not enough information presently available to predict with the required degree of legal certainty whether or not Farley's offer has a meaningful opportunity to succeed. . . . [U]ltimately it may be determined that the Georgia statute does in fact deny a hostile offeror a meaningful opportunity to complete a hostile offer . . . [H]owever, based upon the evidence presented the court is unable to reach such a conclusion.[234]

Table 4 summarizes the major features of freeze-out statutes in other states. The table shows that four states (Illinois, Kansas, Oklahoma, and Oregon) have statutes that are virtually identical to Delaware's Section 203, and one more state (Iowa) is identical in all major respects except that the threshold for becoming an "interested shareholder" is 10% rather than 15%. Most other states have business combination statutes that are substantially more onerous than Section 203. For example, many states set a lower bar than Delaware, most commonly 10%, for becoming an interested shareholder, e.g., Connecticut, Maryland, New Jersey, and Massachusetts (the last setting the bar at 5%). Many states impose a five-year moratorium on business combinations rather than Delaware's three years, e.g., Georgia, Indiana, Michigan, and Pennsylvania. Perhaps most importantly, 25 out of the 32 other statutes (78%) provide no exemption at all for offers that receive a high percentage of shares tendered, and two states (Georgia and Massachusetts) set the hurdle at 90% rather than Delaware's 85%. Finally, 22 out of the 32 other statutes (69%) impose further criteria for a freeze-out merger *even after* the bidder has waited for three or five years – for example, supermajority approval from the disinterested shareholders, or "fair price" criteria that must be met. Delaware, in contrast, imposes no such restrictions on a post-moratorium freeze-out merger.

We take no position in this Article as to whether these other business combination statutes should be invalidated if Delaware's Section 203 were to be found unconstitutional. Such an analysis would require a detailed analysis of each individual statute, and the experience of bidders against targets subject to the statute. The evidence presented here would be suggestive, though not dispositive, on whether these other statutes are preempted by the Williams Act under a "meaningful opportunity for success" test.

Echoing the aftermath of the U.S. Supreme Court's decision in *Edgar v. MITE*, invalidation of Section 203 might cause other states to simply take their business combination statutes off the books. If correct, then the implications of

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[234] *See* West Point-Pepperrell Inc. v. Farley Inc., 711 F. Supp. 1096, 1105-06 (N.D. Ga. 1989).

Section 203's constitutionality have even larger implications for the U.S. takeover marketplace than the analysis in this Article would suggest.

V. Conclusion

We conclude with some observations on the bigger picture. Our review of the legislative history makes clear that a primary motivation for the Delaware bar in proposing, and the Delaware legislature in passing, Section 203 was to appease Delaware's customers.[235] Corporate management and corporate directors were clamoring for protection against hostile bidders, and Delaware delivered Section 203 in order to avoid an exodus from the state. In our opinion, the legislative history for Section 203 is a clear illustration of a "race to the bottom" in regulatory competition among the states.[236]

States have the right to pursue parochial interests, even if they reduce overall social welfare, but they must do so within the boundaries set by the U.S. Constitution. This Article presents evidence that Section 203 has not given bidders a "meaningful opportunity for success" for the past nineteen years, as three district courts have held that the Williams Act requires. Instead, Section 203 appears to be a "show-stopper" that disrupts the balance between bidders and targets in ways that would seem to frustrate the purposes of the Williams Act. At the very least, the constitutionality of Section 203 would seem to be up for grabs. Only an amendment from the Delaware legislature or further litigation in the federal courts would definitively resolve the matter.

Some prior commentators have proposed federalization of corporate law, or at least a federal alternative regime that shareholders can unilaterally opt-in to, in order to stem destructive regulatory competition among the states.[237] The analysis in this Article suggests a different approach for stemming a race to the bottom in corporate law. Rather than bringing facial challenges to state antitakeover laws under the Supremacy Clause and the Commerce Clause of the U.S. Constitution,

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[235] *See supra* Part II.B.

