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DELAWARE'S CHOICE

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DELAWARE'S CHOICE

BY GUHAN SUBRAMANIAN*

ABSTRACT

This Article first documents the shift to annual elections of all directors at most U.S. corporations, and argues that the alternative of "ineffective" staggered boards would have been more desirable, as a policy matter, but is now a missed opportunity. Using this experience on staggered boards as a motivating case study, the Article then examines a policy choice regarding Section 203 of the Delaware General Corporation Law. Four facts are uncontested: (1) in the 1980s, federal courts established the principle that Section 203 must give bidders a "meaningful opportunity for success" in order to withstand scrutiny under the Supremacy Clause of the U.S. Constitution; (2) federal courts upheld Section 203 at the time, based on empirical evidence from 1985–1988 purporting to show that Section 203 did in fact give bidders a meaningful opportunity for success; (3) between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203, thereby calling into question whether Section 203 has in fact given bidders a meaningful opportunity for success; and (4) perhaps most damning, the original evidence that the courts relied upon to conclude that Section 203 gave bidders a meaningful opportunity for success was seriously flawed—so flawed, in fact, that even this original evidence supports the opposite conclusion: that Section 203 did not give bidders a meaningful opportunity for success. The constitutionality of Section 203 is therefore "in play," and, with the decline of the poison pill, a new constitutional challenge against Section 203 will eventually come. Delaware could avoid this showdown by lowering Section 203's 85% threshold to 70%. Like the middle-ground approach on staggered boards, this amendment—to a single number—would also represent good policy: facilitating high-premium offers that attract a supermajority

*Joseph Flom Professor of Law & Business, Harvard Law School; Douglas Weaver Professor of Business Law, Harvard Business School. I thank John Laide of FactSet Research for providing updates to prior SharkRepellent analyses for use in this Article; and Charlotte Krontiris for excellent research assistance. I also thank Joel Friedlander, Joe Grundfest, Larry Hamermesh, the Honorable Travis Laster, the Honorable Leo Strine, my colleagues in the Harvard Law School corporate lunch group, and my students in the JD/MBA seminar at Harvard for helpful comments on earlier drafts. All views expressed in this Article remain my own.

of disinterested shares, but also providing companies with reasonable insulation against opportunistic low-ball offers. This Article was presented as the 29th Annual Francis G. Pileggi Distinguished Lecture in Law in Wilmington, Delaware on November 22, 2013.

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I. INTRODUCTION

Over the past ten years, corporate America has largely given up staggered elections for the board of directors.¹ Among the S&P 500, staggered board incidence has gone from 60% in 2002 to 18% by 2012.² This movement has been led by shareholder activists and bolstered by academic research showing that staggered elections, on average, increase board entrenchment and reduce overall shareholder value.³ The result is that we live in a world today in which most corporate directors are elected each year.⁴

I believe that this movement toward annual elections of all directors has been a mistake. I say this with some unease, since my own academic work has been used over the past decade as evidence in favor of de-staggering corporate America. However, in our 2002 and 2003 *Stanford Law Review* articles on staggered boards, my co-authors and I

¹See *infra* Figure 2.

²See *infra* Part II.C.

³See *infra* Parts II.A, II.C, IV.

⁴See *infra* Parts II.A, II.C.

never proposed de-staggering; rather, our doctrinal approach would have made all staggered boards into ineffective staggered boards, thereby preserving the long-term focus for directors in the ordinary course of business, but preserving the right of shareholders to consider an unsolicited offer for the company in a single, up-or-down referendum.⁵ In 2007, as the movement against staggered boards was gathering steam, I published an op-ed in the *New York Times*, again advocating an ineffective staggered board as a win-win compromise between an effective staggered board and a unitary board.⁶ But this middle-ground approach was never endorsed by the Delaware courts, nor was it unilaterally adopted by boards.⁷

And so the unwillingness of corporate America to adopt a middle-ground solution led to an extreme outcome once shareholder activists gained more power.⁸ The irony is that most commentators today believe that boards are more vigilant in monitoring management and more focused on long-term shareholder value than boards were in the 1990s. But activists, motivated by a corporate America that had overplayed its hand, ignored this shift in boardroom culture that had largely corrected the problem they were seeking to solve, and pushed instead for the structural solution of the unitary board.⁹ Both sides are to blame for the current state of play.

It is virtually tautological that shorter terms for directors, particularly when combined with other reforms that have made the election process itself more meaningful, reduce directors' time horizons. The result is short-termism in corporate boardrooms.¹⁰ As a director of a Delaware public company, an advisor to corporate boards, and a teacher to public-company directors in Harvard Business School executive education programs, I have witnessed this pressure for short-term results firsthand. The consequences will play out in the global marketplace, against foreign competitors that are structurally situated to have a longer-term perspective in the boardroom.¹¹

⁵Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 896, 901-02, 924 (2002).

⁶Guhan Subramanian, *Board Silly*, N.Y. TIMES (Feb. 14, 2007), http://www.nytimes.com/2007/02/14/opinion/14subramanian.html?_r=0.

⁷See *infra* Parts II.B, II.C.

⁸See *infra* Part II.C.

⁹See *infra* Part II.C.

¹⁰See *infra* Part IV.

¹¹See *infra* Part II.C.

All of this is troubling, as a policy matter, but it is water under the bridge. Corporate America will not be moving back to staggered boards, even ineffective staggered boards, anytime soon. But (to mix metaphors), there is another shoe waiting to drop: Delaware's antitakeover statute, codified at Section 203 of the Delaware General Corporation Law ("DGCL").¹² In 2010, in a pair of articles published in the *Business Lawyer*, my co-authors and I presented four facts: (1) in the 1980s, federal courts established the principle that Section 203 must give bidders a "meaningful opportunity for success" in order to withstand scrutiny under the Supremacy Clause of the U.S. Constitution; (2) federal courts upheld Section 203 at that time, based on empirical evidence from 1985–1988 purporting to show that Section 203 did, in fact, give bidders a meaningful opportunity for success; (3) between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203, thereby calling into question whether, in fact, Section 203 has given bidders a "meaningful opportunity for success;" and (4) perhaps most damning, the original empirical evidence that the courts relied upon to conclude that Section 203 gave bidders a "meaningful opportunity for success" was seriously flawed—so flawed, in fact, that even this original evidence supports the opposite conclusion: that Section 203 did *not* give bidders a meaningful opportunity for success.¹³ We concluded from our analysis that the constitutionality of Section 203 was unclear, at best.¹⁴

While critics of our article argued vehemently that we were wrong, none of them challenged these four basic facts.¹⁵ Our article was subsequently selected by academics as one of the "top ten" articles in corporate/securities law for 2010, out of 447 articles published in that year.¹⁶ In its 2010 hostile bid for Casey's General Stores, Couche-Tard cited our "landmark study" as the basis for its challenge to Iowa's antitakeover statute, which is structured similarly to Section 203.¹⁷ Then-Delaware Chancellor Bill Chandler, in his seminal *Airgas* opinion, agreed with our assessment that an 85% threshold was virtually impossible to achieve.¹⁸ But in the three years since we published our study, the challenge has not yet come in Delaware. For those who

¹²DEL. CODE ANN. tit. 8, § 203 (2011).

¹³Guhan Subramanian, Steven Herscovici & Brian Barbeta, *Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1998–2008*, 65 BUS. LAW. 685, 687, 702, 715–16, 725, 729 (2010).

¹⁴*Id.* at 729.

¹⁵*See infra* Part III.A.

¹⁶*See infra* Part III.A.

¹⁷*See infra* Part III.A.

¹⁸*See infra* Part III.A.

believe that Section 203 is dominated by the poison pill (and therefore the challenge will never come), consider that 88% of S&P 1500 companies do not currently have pills, and in recent years 59% of companies without pills have not put them in when a bid is brought.

So Delaware has a choice. As with staggered boards, Delaware could ignore the problem. And as with staggered boards, the challenge will inevitably come with the right facts. If the challenge is successful, Delaware companies will lose an important antitakeover device, one that is more important than it used to be with the decline of the poison pill. Unlike the staggered board experience, the change will come in one fell swoop rather than on a company-by-company basis.

Of course, Delaware can avoid this all-or-nothing showdown by amending Section 203.¹⁹ Specifically, my co-authors and I argued in our 2010 article that a 70% threshold rather than an 85% threshold would eliminate the constitutional problem.²⁰ Like the middle-ground approach on staggered boards, this amendment—to a single number—would also represent good policy: facilitating high-premium offers that attract a supermajority of disinterested shares, but also providing companies with reasonable insulation against opportunistic low-ball offers.²¹ Unlike the staggered board question, it is not too late for Delaware to act.²² I humbly urge the Delaware bar and the Delaware legislature to do so.

The remainder of this Article proceeds as follows. Part II provides a chronological tour of the empirical evidence, the academic and practitioner debate, and the resolution (at least for the foreseeable future) on staggered boards.²³ Part III reviews Section 203: summarizing the empirical evidence, our proposal for reform, and practitioner commentary.²⁴ Part IV concludes.

II. THE U.S. EXPERIENCE ON STAGGERED BOARDS, 2002–2012

A. *The ISB Proposal*

In the 1990s, most companies had staggered elections of directors, in which one-third of directors were elected each year, to three-year

¹⁹See *infra* Part III.D.

²⁰See *infra* Part III.D.

²¹See *infra* Part III.D.

²²See *supra* text accompanying notes 6-8; *infra* Part IV.

²³See *infra* Part II.

²⁴See *infra* Part III.

terms. On the positive side, staggered terms provide stability for the board and encourage a long-term perspective. On the negative side, staggered terms have a potent antitakeover effect: because the poison pill channels hostile bidders through the proxy contest route, staggered terms prevent the bidder from gaining board control in a single election. Instead, a bidder must win two elections, which can be as much as fourteen months apart, in order to gain board control, dismantle the poison pill, and proceed with its offer.²⁵ Among all hostile takeover bids announced between 1995 and 2010 (n=252), there is not a single instance where a bidder has successfully won two proxy contests, one year apart, in order to gain control of a target company.²⁶

Not all staggered boards have this antitakeover effect, because some staggered boards can be dismantled by a hostile bidder.²⁷ There are three main methods for dismantling a staggered board: removing all directors without cause and replacing them with new nominees; "packing" the board, by increasing the number of board seats and filling the vacant seats; and/or converting the staggered board to a unitary board, where all directors are elected to one-year terms.²⁸ In a pair of articles published in the *Stanford Law Review* in 2002 and 2003, Lucian Bebchuk, John Coates, and I coined the term "effective staggered board" ("ESB") to refer to a staggered board that cannot be dismantled in one of these three ways.²⁹ All other staggered boards are ineffective staggered boards ("ISB's").

²⁵Bebchuk, Coates & Subramanian, *supra* note 5, at 950 ("An ESB prevents a hostile bidder, no matter when it emerges, from gaining control of the target unless it can wait at least fourteen months and win two elections that are far apart in time.").

²⁶*See id.* at 914 n.100 ("[W]e examine all proxy contests against ESBs between 1996 and 2000 and find no contests in which a bidder had won two elections against an ESB."). In unpublished work, we have expanded the database to include transactions through 2010, with the same overall findings. Guhan Subramanian, *Hostile Bids Database* (unpublished research) (on file with author).

²⁷*See id.* at 910-12 (considering how, despite their having staggered boards, hostile bidders may be able to dismantle the target boards of certain companies if those boards fall into categories that the authors call "no minimum term" targets or "effective annual term" targets).

²⁸*See id.* at 900-01, 910 (discussing shareholder proposals to eliminate staggered boards in favor of one-year terms; and removing directors without cause and "packing" boards).

²⁹Bebchuk, Coates & Subramanian, *supra* note 5, at 912-13; 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, 886 (2002).

We then examined all hostile takeover bids announced between 1996 and 2000 and reached three main conclusions.³⁰ First, targets with ESB's were substantially more likely to remain independent than targets without ESB's.³¹ Second, targets that remained independent did not, on average, achieve the same returns as offered by the hostile bidder or white knight.³² And third, ESB's did not seem to provide countervailing benefits in the form of higher premiums in deals that were eventually successful.³³ Putting these three findings together, we found that ESB's reduced returns for target shareholders in our sample on the order of 8–10% in the nine months after a hostile bid was announced.³⁴ In contrast, ISB's did not have the same antitakeover effect, and, by extension, did not have the same negative shareholder wealth effect.³⁵

Based on these findings, we offered a very specific doctrinal reform: continued maintenance of a poison pill after losing a first proxy contest should not be considered "reasonable in relation to the threat posed" under *Unocal Corp. v. Mesa Petroleum Co.*³⁶ In effect, our proposal would have converted every ESB into an ISB.³⁷ In the everyday course of business, directors would have three-year terms.³⁸ But in the event of a hostile takeover bid, our proposal would have given shareholders the right to consider the offer in a single, up-or-down referendum.³⁹

B. *The Delaware Courts' Response*

Our proposed approach was a straightforward application of *Unocal* "reasonableness" review,⁴⁰ and as such could have been endorsed

³⁰See *infra* notes 40–42 and accompanying text. In unpublished work, we have expanded the database to include transactions through 2010, with the same overall findings. Subramanian, *supra* note 26.

³¹Bebchuk, Coates & Subramanian, *supra* note 5, at 927–33.

³²*Id.* at 933–35.

³³*Id.* at 935–36.

³⁴*Id.* at 936–39.

³⁵Bebchuk, Coates & Subramanian, *supra* note 5, at 936–39.

³⁶493 A.2d 946, 955 (Del. 1985); see also Jeffrey N. Gordon, "Just Say Never?" *Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet*, 19 CARDOZO L. REV. 511, 529–31 (1997) (noting the powerful antitakeover force of an ESB in the Moore-Wallace contest).

³⁷See *supra* text accompanying notes 34–35.

³⁸Bebchuk, Coates & Subramanian, *supra* note 5, at 893.

³⁹*Id.* at 949.

⁴⁰*Unocal*, 493 A.2d at 955 (explaining that in a selective self-tender context, before a director can invoke the business judgment rule, the director must show: (1) a reasonable belief that there was a danger to the corporation's policy and effectiveness; and (2) the defensive

by the Delaware courts without conflict with existing precedent and without the need for intervention by the Delaware legislature.⁴¹ Years passed, however, and no situation presented itself to provide a test case for our proposed reading of *Unocal*.⁴² The closest to an endorsement came in a pair of cases in 2010–2011, eight years after our initial proposal.⁴³ In *Yucaipa American Alliance Fund II, L.P. v. Reggio*,⁴⁴ then-Vice Chancellor Strine, cited our article and suggested some modest sympathy for our proposed approach:

[T]here is a plausible argument that a rights plan could be considered preclusive, based on an examination of real world market considerations, when a bidder who makes an all shares, structurally non-coercive offer has: (1) won a proxy contest for a third of the seats of a classified board; (2) is not able to proceed with its tender offer for another year because the incumbent board majority will not redeem the rights as to the offer; and (3) is required to take all the various economic risks that would come with maintaining the bid for another year.⁴⁵

However, then-Vice Chancellor Strine did not reach the ESB question, because the insurgent had not yet gained one-third of the board seats.⁴⁶ Six months later, in the seminal *Air Products and Chemicals, Inc. v. Airgas, Inc.*⁴⁷ decision, then-Chancellor Chandler quoted with approval the "plausible argument" language from *Yucaipa*,⁴⁸ but then similarly concluded that he did not need to reach the ESB question:

measure was reasonable in relation to the threat posed).

⁴¹Bebchuk, Coates & Subramanian, *supra* note 5, at 947 (explaining why a judicial solution would have a substantive benefit over a legislative solution).

⁴²*Unocal*, 493 A.2d at 955. The absence of a test case was not what I, or others, predicted at the time. See, e.g., Leo E. Strine, Jr., *The Professorial Bear Hug: The ESB Proposal as a Conscious Effort to Make the Delaware Courts Confront the Basic "Just Say No" Question*, 55 STAN. L. REV. 863, 883 (2002) ("Because of the authors' skillful arguments and thorough research, . . . we in the Delaware judiciary may find these questions harder to avoid.").

⁴³See *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 128 (Del. Ch. 2011); *Yucaipa Am. Alliance Fund II, L.P. v. Reggio*, 1 A.3d 310, 351 n.229 (Del. Ch. 2010); *infra* text accompanying notes 55-56.

⁴⁴1 A.3d 310 (Del. Ch. 2010).

⁴⁵*Id.* at 351 n.229 (citing Bebhuk, Coates & Subramanian, *supra* note 5, at 946).

⁴⁶*Id.* at 353-54.

⁴⁷16 A.3d 48.

⁴⁸1 A.3d at 351 n.229.

At that point, it is argued, it may be appropriate for a Court to order redemption of a poison pill. That hypothetical, however, is not exactly the case here for two main reasons. First, Air Products did not run a proxy slate running on a "let the shareholders decide" platform. Instead, they ran a slate committed to taking and [sic] independent look and deciding for themselves afresh whether to accept the bid. . . . The incumbents now share in the rest of the board's view that Air Products' offer is inadequate—this is not a case where the insurgents want to redeem the pill but they are unable to convince the majority. This situation is different from the one posited by [then-]Vice Chancellor Strine and the three professors in their article, and I need not and do not address that scenario.

Second, Airgas does not have a true "ESB" as articulated by the professors. As discussed earlier, Airgas's charter allows for 33% of the stockholders to call a special meeting and remove the board by a 67% vote of the outstanding shares. Thus, according to the professors, no court intervention would be necessary in this case.⁴⁹

With the courts declining to reach the ESB question, practitioners could have adopted the functional equivalent of our proposed approach by converting their ESBs into ISBs: most simply, by moving their staggered board from the charter to the bylaws; or by overriding the Delaware default and allowing removal without cause even when the board is staggered.⁵⁰ The benefit would have been three-year terms, thereby preserving the long-term focus for directors in the ordinary course of business, but preserving the right of shareholders to consider an unsolicited offer for the company in a single, up-or-down referendum.⁵¹ Yet to my knowledge, no public company board converted its ESB into an ISB during this period.⁵²

⁴⁹*Air Prods.*, 16 A.3d at 128. This conclusion is in tension with the Court's finding that removal would require approval from 85-86% of the disinterested shares. *See infra* note 139 and accompanying text.

⁵⁰Section 141(k)(1) of the DGCL provides for removal only with cause if the board is staggered, "[u]nless the certificate of incorporation otherwise provides." DEL. CODE ANN. tit. 8, § 141(k)(1) (2011).

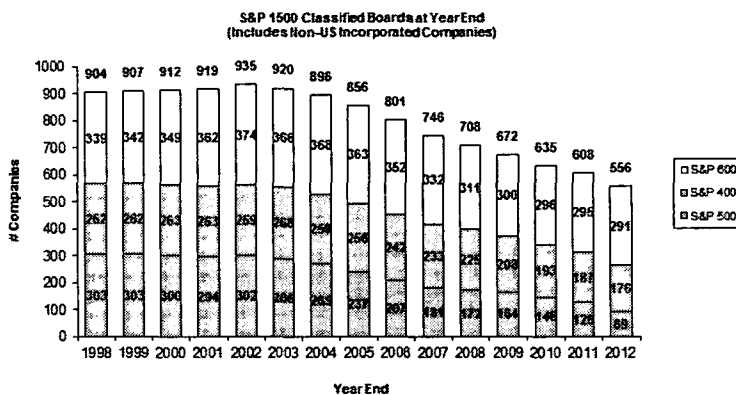
⁵¹Bebchuk, Coates & Subramanian, *supra* note 5, at 892, 948-49.

⁵²These approaches would require board initiation and shareholder approval. In 2006,

C. The Missed Opportunity

Meanwhile, with the ESB question remaining open as a matter of Delaware corporate law and directors not themselves addressing the antitakeover effect that staggered boards created, shareholder activists took matters into their own hands. The following chart shows the incidence of staggered boards at U.S. public companies during this period:

Figure 1: S&P 1500 Classified Boards at Year End



Source: www.SharkRepellent.net

my co-author Lucian Bebchuk proposed another, very clever, method for achieving an ISB unilaterally by the shareholders: a bylaw amendment that only allowed the board to adopt a pill through an unanimous board vote, and any pill so adopted would automatically expire one year after it was adopted, unless ratified by shareholders. *Bebchuk v. CA, Inc.*, 902 A.2d 737, 745 (Del. Ch. 2006). The SEC refused to issue a no-action letter when Professor Bebchuk brought this proposal at Computer Associates under Rule 14a-8, and the Delaware Court of Chancery refused to rule on whether the proposed bylaw would have violated Delaware law if enacted, citing ripeness problems. *Id.* The proposal failed to gain shareholder approval at Computer Associates, but CVS Caremark, Disney, and Bristol-Meyers adopted bylaws based on the "Bebchuk Bylaw," though these companies had unitary boards already. See Lucian Bebchuk, *CVS Caremark Adopts My Proposal and Amends its By-laws*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (Feb. 7, 2008), <http://blogs.law.harvard.edu/corpgov/2008/02/07/cvs-adopts-my-proposal-and-amends-its-by-laws/>. To my knowledge, no company converted its ESB into an ISB through adoption of the Bebchuk Bylaw. If the Bebchuk Bylaw had in fact gained traction among ESB companies, it could in turn be defanged by adopting a one-year pill the day before each annual meeting, since it would take a majority board vote to eliminate such a pill once installed, and an insurgent would have at most one-third of the board seats after a first annual meeting. The result would be the same antitakeover effect (minus one day) as the original ESB. Such is the chess game that is the takeover marketplace.

Each story is slightly different, but the overall trend is unmistakable. Staggered board incidence declined sharply between 2002 and 2012, from 60% incidence among the S&P 500 to 18% by 2012. And this trend is likely to continue: the Shareholder Rights Project at Harvard Law School, one of the most powerful and effective promoters of unitary boards at U.S. public companies, recently reported thirty-one de-staggering proposals submitted to S&P 500 companies for their 2014 annual meetings, with seven of these companies preemptively agreeing to de-stagger their boards.⁵³

In 2007, as the de-staggering movement began to gain momentum, I wrote—individually this time—an op-ed in the *New York Times* explaining the benefits of the middle-ground solution of an ineffective staggered board:

Staggered boards offer many benefits over unitary boards: greater stability, improved independence of outside directors and a longer-term perspective[—]things shareholders should want, too. A bylaws-based staggered board [one manifestation of an ISB] would provide directors with three-year terms but allow shareholders to 'recall' them in the event of a hostile takeover bid that a majority of shareholders want to accept. This is the norm in many European countries, where directors can be elected to six-year terms but shareholders retain the right to remove them from office at any time.

Shareholders rightly decided that they did not like the anti-takeover effect of staggered boards, but their campaign unnecessarily casts the baby out with the bathwater. A bylaws-based staggered board meets the interests of all sides.⁵⁴

Patrick McGurn, Special Counsel at Institutional Shareholder Services ("ISS"), offered a thoughtful counterpoint:

⁵³*Advancing Annual Elections in the 2014 Proxy Season: Towards Declassification at 100 S&P 500 and Fortune 500 Companies*, HARVARD LAW SCH., S'HOLDER RIGHTS PROJECT NEWS ALERT (Dec. 4, 2013), http://srp.law.harvard.edu/newsletters/12-4-2013_SRP_newsletter.shtml.

⁵⁴Subramanian, *supra* note 6.

Saw your piece in the NYT. While it raises an interesting question, it looks like an attempt to snatch defeat from the jaws of victory. Classified boards are disappearing from the corporate landscape at a fast pace. Why pull the break on this momentum? While I agree that a bylaw approach is preferable to the prevailing charter approach (especially with lock-ins), I'm not sure that I buy any of the purported 'benefits' of classification that you identify. I strongly disagree with your statement that shareholders don't oppose classification outside of the takeover context. Classification[—]whether in the charter or the bylaws[—]cuts against majority voting. Staggering board terms undermines the accountability that is created by providing an annual opportunity to vote FOR or AGAINST each member of the board. We regularly face situations, for example, where none of the members of an audit or compensation panel will stand for election at a meeting due to the stagger. That leaves investors with little recourse.⁵⁵

From the opposite end of the ideological spectrum from ISS, Daniel A. Neff, Co-Chairman of the Executive Committee of Wachtell, Lipton, Rosen & Katz, had the following commentary:

I respectfully believe that your compromise on the staggered board will not work, because the relevant parties will see the target company as effectively having annual elections of all directors: directors will understand that a long-term capital program, such as an SAP installation which has a high upfront cost, uncertainties in implementation, but ultimately a big upside, is highly risky because the target company can be jumped at any time, before the expected benefits are realized; cyclical companies will not have time to work their way out of a bad part of the cycle; companies with earnings 'misses' will not have the time they need to respond to a market overreaction; and hostile bidders will be encouraged to make their move during a moment of weakness of their intended targets. Ultimately, a value judgment must be made—which has greater potential for mischief: boards that

⁵⁵E-mail from Patrick McGurn, Special Counsel, Institutional S'holder Servs. (Feb. 2007) (used with permission) (on file with author).

decide not to sell and are later proven to have made the wrong decision; or forcing companies to appease the ever-increasing clamor for short-term results, to avoid being put 'in play.'⁵⁶

It is either a very good sign or a very bad sign that neither end of the debate spectrum likes the idea of an ineffective staggered board. ISS dislikes the fact that they would have "little recourse" in the everyday course of business against specific directors that they wish to punish;⁵⁷ while Wachtell Lipton believes that in the one area where an ESB really matters—to defend against a hostile takeover—an ISB is substantively equivalent to a unitary board.⁵⁸ I will not seek to re-engage with the grand debate over the wisdom of takeover defenses here. I will, however, make two observations that are prompted by the specific concerns raised by these thoughtful commentators.⁵⁹

On the ISS viewpoint that shareholders want "recourse" against a director on an audit or compensation committee: based on my experience working with thousands of directors of public companies, this is precisely the phenomenon that fuels a short-term focus in the boardroom.

⁵⁶E-mail from Daniel A. Neff, Esq., Co-Chairman of the Executive Committee, Wachtell, Lipton, Rosen & Katz (Nov. 29, 2012) (used with permission) (on file with author).