[236] Whether corporate charter competition is a "race to the top" or a "race to the bottom" is of course a classic debate in corporate law. *Compare* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663, 666 (1974) (arguing that the market for incorporation is a "race to the bottom") *with* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEG. STUD. 251, 256 (1977) (arguing that competition among states to attract corporations will result in a "race to the top"); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001) (presenting empirical evidence consistent with a race to the top) *with* Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J. L. ECON. & ORG. 32 (2004) (presenting empirical evidence consistent with a race to the bottom).

[237] *See, e.g.*, Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111 (2001).

as bidders did in the 1980s, bidders today might be more successful bringing as-applied challenges that rely on the available empirical evidence. In a political environment today that is more receptive both to hostile takeovers and federal intervention, a court that was willing to read the Supremacy Clause and the Williams Act broadly might strike down Section 203 in view of the evidence presented here. Other state antitakeover statutes might fall as a result. The result would be a more open market for corporate control in the United States.

Table 1: Hostile Tender Offers Against Delaware Targets, 1988-2008

Date Announced	Target	Bidder	Resolution
3/3/1988	Koppers Co Inc	BNS Inc	Completed Friendly
3/9/1988	Facet Enterprises Inc	Prospect Group Inc	Withdrawn
3/21/1988	Wilson Foods Corp	Doskocil Cos Inc	Completed Friendly
3/22/1988	Lucky Stores Inc	American Stores Co	Completed Friendly
4/8/1988	Staley Continental Inc	Tate & Lyle PLC	Completed Friendly
4/29/1988	Arkansas Best Corp	Razorback Acquisition Corp	Withdrawn
6/9/1988	Damon Corp	Nomad Partners LP	Completed Friendly
7/20/1988	Macmillan Inc	Maxwell Communication Corp PLC	Completed Friendly
7/28/1988	INTERCO Inc	City Capital Associates LP	Withdrawn
9/6/1988	Nantucket Industries Inc	Integrated Resources Inc	Withdrawn
9/9/1988	MSI Data Corp	Telxon Corp	Withdrawn
9/23/1988	Isomedix Inc	Radiation Sterilizers Inc	Withdrawn
10/4/1988	Pillsbury Co	Grand Metropolitan PLC	Completed Friendly
10/6/1988	TW Services Inc	SWT Associates LP	Completed Friendly
10/11/1988	Holly Farms Corp	Tyson Foods Inc	Completed Friendly
10/31/1988	Dataproducts Corp	DPC Acquisition Partners	Withdrawn
11/14/1988	Prime Computer Inc	Investor Group	Withdrawn
11/18/1988	Recognition Equipment Inc	Prospect Group Inc	Withdrawn
1/16/1989	Texas Eastern Corp	Coastal Corp	Withdrawn
2/8/1989	Di Giorgio Corp	DIG Holding Corp	Completed Friendly
2/22/1989	Triad Systems Corp	Volt Information Sciences Inc	Withdrawn
3/30/1989	NWA Inc	NWA Co	Withdrawn
4/20/1989	Dunkin' Donuts Inc	DD Acquisition Corp	Withdrawn
8/9/1989	Anchor Glass Container Corp	Vitro SA de CV	Completed Friendly
11/9/1989	DeSoto Inc	Investor Group	Withdrawn
12/20/1989	Cipher Data Products Inc	Archive Corp	Completed Friendly
7/7/1992	Durr-Fillauer Medical Inc	Bergen Brunswig Corp	Completed Friendly
5/12/1993	Magellan Petroleum Corp	Sagusa Inc(Sagasco Holdings)	Withdrawn
10/8/1993	Nostalgia Network Inc	International Family Ent Inc	Withdrawn
3/21/1994	Mark Controls Corp	Tyco International	Withdrawn
10/6/1994	Puritan-Bennett	Thermo Electron Corp	Withdrawn
10/28/1994	Younkers Inc	Carson Pirie Scott & Co	Withdrawn
12/2/1994	Medical Diagnostics Inc	Raytel Medical Corp	Withdrawn

Table 1 (cont): Hostile Tender Offers Against Delaware Targets

Date Announced	Target	Bidder	Resolution
3/17/1995	Triton Group Ltd	TAC Inc	Withdrawn
4/4/1995	Moorco International	FMC Corp	Completed Friendly
7/28/1995	Wallace Computer Services Inc	Moore Corp Ltd	Withdrawn
8/14/1995	National Convenience Stores	Circle K Corp	Withdrawn
10/27/1995	CBI Industries Inc	Praxair Inc	Completed Friendly
8/2/1996	Circon Corp	US Surgical Corp	Withdrawn
6/23/1997	Pennzoil Co	Union Pacific Resources Group	Withdrawn
7/9/1997	Exide Electronics Group Inc	Danaher Corp	Withdrawn
8/12/1998	Quickturn Design Systems Inc	Mentor Graphics Corp	Withdrawn
12/15/1998	Global Industrial Technologies	WHX Corp	Withdrawn
2/26/1999	VLSI Technology Inc	Koninklijke Philips Electronic	Completed Friendly
4/5/1999	Rental Service Corp	United Rentals Inc	Withdrawn
5/18/1999	Varlen Corp	Amsted Industries Inc	Completed Friendly
6/7/1999	Columbia Energy Group	New NiSource Inc	Withdrawn
11/18/1999	Shorewood Packaging Corp	Chesapeake Corp	Withdrawn
3/23/2000	Wesley Jessen(Bain Capital)	Bausch & Lomb Inc	Withdrawn
3/7/2001	Barrett Resources Corp	Shell Oil Co	Withdrawn
5/8/2001	Newport News Shipbuilding Inc	Northrop Grumman Corp	Completed Friendly
4/9/2003	Salix Pharmaceuticals Ltd	Axcan Pharma Inc	Withdrawn
6/6/2003	PeopleSoft Inc	Oracle Corp	Completed Friendly
11/13/2003	Net Perceptions Inc	Obsidian Enterprises Inc	Withdrawn
2/10/2005	Digital Impact Inc	infoUSA Inc	Withdrawn
10/26/2005	Whitehall Jewellers Inc	Newcastle Partners LP	Withdrawn
6/25/2007	Ventana Medical Systems Inc	Roche Holding AG	Completed Friendly
2/24/2008	Take-Two Interactive Software	Electronic Arts Inc	Withdrawn
3/5/2008	Packeteer Inc	Elliott Associates LP	Withdrawn
10/19/2008	NRG Energy Inc	Exelon Corp	Withdrawn

Table 2: Analysis of Shares Tendered for Delaware Targets

Date Announced	Target	Shares Outstanding	Owned by Officer Directors	ESOP	203 Shares Outstanding	Max Tendered	Owned at Time of Bid	Max % Conditionally Owned
3/3/1988	Koppers Co Inc	28,600,000	2,766	-	28,597,234	20,402,310	2,094,100	78.67%
3/9/1988	Facet Enterprises Inc	5,000,000	87,568	-	4,912,432	247,179	380,900	12.79%
3/21/1988	Wilson Foods Corp	10,176,918	56,265	-	10,120,653	7,798,665	982,000	86.76%
3/22/1988	Lucky Stores Inc	38,600,000	93,101	-	38,506,899	121,352	-	0.32%
4/8/1988	Staley Continental Inc	30,400,000	690,262	-	29,709,738	1,029,648	1,500,000	8.51%
4/29/1988	Arkansas Best Corp	9,959,000	2,079,633	-	7,879,367	405,144	1,034,600	18.27%
6/9/1988	Damon Corp	9,550,000	388,750	-	9,161,250	5,893,158	1,027,000	75.54%
7/20/1988	Macmillan Inc	27,800,000	1,014,617	-	26,785,383	1,921,554	-	7.17%
7/28/1988	INTERCO Inc	35,656,976	285,551	-	35,371,425	29,441,198	3,158,700	92.16%
9/6/1988	Nantucket Industries Inc	2,700,000	906,626	-	1,793,374	381,977	146,200	29.45%
9/9/1988	MSI Data Corp	5,263,620	49,314	-	5,214,306	3,060	-	0.06%
9/23/1988	Isomedix Inc	4,900,000	338,850	-	4,561,150	299,754	704,100	22.01%
10/4/1988	Pillsbury Co	86,200,000	85,336	-	86,114,664	75,446,595	-	87.61%
10/6/1988	TW Services Inc	48,500,000	197,940	-	48,302,060	34,616,126	9,267,400	90.85%
10/11/1988	Holly Farms Corp	18,092,489	242,007	-	17,868,865	10,600,000	361,850	61.41%