⁵⁷See *supra* text accompanying note 55.

⁵⁸See *supra* text accompanying note 56.

⁵⁹In what I consider to be a less thoughtful critique, Professor Jeff Lipshaw of Suffolk University Law School argued that the problem was meaningful elections for directors: Professor Subramanian's clever and well-written piece is entitled "Board Silly," but to most corporate lawyers who have spent time in the real world, I'd wager its proposal seemed just plain silly. . . . [I]f I were a director, and the professor offered this to me as a compromise, I'd say "To what? Don't do me any favors[—]I can have continuity and stability as long as your constituencies refrain from making our elections into referenda about class inequalities and wealth redistribution."

See Jeff Lipshaw, *Board Silly or Silly Proposal? A Response to Professor Subramanian*, LEGAL PROF. BLOG (Feb. 14, 2007), http://lawprofessors.typepad.com/legal_profession/2007/02/board_silly_or_.html. This argument assumes away one of the main problems that my proposal solves. The fact is that ISS and other shareholder activists want "recourse" against directors, and the rules of the game have changed in a way that has given them a powerful club. An ISB provides recourse, but only every three years. In response to Professor Lipshaw's more general assertion that my proposal is "just plain silly" to "most corporate lawyers who have spent time in the real world," I noted at the time: "All I can say in response to this attack is that I have received many e-mails and other reactions from sophisticated practitioners who are hoping that my op-ed will spur a more thoughtful dialogue on staggered boards this proxy season. I hope so too." Guhan Subramanian, Comment to *Board Silly or Silly Proposal? A Response to Professor Subramanian* (Feb. 23, 2007, 9:32 AM), http://lawprofessors.typepad.com/legal_profession/2007/02/board_silly_or_.html.

In the *Making Corporate Boards More Effective* program at Harvard Business School, directors regularly bemoan the pressure that they perceive from ISS to do what is optically the right thing.⁶⁰ Those who attempt to do otherwise, because they believe in good faith that a different course of action is in the best long-term interests of the company, are rewarded with a threatened, or actual, withhold-vote campaign against them.⁶¹ This is not to say that ISS should have not "recourse", but an ISB provides recourse every three years rather than every year. In my opinion, a tri-annual check is more aligned with long-term wealth creation than an annual check on director decisions.⁶²

Skeptics might contend that directors elected to single-year terms can still have a long-term focus because director elections are invariably uncontested, and therefore are largely a formality.⁶³ However, several recent trends have conspired to make director elections far more meaningful. Most importantly, the dramatic proliferation of majority vote requirements have made even uncontested director elections into a contest between "Director X" and "Not Director X." Shareholder activists have not been shy in using the withhold-vote campaign to embarrass corporate directors, even if they do not actually achieve a majority of the vote withheld.⁶⁴ Studies show that a negative recommendation from ISS yields as much as a 20% decrease in support for an individual director.⁶⁵ No public-company director wants this; and to avoid it, there will be pressure to do whatever ISS tells them to do. And the ISS club will only be stronger going forward: beginning in the 2014 proxy season, ISS's "responsiveness analysis" is triggered whenever a board does not implement a precatory resolution that is approved by a majority of the votes cast (rather than shares outstanding).⁶⁶

⁶⁰For information regarding the program, see *Making Corporate Boards More Effective*, HARVARD BUS. SCH., <http://www.exed.hbs.edu/programs/mcb/Pages/default.aspx> (last visited Feb. 1, 2014).

⁶¹*See id.*

⁶²*See supra* text accompanying note 54.

⁶³Bo Becker & Guhan Subramanian, *Improving Director Elections*, 3 HARV. BUS. L. REV. 1, 1 (2013).

⁶⁴*See, e.g.*, Kimberly Gladman, Agnes Grunfeld & Michelle Lamb, *What Really Drives "Majority Withhold" Votes?*, THE CORP. BOARD., Jan.-Feb. 2013, at 8, 13 (discussing withhold votes); Holly J. Gregory, *Trends in Director Elections: Key Results from the 2012 Proxy Season*, PRAC. L.J., Sept. 2012, at 22 (noting that a negative vote campaign could be "embarrassing").

⁶⁵Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 886-87, 907-08 (2010).

⁶⁶*Board Response to Majority-Supported Shareholder Proposals (U.S.)*, ISS,

Pushing in the same direction, Rule 452 of the New York Stock Exchange ("NYSE") Listing Guidelines no longer allows a company to vote uninstructed shares in favor of the incumbent slate, thereby eliminating a "thumb on the scale" in favor of the incumbents.⁶⁷ eProxy theoretically reduces the cost of running a proxy contest, though take-up has been low thus far.⁶⁸ Shareholder proxy access is available to shareholders on a company-by-company basis,⁶⁹ and even the threat of proxy access can prompt electoral reform.⁷⁰

Each of these reforms on its own may make sense. But taken together, they give ISS and other shareholder advocates a larger club with which to police corporate boardrooms. In my opinion, the idea that ISS needs to be able to use that club every year in order to improve boardroom decision-making is questionable at best. By way of analogy, most observers would not argue that the U.S. House of Representatives is a better decision-making body than the U.S. Senate; in fact, if anything, most would say the opposite is closer to the truth, precisely because the Senate is more insulated from the everyday pressures of popular opinion.

On the Wachtell Lipton viewpoint that an ISB is substantively equivalent to a unitary board, in my view there is an important difference because a referendum on the board is only triggered in the event of a hostile takeover bid.⁷¹ Operational investments in long-term performance are protected by a three-year term of office, unless they cause such underperformance so as to attract a hostile bid.⁷² This structure gives

<http://www.issgovernance.com/files/2014ISSDraftPolicyUSBoardResponsetoMajoritySupportedShareholderProposals.pdf>.

⁶⁷*Information Memo 124*, NYSE, (Jan. 25, 2012), http://www.nyse.com/nysenotices/nyse/information-memos/detail?memo_id=12-4.

⁶⁸See Becker & Subramanian, *supra* note 63, at 14-16.

⁶⁹For example, CenturyLink (72%) and Verizon (53%) both had precatory proxy access resolutions pass in the 2013 proxy season. See Noam Noked, *Key Issues From the 2013 Proxy Season*, HARVARD LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (Aug. 30, 2013, 8:43 AM), <http://blogs.law.harvard.edu/corpgov/2013/08/30/key-issues-from-the-2013-proxy-season/>.

⁷⁰For example, Hewlett-Packard implemented proxy access after one of its shareholders, Amalgamated Bank, threatened to put a proxy access proposal on the ballot. See Ronald Barusch, *Dealpolitik: Is H-P Setting a Trend for Proxy Access?*, WALL ST. J. DEAL J., (Feb. 7, 2013, 4:55 PM), <http://blogs.wsj.com/deals/2012/02/07/dealpolitik-is-h-p-setting-a-trend-for-proxy-access/> ("Amalgamated agreed to withdraw this year's shareholder proposal in return for H-P agreeing to recommend a similar proposal at the 2013 meeting. H-P thereby avoided the substantial risk that it would lose the vote at its March annual meeting.").

⁷¹See Bechuk, Coates & Subramanian, *supra* note 5, at 949-50.

⁷²A recent working paper provides empirical evidence supporting this point. See K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Firm Value, Revisited* 38-39 (Dec. 19, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2364165 (reporting that adoption of a staggered board is associated with higher firm value for firms with more R&D and more intangible assets).

directors the insulation they need to safely pursue long-term projects, such as an enterprise software installation or other investments that have "uncertainties in implementation, but ultimately a big upside."⁷³ In assessing the benefits of an ISB, one also has to consider the current state of play: presumably Wachtell Lipton would prefer an ISB regime to the current unitary board regime.⁷⁴

To see how an ISB can work in practice, consider the recent case of Commonwealth REIT (ticker: CWH).⁷⁵ CWH is a Maryland corporation with a five-member staggered board.⁷⁶ With sluggish performance in recent years, two hedge funds (Corvex Management, an Icahn spin-off, and Related Fund Management) announced a 9.8% stake in February 2013,⁷⁷ sending the stock up 54%.⁷⁸ Corvex and Related offered to buy the company at \$25 per share, amounting to a 58% premium over the unaffected market price.⁷⁹ They subsequently increased their offer to \$27 per share, a 70% premium over the unaffected market price.⁸⁰

The Corvex/Related value-creation strategy was relatively simple. As explained on the Seeking Alpha website:

CommonWealth is managed by a company called Reit Management & Research LLC ("RMR"). It's not uncommon for REITs to have external management companies for business and/or property management. But in this case, the relationship is questionable to say the least. The management and board members for Commonwealth [sic] own only 0.8% of the outstanding shares of Commonwealth, but own 100% of RMR. The estimate by Corvex/Related that CWH has paid out \$209 million of

⁷³Neff, *supra* note 56.

⁷⁴*Id.*

⁷⁵See Eliot Brown, *Related and Corvex Target Commonwealth's Management*, WALL ST. J. (Feb. 26, 2013, 10:58 AM), <http://online.wsj.com/news/articles/SB10001424127887324338604578328101475511068>.

⁷⁶Steven M. Davidoff, *What's at Stake in the Fight Over a REIT*, N.Y. TIMES DEALBOOK (Apr. 18, 2013, 1:39 PM), http://dealbook.nytimes.com/2013/04/18/whats-at-stake-in-the-fight-over-commonwealth-reit/?_php=true&_type=blogs&r=0.

⁷⁷CommonWealth REIT, Schedule 13D (Feb. 20, 2013), *available at* <http://www.sec.gov/Archives/edgar/data/803649/000119312513075277/d491275dsc13d.htm>.

⁷⁸Brown, *supra* note 75.

⁷⁹*Id.*

⁸⁰See Michael J. De La Merced, *Corvex and Related Dangle Promise of Higher Bid for REIT*, N.Y. TIMES DEALBOOK (Feb. 27, 2013, 3:19 PM), <http://dealbook.nytimes.com/2013/02/27/corvex-and-related-dangle-promise-of-higher-bid-for-reit/>.

management fees to RMR[—]during a period in which CWH's market cap has declined by \$647 million[—]draws this relationship into question. The Corvex/Related proposal suggests an internalization of management to eliminate this huge conflict of interest and to align objectives with those of shareholders. This change is expected to represent a 15% improvement in equity value, according to Corvex/Related.⁸¹

CWH had an ISB because Section 2.3 of its Declaration of Trust (the REIT equivalent of the articles of incorporation) provides for removal with or without cause by two-thirds of the shareholders.⁸² In fact, in repeated filings with the SEC, CWH trumpeted the fact that its Trustees could be removed without cause.⁸³ Corvex/Related accordingly solicited consents from two-thirds of the shareholders to remove the trustees without cause.⁸⁴ The caselet illustrates the usefulness of the ISB compromise: the CWH Trustees had three-year terms in the everyday course of business, but could be "recalled" by two-thirds of the shareholders when underperformance, poor corporate governance, and/or capture by management warranted it.⁸⁵

But if an ISB provides a compromise solution that is better than either a unitary board or an ESB, then why haven't corporate boards signed up? Some representative reactions to my *New York Times* op-ed in 2007 provide some insights on this question:

I like the theory. . . . Unfortunately, I fear the opposition to staggered boards is just insufficiently thoughtful to have this

⁸¹*CommonWealth Can Make Us Commoners Wealthy*, SEEKING ALPHA (Feb. 27, 2013), <http://seekingalpha.com/article/1228401-commonwealth-can-make-us-commoners-wealthy>.

⁸²It should be noted that I served as an expert witness for Corvex/Related on the question of whether CWH has an ISB or an ESB. The arbitration panel eventually agreed with what should have been obvious from the outset, that CWH has an ISB. See *CommonWealth REIT v. Corvex Mgmt.*, AAA No. 11-512-Y-276-13, at 2 n.3, 5-6 (Nov. 18, 2013) (Interim Arbitration Award), available at <http://www.bergermontague.com/media/421630/arbitration-order-re-commonwealth-reit.pdf>.

⁸³In various Offering Prospectuses, CWH stated: "Our declaration of trust provides that a trustee may be removed with or without cause by the affirmative vote of the holders of at least two-thirds of our common shares." See *CommonWealth REIT*, Prospectus (Form 424B5) (Mar. 1, 2013); *CommonWealth REIT*, Prospectus (Form 424B5) (July 24, 2012); *CommonWealth REIT*, Prospectus (Form 424B5) (July 13, 2011).

⁸⁴See *CommonWealth*, AAA No. 11-512-Y-276-13, at 4.