Table 2: Analysis of Shares Tendered for Delaware Targets (cont)

Date Announced	Target	Shares Outstanding	Owned by Officer Directors	ESOP	203 Shares Outstanding	Max Tendered	Owned at Time of Bid	Max % Conditionally Owned
10/31/1988	Dataproducts Corp	19,684,382	238,248	-	19,446,134	7,211,373	1,534,600	44.98%
11/14/1988	Prime Computer Inc	48,138,596	4,771	-	48,133,825	33,389,994	1,980,000	73.48%
11/18/1988	Recognition Equipment Inc	10,151,069	114,398	911,743	9,124,928	906,845	1,431,800	25.63%
1/16/1989	Texas Eastern Corp	53,337,329	15,046	-	53,322,283	162,519	-	0.30%
2/8/1989	Di Giorgio Corp	5,163,659	48,711	-	5,114,948	3,422,711	717,900	80.95%
2/22/1989	Triad Systems Corp	7,830,091	692,643	-	7,137,448	156,865	1,054,900	16.98%
3/30/1989	NWA Inc	30,110,325	169,250	-	29,941,075	282,209	850,000	3.78%
4/20/1989	Dunkin' Donuts Inc	6,433,620	354,277	-	6,079,343	2,213,676	772,034	49.11%
8/9/1989	Anchor Glass Container Corp	13,902,716	975,008	-	12,927,708	8,944,976	1,430,300	80.26%
11/9/1989	DeSoto Inc	4,030,059	52,049	417,037	3,560,973	2,661,784	386,000	85.59%
12/20/1989	Cipher Data Products Inc	14,560,945	160,394	-	14,400,551	11,897,438	675,000	87.31%
7/7/1992	Durr-Fillauer Medical Inc	11,946,765	670,750	-	11,276,015	5,540,000	-	49.13%
5/12/1993	Magellan Petroleum Corp	24,381,890	86,832	-	24,295,058	3,423,395	-	14.09%

Table 2: Analysis of Shares Tendered for Delaware Targets (cont)

Date Announced	Target	Shares Outstanding	Owned by Officer Directors	ESOP	203 Shares Outstanding	Max Tendered	Owned at Time of Bid	Max % Conditionally Owned
10/8/1993	Nostalgia Network Inc	14,384,166	3,192,376	-	11,191,791	5,674,951	-	50.71%
3/21/1994	Mark Controls Corp	5,038,310	164,608	-	4,873,702	15,720	-	0.32%
10/6/1994	Puritan-Bennett	12,524,965	238,200	-	12,286,765	8,388,484	610,000	73.24%
10/28/1994	Younkers Inc	8,962,912	267,715	-	8,695,197	3,508,637	1,047,500	52.40%
12/2/1994	Medical Diagnostics Inc	3,564,000	615,710	-	2,948,290	1,306,307	-	44.31%
3/17/1995	Triton Group Ltd	21,451,502	616,970	-	20,834,532	1,097,840	-	5.27%
4/4/1995	Moorco International	11,127,309	206,021	-	10,921,288	48,789	100	0.45%
7/28/1995	Wallace Computer Services Inc	22,534,380	53,400	-	22,480,980	16,698,706	350	74.28%
8/14/1995	National Convenience Stores	6,050,069	51,345	9,706	5,989,018	130,466	85	2.18%
10/27/1995	CBI Industries Inc	38,206,403	164,742	3,544,480	34,497,181	23,732,102	79,200	69.02%
8/2/1996	Circon Corp	12,588,677	1,538,142	-	11,050,535	7,809,304	1,000,100	79.72%
6/23/1997	Pennzoil Co	46,951,151	269,163	-	46,681,988	28,894,618	87,600	62.08%
7/9/1997	Exide Electronics Group Inc	10,049,543	273,090	-	9,776,453	124,000	397,300	5.33%
8/12/1998	Quickturn Design Systems Inc	17,809,342	473,750	-	17,335,592	9,547,349	591,500	58.49%

Table 2: Analysis of Shares Tendered for Delaware Targets (cont)

Date Announced	Target	Shares Outstanding	Owned by Officer Directors	ESOP	203 Shares Outstanding	Max Tendered	Owned at Time of Bid	Max % Conditionally Owned
12/15/1998	Global Industrial Technologies	22,039,455	193,034	-	21,846,421	7,979,200	2,173,800	46.47%
2/26/1999	VLSI Technology Inc	45,701,934	1,376,751	-	44,325,183	238,154	1,235,000	3.32%
4/5/1999	Rental Service Corp	24,123,392	253,944	-	23,869,448	5,242,376	100	21.96%
5/18/1999	Varlen Corp	17,010,934	156,357	-	16,854,577	160,695	100	0.95%
6/7/1999	Columbia Energy Group	82,691,662	378,795	-	82,312,867	49,645,081	179,900	60.53%
11/18/1999	Shorewood Packaging Corp	27,560,000	5,593,173	-	21,966,827	2,458,271	100	11.19%
3/23/2000	Wesley Jessen	18,175,585	1,188,121	-	16,987,464	22,866	200	0.14%
3/7/2001	Barrett Resources Corp	33,055,586	80,799	-	32,974,787	155,420	107,100	0.80%
5/8/2001	Newport News Shipbuilding Inc	35,396,356	467,155	4,824,000	30,105,201	7,571,023	100	25.15%
4/9/2003	Salix Pharmaceuticals Ltd	21,375,486	941,563	-	20,434,283	275	100	0.00%
6/6/2003	PeopleSoft Inc	316,605,941	3,786,494	-	312,819,447	228,702,471	3	73.11%
11/13/2003	Net Perceptions Inc	28,145,338	5,628,300	-	22,517,038	1,135,149	-	5.04%
2/10/2005	Digital Impact Inc	37,151,732	4,796,012	-	32,355,720	2,642,314	1,737,000	13.53%
10/26/2005	Whitehall Jewelers Inc	13,961,216	-	380,000	13,581,216	4,748,527	2,018,400	49.83%

Table 2: Analysis of Shares Tendered for Delaware Targets (cont)

Date Announced	Target	Shares Outstanding	Owned by Officer Directors	ESOP	203 Shares Outstanding	Max Tendered	Owned at Time of Bid	Max % Conditionally Owned
6/25/2007	Ventana Medical Systems Inc	33,668,000	835,703	-	32,832,297	63,711	142,000	0.63%
2/24/2008	Take-Two Interactive Software	76,865,236	390,649	-	76,474,587	11,741,339	10	15.35%
3/5/2008	Packeteer Inc	36,465,131	608,832	-	35,856,299	332,379	3,559,117	10.85%
10/19/2008	NRG Energy Inc	233,027,222	1,740,628	-	231,286,594	125,403,103	1,000	54.22%

Notes:

[1] Berjaya Corp. disclosed that a "minimal" number of shares were tendered in their offer for SSMC inc.

[2] 203 Shares Outstanding = Shares Outstanding - Shares Owned by Officer Directors - Shares Owned by ESOP

[3] Shading indicates > 85% owned after tender

Table 3: Analysis of Actual Hurdle to Achieve 85% Out

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
3/3/1988	Koppers Co Inc	28,600,000	85,847	85.26%	Unanimously Against
3/9/1988	Facet Enterprises Inc	5,000,000	278,889	90.12%	Unanimously Against
3/21/1988	Wilson Foods Corp	10,176,918	20,700	85.17%	Against (composition not disclosed)
3/22/1988	Lucky Stores Inc	38,600,000	193,659	85.43%	Unanimously Against
4/8/1988	Staley Continental Inc	30,400,000	680,695	86.99%	Unanimously Against
4/29/1988	Arkansas Best Corp	9,959,000	162,397	86.79%	Unanimously Against
6/9/1988	Damon Corp	9,550,000	168,439	86.59%	Unanimously Against
7/20/1988	Macmillan Inc	27,800,000	397,143	86.28%	Against (composition not disclosed)
7/28/1988	INTERCO Inc	35,656,976	3,824,624	95.31%	Against (composition not disclosed)
9/6/1988	Nantucket Industries Inc	2,700,000	1,648	85.08%	Unanimously Against
9/9/1988	MSI Data Corp	5,263,620	435,910	92.75%	Unanimously Against
9/23/1988	Isomedix Inc	4,900,000	98,753	86.88%	Unanimously Against