⁸⁵See *id.* at 5.

kind of discussion with activists and pundits. I certainly am not aware of any public company that has been able to deflect the activists with a proposal of this nature.⁸⁶

I like the idea from [the] standpoint of preserving some positive aspects of staggered board but, from my perspective, you need to sell the activists (and ISS) on the idea because I don't believe most corporations, having decided to get rid of it, will spend the time and effort on this topic "fighting" to preserve bits of the pie.⁸⁷

On your op-ed, I don't disagree with the concerns. . . . What interests me is how business is behaving. They're used to riding things out. But they're playing a prevent defense in a game without a clock and they're playing unidirectionally [sic]. They're also playing against a lot of unaccountable folks and folks who profit from the game of corp[orate] governance itself.⁸⁸

I do indeed think that Professor Subramanian has devised an elegant solution to an urgent problem of the governance of publicly-traded corporations. . . . Classified boards provide stability, institutional memory. They also afford directors the time to get to know their companies. I will always remember a conference I attended early in my career where a prominent trust lawyer confessed that it took him ten years as a board member to really understand the operations of a small, non-profit hospital chain. What does that reveal about an Exxon director?⁸⁹

⁸⁶E-mail correspondence cited in Guhan Subramanian, Professor, Harvard Law School, *Getting to Yes On Staggered Boards*, Presentation at Harvard Law School Admitted Students Weekend (March 2007) (on file with author).

⁸⁷*Id.*

⁸⁸*Id.*

⁸⁹Peter Kinder, *On the Debate Regarding Corporate Governance Reforms? Staggered Boards*, ACCOUNTABILITY-CENTRAL.COM (Feb. 15, 2007, 3:35 PM), <http://www.accountability-central.com/nc/single-view-default/article/on-the-debate-regarding-corporate-governance-reforms-staggered-boards/?&type=123>.

Absent a particular forcing mechanism, corporate America put its head in the sand: "They're used to riding things out."⁹⁰ And once the de-staggering of corporate America began gathering steam, it became increasingly difficult to explain to shareholder activist groups how an ISB was an appealing alternative.⁹¹ Unitary boards are the norm in corporate America today, giving shareholder-rights' groups the club that they desired; but the irony is that corporate boards are more vigilant than ever on maximizing long-term shareholder value.⁹² Stories of board entrenchment that led to value destruction in the 1990s (e.g., Pennzoil, Circon) have given way to similar fact patterns that led to value enhancement in the current decade (e.g., Airgas).⁹³ But activists, motivated by a corporate America that had overplayed its hand, ignored this shift in boardroom culture that largely corrected the problem they were seeking to solve, and pushed instead for the structural solution of the unitary board. Both sides are to blame for the current state of play.

All of this is troubling, as a policy matter, but it is water under the bridge. Corporate America will not be moving back to staggered boards, even ISB's, anytime soon. But it is a motivating case study for another takeover defense that I believe will be put to the test, like ESB's,

⁹⁰See *supra* text accompanying note 88.

⁹¹See Steven M. Davidoff, *The Case Against Staggered Boards*, N.Y. TIMES DEALBOOK (Mar. 20, 2012, 12:43 PM), http://dealbook.nytimes.com/2012/03/20/the-case-against-staggered-boards/?_php=true&_type=blogs&r=0 (stating that companies that are already public are rushing to ditch their staggered board, and that the Harvard Law School Shareholder Rights Project has focused on eliminating staggered boards because such boards are particularly abhorrent to shareholder rights activists).

⁹²See Lucian Bebchuk, *Giving Shareholders a Voice*, N.Y. TIMES DEALBOOK (Apr. 19, 2012, 2:29 PM), http://dealbook.nytimes.com/2012/04/19/giving-shareholders-voice/?_php=true&_type=blogs&r=0 ("In recent years, supporters of staggered boards have been on the losing side at an overwhelming majority of votes on shareholder proposals urging board declassification."); Bhattiprolu Murti, *More Boards May End Staggered Terms*, WALL ST. J., Jun. 8, 2005 ("[I]f all the proposals in 2005 to end tiered-term boards pass, the year could end with fewer than half of the S&P 500 companies still having a classified board of directors. This change would represent a big shift from a few years ago, when about two-thirds of S&P 500 companies had staggered-term boards.").

⁹³See Bebchuk, Coates & Subramanian, *supra* note 29, at 891-93 (describing how the value of Pennzoil shares dropped from \$84 to \$35 as a result of the staggered board rejecting the attempts of Union Pacific Resources Group to acquire the company); Bebchuk, Coates & Subramanian, *supra* note 5, at 913-14 (using U.S. Surgical's attempted takeover of Circon to illustrate the difficulty of the proxy route with staggered boards); Steven M. Davidoff, *A Case Study: Air Products v. Airgas and the Value of Strategic Judicial Decision-Making*, 2012 COLUM. BUS. L. REV. 502, 507-33 (2012) (chronicling Air Products' attempted takeover of Airgas, and how Airgas' staggered board contributed to higher offers).

sometime soon: Section 203 of the Delaware corporate code.⁹⁴ I now turn to the shoe that has yet to drop.

III. SECTION 203 OF THE DELAWARE CORPORATE CODE

As takeover junkies will know, the Delaware legislature enacted its first antitakeover statute in 1976 and repealed it in 1987 on the "generally accepted"⁹⁵ view that it was unconstitutional in light of the U.S. Supreme Court's decision in *Edgar v. MITE Corp.*⁹⁶ In 1988, Delaware enacted a new antitakeover statute, codified in Section 203 of the DGCL, as part of the "third generation" wave of state antitakeover statutes that followed the blueprint laid out in *CTS Corp. v. Dynamics Corp. of America.*⁹⁷ Section 203 prevents a bidder from executing a back-end freeze-out merger for three years after buying more than 15% of the target's stock, unless one of three exceptions is met.⁹⁸ For present purposes, the most relevant exception is contained in Section 203(a)(2): moving from less than 15% ownership to more than 85% ownership in a single tender offer, excluding for purposes of this calculation shares that are held by "persons who are directors and also officers" and shares held by certain kinds of employee stock plans.⁹⁹

Commentators at the time debated the wisdom of the 15% and 85% thresholds.¹⁰⁰ The final thresholds were adopted by the Delaware

⁹⁴See *infra* Part III.

⁹⁵See MICHAEL D. GOLDMAN & EDWARD M. McNALLY, 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).

⁹⁶457 U.S. 624, 646 (1982) (holding that an Illinois antitakeover statute, which was similar to the Delaware statute, was unconstitutional).

⁹⁷481 U.S. 69, 93 (1987) (holding that Indiana's antitakeover statute was constitutional and distinguished it from Illinois' statute in *MITE*, thereby laying the blueprint for other state antitakeover statutes); see also Leigh Perkins Murphy, Note, *Delaware's "Third Generation" Antitakeover Statute: The Decline and Fall of Legislative Neutrality*, 23 SUFFOLK U. L. REV. 755, 775 (1989) ("In response to the parameters set out by the *CTS* Court, the Delaware legislature enacted the first 'third generation' antitakeover statute."); Peter L. Tracey, Comment, *The Delaware Debate on Takeover Legislation: No Small Wonder*, 93 DICK. L. REV. 339, 349-50, 352 (1989) (explaining the blueprint laid out in *CTS*, and highlighting the factors distinguishing it from *MITE*).

⁹⁸DEL. CODE ANN. tit. 8, § 203(a), (c)(5) (2011).

⁹⁹*Id.* § 203(a)(2).

¹⁰⁰See, e.g., *In re Digex, Inc. S'holders Litig.*, 789 A.2d 1176, 1201 (Del. Ch. 2000) ("[T]he 85% shareholder exemption was one of the most disputed provisions in the entire statute and received a tremendous amount of scrutiny.").

legislature on guidance from the Corporate Law Section of the Delaware bar stating, without any supporting empirical evidence, that: "If an offer is a good one, it should obtain 85% of the stock of the company."¹⁰¹ The question of whether the 85% "out" is realistically attainable has constitutional implications: under the Supremacy Clause, state laws cannot "frustrate the purpose" of federal law;¹⁰² and the Williams Act, passed by the U.S. Congress in 1968, provided disclosure and procedural requirements that were intended to "place[] investors on an equal footing with the takeover bidder."¹⁰³ A state antitakeover law that tilted the playing field too far toward target companies risked "frustrating the purpose" of the Williams Act, thereby running afoul of the Supremacy Clause of the U.S. Constitution.¹⁰⁴

A. *The Constitutional Claim*

When Section 203 was enacted in 1988, three hostile bidders for Delaware targets challenged its constitutionality under the Supremacy Clause.¹⁰⁵ In all three cases, the federal district court held that Section 203 must give the bidder a "meaningful opportunity for success" in order to survive scrutiny.¹⁰⁶ Two courts then reviewed empirical evidence presented by an expert witness to conclude that Section 203 did in fact give bidders a meaningful opportunity for success, and therefore did not disrupt the balance between bidders and targets that Congress envisioned.¹⁰⁷ The constitutionality of Section 203 was thought to be settled law.¹⁰⁸

¹⁰¹GOLDMAN & McNALLY, *supra* note 95, at 62.

¹⁰²See LAURENCE TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1179 (3d ed. 1999); see also Jeffrey L. Silberman, Note, *How Do Pennsylvania Directors Spell Relief? Act 36*, 17 DEL. J. CORP. L. 115, 143 (1992) ("A state statute is preempted by federal law if the statute makes compliance with the federal law impossible or frustrates the objectives of the federal law.").

¹⁰³CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 82 (1987) (quoting Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 30 (1977) (internal quotations omitted)).

¹⁰⁴See *supra* text accompanying notes 100-03.

¹⁰⁵See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 460 (D. Del. 1988); *RP Acquisition Corp. v. Staley Cont'l, Inc.*, 686 F. Supp. 476, 476-77, 479 (D. Del. 1988); *City Capital Assocs. Ltd. P'ship v. Interco, Inc.*, 696 F. Supp. 1551, 1552, 1554-56 (D. Del. 1988).

¹⁰⁶See *BNS*, 683 F. Supp. at 469 ("[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."); see also *Staley*, 686 F. Supp. at 482; *Interco*, 696 F. Supp. at 1554-55.

¹⁰⁷See *Staley*, 686 F. Supp. at 482-89 (showing that the plaintiff's expert did not successfully show that Section 203 was unconstitutional); *Interco*, 696 F. Supp. at 1555 (noting that although City Capital submitted an updated version of the statistical data in *Staley*,

In 2010, however, in a pair of articles published in the *Business Lawyer*,¹⁰⁹ my co-authors and I revisited the question and presented two new facts: (1) between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203, thereby calling into question whether in fact Section 203 has given bidders a "meaningful opportunity for success"; and perhaps more importantly, (2) the original empirical evidence that the courts relied upon to conclude that Section 203 gave bidders a "meaningful opportunity for success" was seriously flawed—so flawed, in fact, that even this original evidence supports the opposite conclusion: that Section 203 did not give bidders a meaningful opportunity for success.¹¹⁰

Let me repeat that last point: the empirical evidence that the federal courts relied upon to conclude that Section 203 gives bidders a "meaningful opportunity for success" is totally screwed up. More detail is obviously warranted in order to support this strong claim. In *BNS*, the first case in the Delaware trilogy, the court established the "meaningful opportunity for success" test, and concluded, without elaboration, that Section 203 "in all likelihood [is] constitutional and not preempted."¹¹¹ One commentator read the tone of *BNS* to "impl[y] that section 203 barely falls within the bounds of what the Williams Act allows."¹¹² 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."¹¹³

In the second and third cases in the Delaware trilogy (*Staley* and *Interco*), the bidders retained the same expert witness, a prominent

the court still found Section 203 constitutional).

¹⁰⁸See *Staley*, 686 F. Supp. at 482-89; *Interco*, 696 F. Supp. at 1555.

¹⁰⁹See generally Subramanian, Herscovici & Barbetta, *supra* note 13; Guhan Subramanian, Steven Herscovici & Brian Barbetta, *Is Delaware's Antitakeover Statute Unconstitutional? Further Analysis and a Reply to Symposium Participants*, 65 BUS. LAW. 799 (2010).

¹¹⁰See Subramanian, Herscovici & Barbetta, *supra* note 13, at 715-16, 736-44 (showing that between 1990 and 2010 no bidders were able to achieve the 85% threshold required by Section 203, and therefore the empirical evidence relied upon was flawed); see also Subramanian, Herscovici & Barbetta, *supra* note 109, at 799 (supporting the proposition that the empirical data that the federal courts have relied upon to uphold the constitutionality of Section 203 is no longer valid).

¹¹¹*BNS*, 683 F. Supp. at 472.

¹¹²Elliott 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).

¹¹³*BNS*, 683 F. Supp. at 472.

economist and former Chief Economist at the SEC, to provide empirical evidence on the "meaningful opportunity for success" test.¹¹⁴ This expert constructed a database of twenty-nine (*Staley*¹¹⁵) and then thirty-one (*Interco*¹¹⁶) hostile tender offers over the prior seven years.¹¹⁷ Out of these thirty-one offers in the final sample, fourteen bidders (45%) achieved less than an 85% tender, while seventeen bidders achieved more than an 85% tender.¹¹⁸ Quite reasonably, both courts 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."¹¹⁹

Twenty-two years later, the expert kindly gave us the list of thirty-one bids, and my co-authors and I revisited the sample of seventeen bidders who allegedly achieved more than 85% on a hostile basis.¹²⁰ The results were striking. We found:

that five bidders already held significantly more than 15% at the time of the tender offer, which means that these bids would not have qualified for the 85% out.¹²¹ It is not surprising that these bidders were able to achieve 85%, because they had virtual control (32-49%) before initiating their tender offers.¹²² Two bids were competing offers, and so would not have been subject to Section 203.¹²³ Four bids were friendly from the outset and three more were approved by the target board prior to reaching the 85% hurdle, so all

¹¹⁴See *City Capital Assocs. Ltd. v. Interco, Inc.*, 696 F. Supp. 1551, 1555 (D. Del. 1988); *RP Acquisition Corp. v. Staley Cont'l, Inc.*, 686 F. Supp. 476, 482-85 (D. Del. 1988).

¹¹⁵*Staley*, 686 F. Supp. at 482-83 (showing that the expert constructed a database of twenty-nine hostile tender offers).

¹¹⁶See *Interco*, 696 F. Supp. at 1555.

¹¹⁷See Subramanian, Herscovici & Barbetta, *supra* note 13, at 703, 716 (showing that seventeen out of thirty-one of the tender offers reached 85%).

¹¹⁸See *id.*

¹¹⁹*Staley*, 686 F. Supp. at 482-83; *Interco*, 696 F. Supp. at 1555-56.

¹²⁰See Subramanian, Herscovici & Barbetta, *supra* note 109, at 803-05.

¹²¹See *generally* DEL. CODE ANN. tit. 8, § 203(b)(6) (2011) (showing that the two bids with competing offers would not be subject to Section 203).

¹²²In six of these bids, the incumbent board approved the offer. See George Brett, *Gracious in Defeat, Cavan Leaves Vulcan*, TORONTO STAR (June 29, 1988) at B1. In the seventh bid (R&R Metal's tender offer for Vulcan Packaging), R&R replaced the incumbent board with its own nominees on June 28, 1988, and closed its tender offer for 87.9% of the Vulcan shares on July 19. *Id.*

¹²³DEL. CODE ANN. tit. 8, § 203(b)(6).

seven were incorrectly coded as hostile-to-the-end offers.¹²⁴ In the three remaining bids, the target boards were formally neutral or remained passive on the offer, and so these bids were also not hostile in the traditional sense.¹²⁵

We concluded from our analysis that "not a single bid that the federal district courts relied upon to conclude that the 85% out gives bidders a 'meaningful opportunity for success' on a hostile basis actually stands for that proposition."¹²⁶ We were not expecting this conclusion, or anything close to it. Our original motivation in asking for the data was to understand what had changed since the 1980s. As it turned out, nothing had changed: an 85% out has never given bidders a meaningful opportunity for success.¹²⁷

One might reasonably ask how an error of this magnitude would not have been caught at the time, through the usual back-and-forth between opposing experts. The answer, at least in part, must lie in the fact that the expert who presented the evidence was retained by the bidder in both cases.¹²⁸ Had the expert been retained by the target, one would assume that one or both of the bidders would have questioned the

¹²⁴*See id.*

¹²⁵*See* Subramanian, Herscovici & Barbeta, *supra* note 109, at 803-05. Among these three, the Mesa Royalty Trust bid was closer to friendly than neutral. The deal involved a repurchase of a spinoff from Mesa Petroleum, T. Boone Pickens's acquisition vehicle. Charles F. McCoy, *Mesa Seeks to Repurchase Royalty Trust at \$35 a Unit as Pickens Reverses Stance*, WALL ST. J., May 16, 1984, at 1. Pickens told the press: "It's such a nice deal; we can acquire this without making anybody's management mad at us." *Id.* (quoting T. Boone Pickens). Thomson Financial also codes the Mesa Royalty deal as "Friendly." In Citicorp's bid for Quotron Systems, Quotron Chairman Milton E. Mohr said that although the board believed the price was inadequate, "[i]t would not be in the shareholders' interest for the company to take actions which might prevent the Quotron shareholders from making their own determinations as to the adequacy of the offer and the desirability of tendering their stock for \$19 a share." *See* Bill Sing, *Quotron Says It Won't Fight Citicorp Bid*, L.A. TIMES, May 28, 1986, at 3 (quoting Quotron Chairman Milton E. Mohr). According to analysts, "[a] Quotron decision not to oppose Citicorp was likely to guarantee that the offer would succeed . . ." *Id.* In the third bid in this category (Cannon Mills), the target board was formally neutral. *See Cannon Mills 'Remains Neutral' on Takeover Offer*, DOW JONES NEWS SERVICE (Jan. 20, 1982).

¹²⁶Subramanian, Herscovici & Barbeta, *supra* note 13, at 805.

¹²⁷Peter Lattman, *New Hostility for an Old Delaware Antitakeover Law*, WALL ST. J. DEAL JOURNAL (Sept. 24, 2009, 11:35 AM), <http://blogs.wsj.com/deals/2009/09/24/with-hostiles-on-the-rise-a-delaware-antitakeover-law-comes-under-scrutiny/> (discussing Professor Subramanian's article that examined hostile takeover bids from 1988 through 2008 and found that none of the bidders were able to achieve 85% on their tender offer).

¹²⁸RP Acquisition Corp. v. Staley Cont'l, Inc., 686 F. Supp. 476, 477, 482-83 (D. Del. 1988); City Capital Assocs. Ltd P'ship v. Interco, Inc., 696 F. Supp. 1551, 1553, 1555 (D. Del. 1988).

validity of the data. But because the data was presented by the bidders' expert, target counsel could simply accept the evidence at face value, and argue from that data that Section 203 gave bidders a meaningful opportunity for success.

Whatever the cause, we concluded from our overall analysis that: "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."¹²⁹ Some commentators agreed with this assessment. Professor Joe Grundfest of Stanford Law School stated: "Lawyers now have the data they need to renew a constitutional battle over these sorts of state takeover laws."¹³⁰ Professor Stephen Bainbridge of UCLA School of Law wrote: "I agree that the article's data calls into question the empirical grounding of the Delaware trilogy. To that extent, I agree that the validity of the Delaware statute could be challenged."¹³¹ Richard Hall, a senior partner at Cravath, Swaine & Moore offered: "Almost no one gets an 85% vote on anything that is opposed by management. If that's the factual underpinning for 203, then [Subramanian, Herscovici & Barbetta are] probably right."¹³²

Eileen Nugent, a senior partner at Skadden, Arps, Slate, Meagher & Flom LLP offered a practitioner point: "[The article] do[es] an excellent job of reminding lawyers of something that none of us should ever forget: it always makes sense to go back and review the premise underlying an accepted approach, particularly when that reliance is of long standing and somewhat unquestioning."¹³³ Nugent's point echoes Oliver Wendell Holmes in his famous *Path of the Law*:

It is revolting to have no better reason for a rule of law than
[] it was laid down in the time of Henry IV. It is still more
revolting if the grounds upon which it was laid down have

¹²⁹Subramanian, Herscovici & Barbetta, *supra* note 13, at 729.

¹³⁰Lattman, *supra* note 127 (quoting Professor Joseph Grundfest).

¹³¹Stephen Bainbridge, *Subramanian Replies re Delaware 203 Constitutionality*, STEPHEN BAINBRIDGE'S J. LAW, POLITICS, & CULTURE (Nov. 19, 2009), <http://www.professorbainbridge.com/professorbainbridge.com/2009/11/submaranian-replies-re-delaware-203-constitutionality.html>.

¹³²David Marcus, *Subramanian and Wachtell Square Off*, CORP. CONTROL ALERT (Dec. 2009), at 26.

¹³³Eileen T. Nugent, Commentary, *A Timely Look at DGCL Section 203*, 65 BUS. LAW. 753, 753 (2010).

vanished long since, and the rule simply persists from blind imitation of the past.¹³⁴

Our article was subsequently selected by academics as one of the "top ten" articles in corporate and securities law for 2010, out of 447 articles published in that year.¹³⁵ In its 2011 hostile bid for Casey's General Stores, Couche-Tard cited our "landmark study" as the basis for its challenge to Iowa's antitakeover statute, which is structured similarly to Section 203.¹³⁶ Our article was featured in prominent practitioner outlets, such as the *Wall Street Journal* "Deal Journal" column¹³⁷ and *Corporate Control Alert* magazine.¹³⁸ Perhaps most importantly, then-Delaware Chancellor Bill Chandler, in his seminal *Airgas* opinion, agreed with our assessment that achieving 85% of the unaffiliated shares was virtually impossible to achieve:

[T]he sheer lack of historical examples where an insurgent has ever achieved such a percentage in a contested control election must mean something. Commentators who have studied actual hostile takeovers for Delaware companies have, at least in part, essentially corroborated this common sense notion that such a victory is not realistically attainable.¹³⁹

Two high-profile situations from 2013 provide further color on then-Chancellor Chandler's "common sense notion" that attaining 85% of the outstanding shares is "not realistically attainable."¹⁴⁰ First, consider

¹³⁴O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

¹³⁵*The Top 10 Corporate and Securities Articles of 2010*, CORP. PRAC. COMMENTATOR, <http://www.professorthompson.com/uploads/2/1/4/7/21478240/corporatesecuritey.unclebob.pdf> (last visited Feb. 8, 2014).

¹³⁶The Iowa statute prevents a business combination for three years unless the bidder goes from less than 10% to more than 85% in its tender offer. IOWA CODE § 490.1110 (2012); see also Defendants Answer, Affirmative Defenses and Counterclaims for Declaratory and Injunctive Relief at 37-38, Casey's Gen. Stores, Inc. v. Alimentation Couche-Tard Inc., (S.D. Iowa June 18, 2010), available at <http://www.scribd.com/doc/33516454/Couche-Tard-s-Complaint-Against-Casey-s>.

¹³⁷Lattman, *supra* note 127.

¹³⁸Marcus, *supra* note 132, at 26.

¹³⁹*Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 120 (Del. Ch. 2011) (citing Subramanian, Herscovici, and Barbeta, *supra* note 109). Air Products could remove the Airgas board with approval from 67% of the outstanding shares, which amounted to 85-86% of the unaffiliated shares. See *id.* at 116.

¹⁴⁰See David Benoit, Shira Ovide & Sharon Terlep, *Dell Races to Sway Voters, Save*

Corvex/Related's June 2013 effort to solicit consents to remove the CWH board; this situation was discussed in Part II of this Article as an example of an ISB.¹⁴¹ CWH (a Maryland corporation) had egregious corporate governance failures and entrenchment devices that participants on both sides agreed would never fly in Delaware.¹⁴² Investors deemed the conflicts "so severe that we deem [CWH] un-investable."¹⁴³ Yet even in this extreme case, and with low (<1%) management ownership, Corvex/Related were able to solicit consents to remove the board from only about 70% of the outstanding shares.¹⁴⁴

Consider, too, the shareholder vote on the Dell buyout in July 2013.¹⁴⁵ Despite being one of the most-watched corporate votes in recent memory, and even with the presence of several large blockholders including highly-motivated merger-arbs on all sides of the vote (such as Carl Icahn and Southeastern's combined 12.7% position), only 77% of the shares unaffiliated with Michael Dell were voted.¹⁴⁶ When combined with a majority-of-the-minority approval condition, the low turnout permitted a relatively small coalition to block the deal—a fact that Icahn exploited.¹⁴⁷

These cases highlight how difficult it is to obtain 85% of the outstanding shares.¹⁴⁸ It is based on some combination of "dead" shares that never vote or tender (estimated to be 5–10% of the outstanding at most widely held companies) and rational shareholder apathy due to the general disappearance of structurally coercive offers.¹⁴⁹ Back in 1987,

Deal, WALL ST. J. (July 18, 2013, 1:35 PM), <http://online.wsj.com/news/articles/SB10001424127887323309404578613561181774992> (stating that consent was only able to be gained from 77% of the outstanding shares); K.C. Hayes, *CommonWealth Reit Board of Trustees Out On 70% Vote*, VALUEWALK (June 21, 2013), <http://www.valuwalk.com/2013/06/commonwealth-reit-board-of-trustees-vote/> (stating that consent was only gained from 70% of the outstanding shares).

¹⁴¹See *supra* Part II.

¹⁴²See *supra* Part II.

¹⁴³Vito J. Racanelli, *Whose CommonWealth Is It Anyway?*, BARRONS (April 20, 2013), http://online.barrons.com/article/SB50001424052748703318404578426652885493518.html#articleTabs_article%3D1 (quoting Jim Sullivan, an analyst with REIT research and analytics firm Green Street Advisors, saying that the family of REITs managed by the Partnoys have conflicts "so severe that we deem them un-investable").

¹⁴⁴Hayes, *supra* note 140.

¹⁴⁵See Benoit, Ovide & Terlep, *supra* note 140.

¹⁴⁶See *id.*

¹⁴⁷See Sharon Terlep, Ben Worthen & Telis Demos, *Icahn Rattles Dell Buyout Proposal*, WALL ST. J. (Mar. 7, 2013, 7:25 PM), <http://online.wsj.com/news/articles/SB10001424127887324128504578345921882404846> (stating that Icahn threatened "years of litigation" if the buyout was not rejected and replaced with his plan).

¹⁴⁸See *supra* Part III.A.