Table 3: Analysis of Actual Hurdle to Achieve 85% Out (cont)

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
10/4/1988	Pillsbury Co	86,200,000	1,897,716	86.92%	Unanimously Against
10/6/1988	TW Services Inc	48,500,000	759,420	86.36%	Against (composition not disclosed)
10/11/1988	Holly Farms Corp	18,092,489	603,813	87.98%	Unanimously Against
10/31/1988	Dataproducts Corp	19,684,382	674,682	88.06%	Against (composition not disclosed)
11/14/1988	Prime Computer Inc	48,138,596	450,597	85.80%	Unanimously Against
11/18/1988	Recognition Equipment Inc	10,151,069	367,704	88.57%	Unanimously Against
1/16/1989	Texas Eastern Corp	53,337,329	420,934	85.68%	Unanimously Against
2/8/1989	Di Giorgio Corp	5,163,659	198,342	88.53%	Unanimously Against
2/22/1989	Triad Systems Corp	7,830,091	399,754	90.04%	Unanimously Against
3/30/1989	NWA Inc	30,110,325	422,955	86.22%	Unanimously Against

Table 3: Analysis of Actual Hurdle to Achieve 85% Out (cont)

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
4/20/1989	Dunkin' Donuts Inc	6,433,620	168,191	87.42%	Unanimously Against
8/9/1989	Anchor Glass Container Corp	13,902,716	294,441	86.98%	Unanimously Against
11/9/1989	DeSoto Inc	4,030,059	177,747	89.47%	Unanimously Against
12/20/1989	Cipher Data Products Inc	14,560,945	141,453	85.84%	Unanimously Against
7/7/1992	Durr-Fillauer Medical Inc	11,946,765	759,545	91.14%	Against (composition not disclosed)
5/12/1993	Magellan Petroleum Corp	24,381,890	72,880	85.26%	Unanimously Against
10/8/1993	Nostalgia Network Inc	14,384,166	4,000,346	132.28%	Unanimously Against
3/21/1994	Mark Controls Corp	5,038,310	138,223	87.48%	No position
10/6/1994	Puritan-Bennett	12,524,965	260,120	86.84%	Unanimously Against
10/28/1994	Younkers Inc	8,962,912	101,776	86.01%	Unanimously Against
12/2/1994	Medical Diagnostics Inc	3,564,000	208,620	91.47%	Unanimously Against

Table 3: Analysis of Actual Hurdle to Achieve 85% Out (cont)

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
3/17/1995	Triton Group Ltd	21,451,502	223,000	85.92%	Unanimously Against
4/4/1995	Moorco International	11,127,309	1,982,289	103.85%	Unanimously Against
7/28/1995	Wallace Computer Services Inc	22,534,380	206,818	85.79%	Unanimously Against
8/14/1995	National Convenience Stores	6,050,069	151,072	87.20%	Unanimously Against
10/27/1995	CBI Industries Inc	38,206,403	1,601,311	89.14%	Unanimously Against
8/2/1996	Circon Corp	12,588,677	579,390	89.70%	Unanimously Against
6/23/1997	Pennzoil Co	46,951,151	571,403	86.05%	Unanimously Against
7/9/1997	Exide Electronics Group Inc	10,049,543	735,941	91.92%	Unanimously Against
8/12/1998	Quickturn Design Systems Inc	17,809,342	2,237,055	97.59%	Unanimously Against
12/15/1998	Global Industrial Technologies	22,039,455	1,027,025	89.19%	Unanimously Against
2/26/1999	VLSI Technology Inc	45,701,934	304,345	85.59%	Unanimously Against

Table 3: Analysis of Actual Hurdle to Achieve 85% Out (cont)