¹⁴⁹See *supra* Part III.A.

when Section 203 was being considered, Martin Lipton of Wachtell Lipton famously claimed that even a 90% out would be a "barn-door size exception" to the antitakeover effects of the statute.¹⁵⁰ He later commented that "[i]t will be a rare situation where a tender offer will not attract 85% of the target's non-management shareholders[.]" and Raymond Groth, an investment banker at then-First Boston, similarly stated that "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."¹⁵¹ Today, no one would make such claims. Instead, the debate today is whether getting to 85% on a hostile basis is "difficult" or "close to impossible."¹⁵² Either way, the constitutionality of Section 203 is in play.¹⁵³

For readers who remain skeptical, I summarize our four points regarding the constitutionality of Section 203 here, and urge readers to identify which of these points is the basis for disagreement:

1. Three federal district courts held in 1988 that Section 203 must give bidders a "meaningful opportunity for success" in order to be valid under the Supremacy Clause of the U.S. Constitution.
2. These courts upheld Section 203 because the empirical evidence available at the time appeared to show that bidders were able to achieve an 85% tender in hostile offers reasonably often, but they explicitly left open the possibility that future empirical evidence could change this constitutional conclusion.
3. No bidder since 1990 has been able to achieve 85% in a hostile tender offer against a Delaware target.

¹⁵⁰*Statement of Joseph A. Grundfest Commissioner U.S. Securities and Exchange Commission Before the House Judiciary Committee of the Delaware State Legislature Concerning Delaware's Proposed Antitakeover Legislation* (Jan. 20, 1988), in *CORPORATE PRACTICE SERIES: GUIDE TO THE TAKEOVER LAW OF DELAWARE* 282-83 (Craig B. Smith & Clark W. Furrow eds., 1988) (quoting November 23, 1987 Memorandum from Martin Lipton from Wachtell, Lipton, Rosen & Katz to Clients).

¹⁵¹*BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 470-71 (D. Del. 1988). Presumably Lipton and Groth were referring to hostile-to-the-end offers, since that was the relevant inquiry for the court, though it is not clear from the quoted language.

¹⁵²See *supra* notes 12-15 and accompanying text.

¹⁵³See *supra* notes 15-18 and accompanying text.

4. The original empirical evidence that the courts relied upon to conclude that Section 203 gave bidders a "meaningful opportunity for success" is seriously flawed, and in fact, supports the opposite conclusion.¹⁵⁴

While critics of our article have argued vehemently that we are wrong,¹⁵⁵ none of them have challenged these four basic facts. Instead, critics offer "Yes, but" arguments: for example, "Yes, but a district court today would no longer endorse the 'meaningful opportunity for success' test."¹⁵⁶ This is possible. But the fact that critics of our article resort to speculation about what a future district court would do proves our point that the constitutionality of Section 203 is in play.¹⁵⁷

Some have argued that the constitutional question, once addressed, becomes untouchable.¹⁵⁸ Professor Larry Ribstein, for example, has written in response to our original article that "[i]t would be inconsistent with [the Delaware trilogy's] reliance on the legislature's judgment to

¹⁵⁴Subramanian, Herscovici & Barbeta, *supra* note 109, at 799; *see also* Guhan Subramanian, 29th Annual Francis G. Pileggi Distinguished Lecture in Law 18 (Sept. 7, 2013) (PowerPoint slides on file with the *Delaware Journal of Corporate Law*).

¹⁵⁵*See* Larry E. Ribstein, Commentary, *Preemption as Micromanagement*, 65 BUS. LAW. 789, 792, 794-95 (2010) (arguing that fiduciary duty constraints on Section 203 would satisfy the constitutional requirement, or, alternatively, that federal courts should and would rework their Supremacy Clause jurisprudence to accommodate Section 203); A. Gilchrist Sparks, III & Helen Bowers, Commentary, *After Twenty-Two Years, Section 203 of the Delaware General Corporation Law Continues to Give Hostile Bidders a Meaningful Opportunity for Success*, 65 BUS. LAW. 761, 768-69 (2010) (arguing that the friendly deal "out" would satisfy the constitutional requirement); ERIS. S. ROBINSON & RYAN A. MCLEOD, WACHTELL, LIPTON, ROSEN & KATZ, *FLAWED ACADEMIC CHALLENGE TO CONSTITUTIONALITY OF DELAWARE'S ANTI-TAKEOVER LAW TO CLIENTS* (2009) (arguing that the evidence from the past 20 years should be ignored because it has been muddied by the concurrent existence of the pill), http://blogs.law.harvard.edu/corpgov/files/2009/11/Critique_Challenge_to_Del_Law.PDF.

¹⁵⁶*See, e.g.*, Ribstein, *supra* note 155, at 789.

¹⁵⁷To offer another possibility: During the delivery of my Pileggi Lecture, one prominent Delaware attorney speculated that a future federal court might draw a distinction between acquiring control of a Delaware company (which Section 203 does not prevent) and having the right to own all of the equity. Guhan Subramanian, 29th Annual Francis G. Pileggi Distinguished Lecture in Law (Sept. 7, 2013), <http://djcl.org/Pileggi.html>. If Section 203 were re-framed as a statute delaying a back-end freeze-out statute rather than as an antitakeover statute, then preemption under the Williams Act becomes less likely. Again, as described in the text, this is entirely possible, but it is not the existing approach to Section 203. To reconceptualize Section 203 as simply a freeze-out statute rather than as an antitakeover statute would be constitutionally convenient, but would represent a sharp break with the Delaware trilogy and twenty-five years of commentary.

¹⁵⁸*See infra* text accompanying notes 159-60.

invalidate the statute based on circumstances arising after the legislature has applied its judgment."¹⁵⁹ I know of no such principle in constitutional law, nor does Ribstein offer one, to support this proposition. Moreover, in this specific context, the Delaware trilogy explicitly envisioned a re-assessment of the constitutional question if the empirical evidence changed.¹⁶⁰

The recent *Halliburton* case provides a useful analogy.¹⁶¹ In 1988 (coincidentally, the same year as the Delaware trilogy), the U.S. Supreme Court endorsed the "fraud-on-the-market" theory of reliance for purposes of liability under Rule 10b-5, based on what the Court perceived to be strong empirical support for the "efficient capital market hypothesis."¹⁶² In dissent, Justice White noted that "with no staff economists, no experts schooled in the 'efficient-capital-market hypothesis,' ["ECMH"] no ability to test the validity of empirical market studies, we are not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory."¹⁶³ Endorsement of the fraud-on-the-market theory was nevertheless a seminal development that significantly expanded liability under Rule 10b-5 for the past 25 years.¹⁶⁴

In November 2013, the Court announced that it would re-consider the validity of the fraud-on-the-market theory of reliance.¹⁶⁵ The Court took up the invitation issued by four justices earlier in 2013—Justices Scalia, Kennedy, Thomas & Alito—in *Amgen v. Connecticut Retirement Plans and Trust Funds*,¹⁶⁶ who noted that reconsideration may be appropriate because of the growing debate among economists and legal scholars on the empirical validity of the ECMH.¹⁶⁷ The case will be

¹⁵⁹Ribstein, *supra* note 155, at 791.

¹⁶⁰Subramanian, Herscovici & Barbeta, *supra* note 13, at 701-04 (citing *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 461-72 (D. Del. 1988); *RP Acquisition Corp. v. Staley Cont'l, Inc.*, 686 F. Supp. 476, 477-86 (D. Del. 1988); *City Capital Assocs. Ltd. P'ship v. Interco, Inc.*, 696 F. Supp. 1551, 1553-55 (D. Del. 1988)).

¹⁶¹*See generally* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011).

¹⁶²*Basic Inc. v. Levinson*, 485 U.S. 224, 241, 248 (1988).

¹⁶³*Id.* at 253.

¹⁶⁴*See, e.g.*, Richard A. Booth, *The Two Faces of Materiality*, 38 DEL. J. CORP. L. 517, 520-23 (2013) (discussing fraud of the market and case law relating to the theory).

¹⁶⁵*See* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011), *cert. granted sub nom.* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 636 (2013).

¹⁶⁶133 S. Ct. 1184 (2013).

¹⁶⁷*See id.* at 1204-06 (Alito, J. concurring) ("As the dissent observes, more recent evidence suggests that the presumption may rest on a faulty economic premise. In light of this development, reconsideration of the *Basic* presumption may be appropriate." (internal citations omitted)); *see also id.* (Scalia, J., dissenting) ("The necessity of materiality for certification is demonstrated by the last sentence of the *Basic* opinion, which comes after the Court has decided to remand the case for reconsideration of materiality under the appropriate legal

heard in March 2014 and is considered the most important case of the decade.¹⁶⁸ It illustrates the willingness and ability of the Court to revisit a well-established prior ruling (one that is, in fact, far more established than the constitutionality of Section 203) when the underlying empirical proposition changes.¹⁶⁹

B. *The Decline of the Pill*

Of course, the challenge has not yet come in Delaware. One potential explanation is that the challenge will never come, because Section 203 is dominated by the poison pill. It is well-understood that most companies have the legal ability to put in a pill after a hostile bid is launched; and conventional wisdom tells us that if a company has a pill with a trigger threshold at or below 15%, it provides just as much if not more protection than Section 203. In this scenario, the pill—then, not Section 203—would be the binding constraint against a hostile bidder.

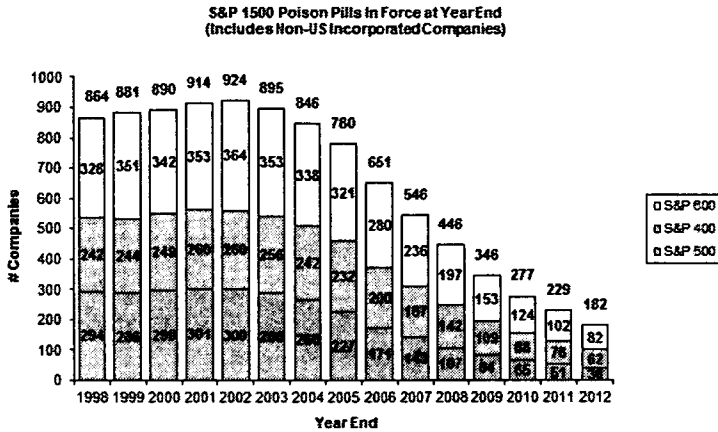
However, there are several problems with this conventional wisdom. First, actual pill incidence has declined dramatically among major U.S. companies:

standard . . .").

¹⁶⁸See Lucian A. Bebchuk & Allen Ferrell, *Rethinking Basic*, 69 BUS. LAW. (forthcoming 2014); see also *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), cert. granted sub nom. *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 636 (2013).

¹⁶⁹One might argue that the Court is using the academic debate over ECMH as an excuse to revisit the fraud-on-the-market theory, which the conservative wing of the Court views as being bad policy. But to the extent this argument is correct it strengthens the point: *MITE* and *CTS* were both motivated by the politics of hostile takeovers at the time; these politics have changed substantially since 1988. See *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982). State antitakeover statutes that may have been viewed as good policy in 1988 may not be viewed as such today.

Figure 2: S&P 1500 Poison Pills In Force At Year End



Source: www.SharkRepellent.net

As shown in Figure 2, pill incidence went from a peak of 62% among the S&P 1500 companies in 2002 down to 12% today.¹⁷⁰ And among Delaware companies, approximately 9% have pills.¹⁷¹ Of course, virtually all companies have a "shadow pill" (or "off-the-shelf" pill) that they can install in response to an unsolicited offer.¹⁷² But an after-the-fact pill is not substantively equivalent to a before-the-fact pill because an after-the-fact pill does not guard against an activist who buys shares aggressively in the 10-day window between crossing 5% and when disclosure is required under Section 13D. Witness J.C. Penney in 2011, where activists Steve Roth and Bill Ackman amassed a 27% stake before

¹⁷⁰This data has been verified by FactSet Research Systems Inc. E-mail from John Laide, Vice President, Senior Product Manager-Corporate Governance, FactSet Research Systems, to James Kilduff (Jan. 23, 2014, 15:53 EST) (on file with the *Delaware Journal of Corporate Law*).

¹⁷¹*See id.* As of January 23, 2014, 326 Delaware companies currently had a poison pill in place. The most recent study I have seen, in November 2013, indicates that 7.1% of S&P 500 companies have pills. Subramanian, *supra* note 26.

¹⁷²Most U.S. public companies have blank check preferred stock, which gives these companies the ability to put in a pill without shareholder authorization. However, according to the SharkRepellent database (which includes only a subset of all public companies), there are 114 Delaware corporations that do not have blank check preferred stock. For these 114 companies, the ability to put in a pill with adequate potency can become much more difficult. For this subset of companies Section 203 may very well be the binding constraint against a hostile bidder.

having to disclose their ownership in the company.¹⁷³ According to the *Wall Street Journal*, J.C. Penney CEO, Mike Ullman, only found out about their position in his company when Roth's name came up on his Caller ID.¹⁷⁴ J.C. Penney is incorporated in Delaware, and did not have a poison pill at the time of the Roth/Ackman position.¹⁷⁵ Had the duo sought 100% control, Section 203 would have been their only impediment.¹⁷⁶

The decline in pill incidence is likely to continue: of the pills that are currently in place, 53% are due to expire in the next three years.¹⁷⁷ Over the past few years, the renewal rate for pills that expire is approximately one-third.¹⁷⁸ Assuming that this historical renewal rate continues, the fraction of companies without pills in place will increase to 92% by 2016.¹⁷⁹ As recently pointed out by Chris Young, Head of Contested Situations at Credit Suisse: "There are no longer any structural defenses It used to be that you could set up staggered boards and put in poison pills. But there is no moat to build around your company anymore."¹⁸⁰

In addition, the decline in pill incidence is set to accelerate as pill life decreases. The following figure shows average pill life, by year of pill installation:

¹⁷³See Rachel Dodes, *Penney to Give Activists a Say on Board*, WALL ST. J. (Jan. 24, 2011), <http://online.wsj.com/news/articles/SB10001424052748703555804576101630964337152>.

¹⁷⁴See *id.*

¹⁷⁵See *JC Penney Adopts 'Poison Pill' Plan*, ASSOCIATED PRESS (Aug. 22, 2013, 5:05 PM), <http://bigstory.ap.org/article/jc-penney-adopts-poison-pill>; Abram Brown, *J.C. Penney Will Use A Poison Pill To Guard Against Another Bill Ackman*, FORBES (Aug. 22, 2013, 9:20 AM), <http://www.forbes.com/sites/abrambrown/2013/08/22/j-c-penney-adopts-poison-pill-to-guard-against-takeover/>.

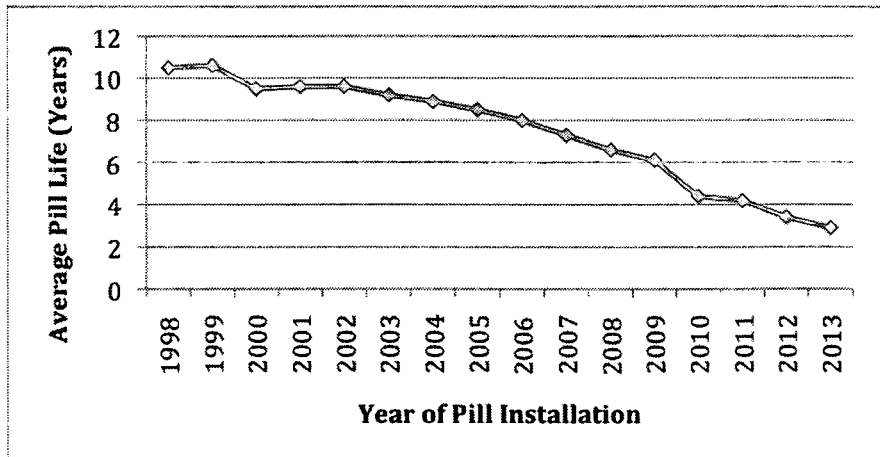
¹⁷⁶See DEL. CODE ANN. tit. 8, § 203 (2011).

¹⁷⁷Based on statistics from the end of 2013, of the 537 pills in effect, 286 pills are set to expire by 2016. Laide, *supra* note 170.

¹⁷⁸*Id.*

¹⁷⁹*Id.*

¹⁸⁰David Gelles, *Boardrooms Rethink Tactics to Defang Activist Investors*, N.Y. TIMES DEALBOOK (Nov. 11, 2013, 5:06 PM), http://dealbook.nytimes.com/2013/11/11/boardrooms-rethink-tactics-to-defang-activist-investors/?src=recg&_r=1 (quoting Chris Young, head of contested situations at Credit Suisse).

Figure 3: Average Pill Life by Pill Installation¹⁸¹

With shorter pill life comes more pill renewal decisions. J.C. Penney provides an example: as noted above the company did not have a pill at the time that Roth/Ackman bought their stake; but in August 2013, the company put in a pill that would last only for one year.¹⁸² In January 2014, Penney reduced the trigger threshold to 5% (arguably to protect tax benefits) and extended the life of the pill through 2017, but made the modified pill subject to shareholder approval.¹⁸³ As of this writing, the shareholder vote on the Penney pill is still pending.

Not coincidentally, the J.C. Penney example, as well as the overall data on pill incidence and pill duration tracks the most recent ISS policy on pills.¹⁸⁴ ISS will recommend against boards that install a pill with a term of more than one year (what they call a "long-term pill"), or that renew any existing pill (of any term), without shareholder approval.¹⁸⁵

¹⁸¹This chart graphically reflects data compiled by the Author from www.sharkrepellent.net resources.

¹⁸²See *JC Penney Adopts 'Poison Pill' Plan*, *supra* note 175.

¹⁸³See Rachel Abrams, *J.C. Penney Amends Poison Pill Plan*, N.Y. TIMES DEALBOOK, (Jan. 28, 2014), http://dealbook.nytimes.com/2014/01/28/j-c-penney-amends-poison-pill-plan/?_php=true&_type=blogs&_r=0.

¹⁸⁴See generally *2013 SRI U.S. Proxy Voting Guidelines*, ISS 1, 10-12 (Jan. 2013), <http://www.issgovernance.com/files/2013ISSRIUSPolicy.pdf>.

¹⁸⁵At companies with staggered boards, ISS will recommend withholding votes for *all nominees every year*. See *id.* at 11. At companies with unitary boards, ISS will recommend withholding votes for *all nominees every three years*. See *id.*

ISS may recommend against boards that install a pill with a term of less than one year, without shareholder approval.¹⁸⁶ Factors to be considered are: the feasibility of putting the pill question to shareholder for ratification at the annual meeting; the board's rationale; the board's governance structure and practices; and the board's track record of accountability to shareholders.¹⁸⁷ The decline of the pill documented in this Article tracks the ISS policy on pills.¹⁸⁸ To see the bite of ISS's new pill policy, consider again the case of J.C. Penney. If the J.C. Penney board renews its pill in August 2014, ISS policy would dictate a recommendation against the entire board.¹⁸⁹ This is something that no director wants.

For companies without pills, after-the-fact pills are less common they used to be. Among unsolicited bids announced between January 2007 and September 2013 (n=96), thirty-two targets had a pill in place at the time of the offer.¹⁹⁰ Of the remaining sixty-four bids, twenty-six targets (41%) put in an after-the-fact pill, while thirty-eight targets (59%) did not.¹⁹¹ While each situation is of course different, at least part of the reason to not put in a pill, both historically and going forward, may very well be Section 203: Why should a board put in a pill, and risk the wrath of ISS, when Section 203 provides adequate protection on its own?¹⁹²

Even for the very few companies that continue to have pills in place, or put them in after a bid is brought, my analysis shows that these pills are weaker than they used to be.¹⁹³ Thirty-two percent of pills currently in place have a permitted offer exception, a "chewability" feature, or both, meaning that the pill disappears if certain procedural requirements and/or "fair price" criteria are met.¹⁹⁴ Because Section 203

¹⁸⁶ See *id.*

¹⁸⁷ See *id.* at 9-12.

¹⁸⁸ See 2013 SRI U.S. Proxy Voting Guidelines, *supra* note 184, at 10-12.

¹⁸⁹ See *id.* at 11.

¹⁹⁰ See John Laide, *Hostile M&A—Increased Use of Proxy Fights and Poison Pill Defense*, SHARKREPELLENT (Feb. 17, 2012), https://www.sharkrepellent.net/request?an=dt.getPage&st=undefined&pg=/pub/rs_20120217.html&Hostile_M&A_Increased_Use_of_Proxy_Fights_and_Poison_Pill_Defense&rnd=850415 (providing data from 2007 to 2012). I thank John Laide of FactSet Research for updating this analysis through September 2013.

¹⁹¹ See *id.*

¹⁹² Unless, of course, the board thinks that Section 203 might be unconstitutional. See DEL. CODE ANN. tit. 8, § 203 (2011); Subramanian, Herscovici & Barbeta, *supra* note 13, at 733-34.

¹⁹³ Subramanian, Herscovici & Barbeta, *supra* note 13, at 706-07.

¹⁹⁴ See Laide, *supra* note 190; Kate Margolis, Comment, *Binding Shareholder Bylaw Amendments: An Antidote for The Poison Pill?*, 67 MISS. L.J. 817, 824-25 (1998).

does not have this vulnerability, it provides a "backstop" behind a chewed pill.¹⁹⁵

A final reason that Section 203 may be a binding constraint in a future takeover contest is the different level of judicial scrutiny associated with it.¹⁹⁶ The pill is a private law innovation and requires affirmative board action.¹⁹⁷ As such, it is subject to, and constrained by, the board's fiduciary duty to the corporation.¹⁹⁸ Although this fiduciary duty constraint has been dormant for many years, it appears to have gained new substantive bite over the past few years—witness, for example, the *Airgas* decision, where the Court took a hard look at whether continued use of a pill was "reasonable in relation to the threat posed."¹⁹⁹ Section 203 is a statutory law innovation and does not require affirmative board action.²⁰⁰ It would be 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.²⁰¹ Put differently, fiduciary duty trumps a board's use of a pill, but it is unlikely to trump a board's use of Section 203.²⁰² For this

¹⁹⁵See Subramanian, Herscovici & Barbeta, *supra* note 13, at 705.

¹⁹⁶See generally *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 91-103 (Del. Ch. 2011).

¹⁹⁷See *id.* at 95.

¹⁹⁸*Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354 (Del. 1985) (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55, 958 (Del. 1985)).

¹⁹⁹*Airgas*, 16 A.3d 48, at 92 (quoting *Unocal*, 493 A.2d 946, at 955).

²⁰⁰See DEL. CODE ANN. tit. 8, § 203 (2011).

²⁰¹See, e.g., *Nomad Acquisition Corp. v. Damon Corp.*, 1988 WL 383667, at *9 (Del. Ch. Sept. 16, 1988), *reprinted in* 14 DEL. J. CORP. L. 814, 829 (1989) (denying plaintiff's request for injunction compelling the defendant board to take action to exempt the plaintiff's tender offer from the provisions of Section 203).

²⁰²In a memorandum to clients, Eric Robinson and Ryan McLeod of Wachtell, Lipton, Rosen & Katz challenge this conclusion. See ROBINSON & MCLEOD, *supra* note 155, 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."). This is wrong. In the one case that is on point, the Delaware Court of Chancery put distance between a board's decision not to redeem a pill and a board's decision not to waive Section 203 when it summarily rejected the plaintiff's "novel request" for a Section 203 waiver, without referencing *Unocal*. See *Nomad*, 1988 WL 383667, at *9, *reprinted in* 14 DEL. J. CORP. L. at 829 ("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 [Section 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."); see also *TW Servs., Inc. v. SWT Acquisition Corp.*, 1989 WL 20290, at *11-*12 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1191-92 (1989) (applying *Unocal* to assess the target's rights plan but declining to apply *Unocal* to the target board's unwillingness to engage in a Section 251 merger with the bidder). Cf. Frank H. Easterbrook & Daniel R. Fischel, *Contract and*

reason as well, it seems possible that Section 203 could be left as the sole remaining impediment against a future bidder's offer.²⁰³

The standard hostile bid playbook has the bidder conditioning its tender offer on inapplicability of both the pill and Section 203.²⁰⁴ In order to satisfy these conditions, the bidder typically challenges both the continued use of the pill and the non-waiver of Section 203 as a breach of fiduciary duty.²⁰⁵ The implication of the doctrinal analysis above is that a fiduciary duty claim has greater traction against the pill than against Section 203.²⁰⁶ A bidder foreseeing all of this would be wise to bring a constitutional challenge against Section 203, in addition to its fiduciary duty claim against the pill. For skeptics, consider the converse question: why wouldn't a bidder challenge the constitutionality of Section 203 in the next hostile takeover contest in which Section 203 is an impediment? I have yet to get an answer—any answer—to this question from Delaware practitioners.

Sanofi's hostile bid for Genzyme in October 2010 provides a close approximation of what the right facts might look like.²⁰⁷ Genzyme was a Massachusetts company, and as such, was subject to Chapter 110F of the Massachusetts Corporate Code.²⁰⁸ Even more severe than Section 203, Chapter 110F provides that a bidder must go from less than 5% to more than 90% in a single tender offer in order to avoid a three-year moratorium on a business combination.²⁰⁹ Genzyme had the ability to stagger its board without shareholder approval²¹⁰ and could also put in a pill, but the presence of activist investors on its board made those defenses less available as a practical matter.²¹¹

Fiduciary Duty, 36 J.L. & ECON. 425, 427 (1993) (arguing that fiduciary duty plays a gap-filling role in cases of incomplete contracts); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1273 (1999).

²⁰³Subramanian, Herscovici & Barbeta, *supra* note 13, at 707-08.

²⁰⁴*See id.* at 709.

²⁰⁵*Id.* at 706-07.

²⁰⁶*See supra* note 202 and accompanying text.

²⁰⁷*See* Sanofi-Aventis, Offer to Purchase (EX-99(A)(1)(A)) (Oct. 4, 2010); *see also* Michael J. de la Merced & Thomas Kaplan, *Sanofi Bid for Genzyme Turns Hostile, and No Sweeter*, N.Y. TIMES (Oct. 4, 2010), http://www.nytimes.com/2010/10/05/business/global/05d_rug.html?_r=0 (explaining that Sanofi took its takeover bid hostile by going directly to Genzyme's shareholders).

²⁰⁸*See* Sanofi-Aventis, Offer to Purchase, *supra* note 207, at 1.