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
4/5/1999	Rental Service Corp	24,123,392	1,616,981	91.18%	Against (composition not disclosed)
5/18/1999	Varlen Corp	17,010,934	1,383,045	92.60%	Unanimously Against
6/7/1999	Columbia Energy Group	82,691,662	448,291	85.47%	Unanimously Against
11/18/1999	Shorewood Packaging Corp	27,560,000	1,497,537	91.22%	Unanimously Against
3/23/2000	Wesley Jessen(Bain Capital)	18,175,585	1,430,061	92.81%	Unanimously Against
3/7/2001	Barrett Resources Corp	33,055,586	2,043,513	90.62%	Unanimously Against
5/8/2001	Newport News Shipbuilding Inc	35,396,356	784,481	87.27%	No position
4/9/2003	Salix Pharmaceuticals Ltd	21,375,486	2,755,568	98.25%	Unanimously Against
6/6/2003	PeopleSoft Inc	316,605,941	32,712,724	94.93%	Unanimously Against
11/13/2003	Net Perceptions Inc	28,145,338	1,344,356	90.40%	Unanimously Against
2/10/2005	Digital Impact Inc	37,151,732	439,010	86.17%	Unanimously Against

Table 3: Analysis of Actual Hurdle to Achieve 85% Out (cont)

Date Announced	Target	Shares Outstanding	Director non-Officers and Officer non-Directors Shares	% of "In Play" Outstanding Needed to Reach 85%	Board Vote
10/26/2005	Whitehall Jewellers Inc	13,961,216	1,791,490	97.92%	Unanimously Against
6/25/2007	Ventana Medical Systems Inc	33,668,000	6,475,793	105.88%	Unanimously Against
2/24/2008	Take-Two Interactive Software	76,865,236	311,627	85.35%	Unanimously Against
3/5/2008	Packeteer Inc	36,465,131	2,292,030	90.80%	Unanimously Against
10/19/2008	NRG Energy Inc	233,027,222	989,448	85.37%	Unanimously Against

Table 4: Main Features of U.S. Business Combination Statutes

State	Threshold for "Interested Shareholder"	Moratorium on back-end freeze-out (years)	Exemption for high percentage tender (if any)	Shareholder approval required for post-moratorium freeze-out (if any)
Arizona	10%	3		Majority of disinterested
Connecticut	10%	5		80% of overall and 2/3 of disinterested
Delaware	15%	3	85%	
Georgia	10%	5	90%	Majority of disinterested
Idaho	10%	3		2/3 of disinterested or fair price
Illinois	15%	3	85%	
Indiana	10%	5		Majority of disinterested or fair price
Iowa	10%	3	85%	
Kansas	15%	3	85%	
Kentucky	10%	5		80% of overall and 2/3 of disinterested, or fair price
Maine	25%	5		Majority of disinterested
Maryland	10%	5		80% of overall and 2/3 of disinterested, or fair price
Massachusetts	5%	3	90%	
Michigan	10%	5		90% of overall and 2/3 of disinterested, or fair price
Minnesota	10%	4		
Missouri	20%	5		Majority of disinterested
Nebraska	10%	5		
Nevada	10%	3		Majority of disinterested or fair price
New Jersey	10%	5		2/3 of disinterested or fair price
New York	20%	5		Majority of disinterested or fair price
Ohio	10%	3		2/3 of outstanding or fair price
Oklahoma	15%	3	85%	
Oregon	15%	3	85%	
Pennsylvania	20%	5		Majority of disinterested or fair price
Rhode Island	10%	5		2/3 of disinterested or fair price
South Carolina	10%	2		Majority of disinterested or fair price

Table 4: Main Features of U.S. Business Combination Statutes (cont)

State	Threshold for "Interested Shareholder"	Moratorium on back-end freeze-out (years)	Exemption for high percentage tender (if any)	Shareholder approval required for post-moratorium freeze-out (if any)
South Dakota	10%	4		Majority of disinterested or fair price
Tennessee	10%	5		2/3 of disinterested or fair price
Texas	20%	3		
Virginia	10%	3		2/3 of disinterested
Washington	10%	5		Majority of disinterested or fair price
Wisconsin	10%	3		Majority of disinterested or fair price
Wyoming	15%	3		

Source: INVESTOR RESPONSIBILITY RESEARCH CENTER, STATE TAKEOVER LAWS (2003 and annual updates).

Note: "Fair price" indicates that fair price criteria must be met.