²⁰⁹MASS. GEN. LAWS ch. 110F, §§ 1-4 (2012).

²¹⁰*See id.* ch. 156B, § 50A.

²¹¹Robert Weisman, *Genzyme's Chief a Master of Survival: Termeer's Tactics Thwart Activist Icahn's Challenge*, BOS. GLOBE, June 15, 2010, at A1 (explaining that Genzyme's chief executive expanded the board and gave two seats to the activist shareholder's candidates); Ronald Barusch, *The Endgame Scenarios for Sanofi-Genzyme*, WALL ST. J. DEAL

The Massachusetts anti-takeover statute was therefore a critical defense. The problem, of course, is that even those who defend Section 203 would agree that the 5%-to-90% feature of Chapter 110F could not possibly provide Sanofi with a "meaningful opportunity for success."²¹² This raises the question as to why Sanofi did not challenge the constitutionality of Chapter 110F. I can confirm that this possibility was considered. Ultimately, the constitutional claim was not pursued for reasons unrelated to the substantive merits. But the calculus could easily tilt in the other direction next time.

C. *The Mechanics of the Constitutional Challenge*

Although the reasons to challenge the constitutionality of Section 203 are clearest when the bidder does not have a poison pill, the absence of a pill is not required in order for the constitutional challenge to come.²¹³ Witness Couche Tard's 2010 hostile bid for Casey's General Stores ("CGS"), described briefly above.²¹⁴ CGS did not have a pill at the time of Couche Tard's bid but put one in after-the-fact.²¹⁵ Citing our article, Couche Tard challenged the constitutionality of Iowa's antitakeover statute,²¹⁶ which is structured similarly to Section 203.²¹⁷ Couche Tard withdrew its offer after losing its proxy contest to replace all the CGS directors at the annual meeting,²¹⁸ and so the constitutional challenge went away.²¹⁹ The caselet nevertheless illustrates the point that

J. (Oct. 4, 2010, 2:40 PM), <http://blogs.wsj.com/deals/2010/10/04/the-endgame-scenarios-for-sanofi-genzyme/> (explaining that the options for the Genzyme board following Sanofi's takeover bid include: renewal of the poison pill; and a proxy fight).

²¹²See *supra* Part III.A.

²¹³See *infra* text accompanying notes 215-16.

²¹⁴See *supra* note 136 and accompanying text.

²¹⁵See *Casey's Adopts Poison Pill to Thwart Couche-Tard Takeover*, CONVENIENCE STORE NEWS (May 24, 2010), available at http://www.csnews.com/article-casey_s_adopts_poison_pill_to_thwart_couche_tard_takeover-391.html.

²¹⁶See Defendants' Amended Answer, Affirmative Defenses and Counterclaims for Declaratory and Injunctive Relief at 41, *Casey's Gen. Stores, Inc. v. Alimentation Couche-Tard Inc.*, 2010 WL 3604097 (S.D. Iowa Sept. 8, 2010), 2010 WL 5635293.

²¹⁷IOWA CODE § 490.1110 (2012) (requiring the bidder to go from less than 15% to more than 85% in order to avoid a three-year moratorium on back-end freeze-out).

²¹⁸See Scott Anderson, *Casey's Rejects Couche-Tard's \$1.85 Billion Bid*, REUTERS (Apr. 9, 2010, 3:16 PM), <http://www.reuters.com/article/2010/04/09/us-couchetardidUSTRE6382JA20100409>.

²¹⁹See Stipulation of Dismissal without Prejudice at 2, *Casey's Gen. Stores, Inc. v. Alimentation Couche-Tard Inc.*, 2010 WL 3604097 (S.D. Iowa Sept. 8, 2010), 2010 WL 5635187.

a bidder may have reason to bring a constitutional challenge even if the target has a pill.²²⁰

Alternatively, the constitutional challenge might come from a plaintiffs' lawyer.²²¹ This is possible, of course, if attorneys' fees could be obtained from a constitutional challenge to Section 203.²²² The Delaware Supreme Court has recently explained that attorneys' fees can be awarded if: "(1) the suit was meritorious when filed, (2) the defendants took an action that produced a corporate benefit before the plaintiffs obtained a judicial resolution, and (3) the suit and the corporate benefit were causally related."²²³ The Court continued that: "[W]hen a defendant took an action after the suit was filed that mooted a claim, there is a rebuttable presumption the suit and the benefit were causally related"²²⁴

Under this approach, attorneys' fees would seem likely where: (a) Section 203 was the remaining impediment to an unsolicited offer; (b) plaintiffs' attorneys brought suit challenging the constitutionality of Section 203; and (c) the target company agreed to a high-premium offer. In fact, the magnitude of the attorneys' fees may be substantial.²²⁵ Under the *Sugarland* factors—which includes the "results achieved" as one of five factors for the court to consider in determining the size of the attorneys' fees²²⁶—imagine, for example, the fees that might be available to a plaintiffs' lawyer for facilitating a \$5 billion takeover bid at a 30% premium.

There is precedent for such an approach. In March 2009, for example, Yahoo put in a so-called "tin parachute" plan, which provided for large payouts to all employees in the event of an unsolicited takeover.²²⁷ Plaintiffs' lawyers challenged the plan as an entrenchment

²²⁰See Defendants' Amended Answer, *supra* note 216, at *14-*19.

²²¹See *infra* notes 225-47 and accompanying text.

²²²See *EMAK Worldwide, Inc. v. Kurz*, 50 A.3d 429, 433 (Del. 2012).

²²³*Id.* at 432.

²²⁴*Id.* at 433.

²²⁵See, e.g., *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 142 (Del. 1980) (awarding \$3.5 million in attorneys' fees for stockholders' action to enjoin proposed sale of corporate property).

²²⁶*Id.* at 149. In addition to the "results achieved" factor, the elements of the Delaware standard to recover attorneys' fees include: "[T]he amount of time and effort applied to a case by counsel for plaintiff, the relative complexities of the litigation, the skills applied to their resolution by counsel, as well as any contingency factor and the standing and abilities of petitioning counsel" *Id.* (quoting *Chrysler Corp. v. Dann*, 223 A.2d 384 (Del. Super. Ct. 1966)).

²²⁷See *Yahoo's Tin Parachutes*, N.Y. TIMES DEALBOOK (June 3, 2008, 10:34 AM) http://dealbook.nytimes.com/2008/06/03/yahoos-tin-parachute/?_php=true&_type=blogs&_r=0 ("Yahoo [] adopt[ed] [] a change-in-control employee compensation plan [a/k/a tin

device and a breach of fiduciary duty,²²⁸ because the parachutes "would have made it approximately \$2.5 billion more expensive for Microsoft" to complete its then-pending unsolicited offer for the company.²²⁹ After Microsoft went away, Yahoo agreed to cancel its plan as part of a settlement with the plaintiffs' lawyers.²³⁰ The Delaware Court of Chancery awarded \$8.4 million in attorneys' fees, on the view that making Yahoo easier to acquire conferred a "substantial benefit" on the company.²³¹ This example illustrates how eliminating an antitakeover device can provide a corporate benefit that then permits attorneys' fees.²³²

One might nevertheless wonder: if these arguments are correct, why hasn't the challenge yet come? The answer is twofold. First, as alluded to in the Sanofi-Genzyme illustration above, the substantive merits of the claim are only one factor that business lawyers consider in determining whether to bring litigation. For example, buy-side legal advisors may decline to bring litigation against a hostile bid target in order to preserve the possibility of friendly dialogue between the two companies; and/or because bringing litigation allows the target to get discovery on the bidder, which may cause logistical and substantive headaches for the bidder. Plaintiffs' lawyers may also decline to bring a constitutional challenge to Section 203 because it would be an unusual claim to bring. One prominent plaintiffs' attorney confided to me that he declined to bring a constitutional challenge against the Massachusetts antitakeover statute at issue in the Sanofi-Genzyme situation because no one else was doing it.²³³ This argument, of course, has a certain self-enforcing quality.²³⁴

Second, and related, by its very nature Delaware corporate law moves slowly.²³⁵ For example, as described in Part II, the first

parachute plan] in response to the Microsoft bid.").

²²⁸See *id.*

²²⁹*Yahoo! Throws Away Parachute*, LAW SHUCKS (Mar. 9, 2009), <http://lawshucks.com/2009/03/yahoo-throws-away-parachute/>.

²³⁰See *id.*

²³¹See *In re Yahoo! Inc. S'holders Litig.*, 2009 WL 6598374, at *2 (Del. Ch. Mar. 6, 2008) ("[Then-Chancellor Chandler] conclude[d] that the settlement . . . amounted to a substantial benefit to Yahoo's shareholders because the key terms of the settlement made [Yahoo] . . . a more attractive target to potential suitors."). The fact that the case settled, and attorneys' fees were awarded, after Microsoft went away suggests the possibility of a facial challenge to Section 203, untethered to any existing takeover bid. See *id.*

²³²See *supra* notes 227-31 and accompanying text.

²³³See *supra* notes 227-31 and accompanying text.

²³⁴I can confirm that plaintiffs' firms have contemplated challenges to certain antitakeover statutes, including Delaware's; but for various reasons, including the fast-paced nature of most hostile takeover situations, these claims have not materialized.

²³⁵See, e.g., *supra* text accompanying note 42.

opportunity for the Delaware courts to address our ESB proposal came eight years after our initial *Stanford Law Review* article.²³⁶ Witness to the migration toward the "unified approach" in freezeout law: this idea has been in the case law at least since 2002,²³⁷ and proposed in academic commentary since 2003,²³⁸ but was only squarely adopted by the Delaware Court of Chancery for freeze-out tender offers in 2010 (*In re CNX Gas*²³⁹) and for freeze-out mergers in 2013 (*In re MFW Shareholders Litigation*²⁴⁰). The Delaware Supreme Court finally endorsed the unified approach in March 2014.²⁴¹

Maybe most relevant for current purposes, Delaware took five years to repeal its first-generation antitakeover statute.²⁴² In 1982, the U.S. Supreme Court's decision in *Edgar v. MITE*, which invalidated Illinois' antitakeover statute, made clear that Delaware's antitakeover statute (also codified at Section 203 of the DGCL) was unconstitutional.²⁴³ According to a report issued by the Delaware corporate bar to the Delaware General Assembly in 1988: "Since the decision in [*MITE*], it was generally accepted that Section 203 of our General Corporation Law was unconstitutional . . ." ²⁴⁴ Yet the clearly unconstitutional Section 203 was not repealed until July 1987, five years after the *MITE* decision.²⁴⁵ If the Delaware legislature were to similarly act on Section 203 today, it would actually be acting two years more quickly than it did the last time around.²⁴⁶

Courts, of course, move even more slowly than legislatures because they cannot "grab" issues in order to clean up doctrine. Like clams,²⁴⁷ Delaware judges must wait for the issues to come to them. And

²³⁶See *supra* Parts II.A-B.

²³⁷See, e.g., *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 444 n.43 (Del. Ch. 2002) (contemplating the benefits that would result from a "slight easing" of the current approach); see also *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 549 n.23 (Del. Ch. 2003).

²³⁸See Ronald J. Gilson & Jeffrey Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 824 (2003); see also Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 56 (2006).

²³⁹See *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d 397, 400 (Del. Ch. 2010).

²⁴⁰See *In re MFW S'holders Litig.*, 67 A.3d 496, 502 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M&F Worldwide Corp.*, 2014 WL 996270 (Del. Mar. 14, 2014).

²⁴¹See *id.*

²⁴²See Subramanian, Herscovici & Barbetta, *supra* note 13, at 693.

²⁴³See GOLDMAN & MCNALLY, *supra* note 95, at 66.

²⁴⁴*Id.*

²⁴⁵*Id.*

²⁴⁶See *id.* at 66.

²⁴⁷I use this analogy with no disrespect intended; in fact, it was offered to me by a sitting Delaware judge.

for reasons described previously, practitioners are motivated by strategic and tactical considerations that go well beyond the substantive merits of the claim in determining whether to bring litigation. All of this is to say a constitutional challenge will take time, but with the right set of facts it will come.

D. Delaware's Self-Help Remedy

Of course, 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.²⁴⁸ The first, and most obvious, amendment would lower the 85% threshold to something that provides a 'meaningful opportunity for success.'²⁴⁹ In our 2010 article, my co-authors and I concluded that a 70% threshold would satisfy this test, since 4-out-of-34 post-1989 bidders (12%) were able to achieve a 70% tender.²⁵⁰ This amendment—to a single number—would also represent good policy: facilitating high-premium offers that attract a supermajority of disinterested shareholders, but also providing companies with reasonable insulation against opportunistic low-ball offers.

As discussed in our 2010 article in the *Business Lawyer*, my co-authors and I stated:

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

²⁴⁸The Delaware General Assembly has the power to amend Section 203. See DEL. CONST. ART. II, § 1 ("The legislative power of this State shall be vested in a General Assembly, which shall consist of a Senate and House of Representatives.")

²⁴⁹Subramanian, Herscovici & Barbetta, *supra* note 13, at 730.

²⁵⁰This proposal is directionally consistent with the 75% threshold advocated by then-SEC Commissioner, now-Stanford Law School professor, Joseph Grundfest and others in the original hearings on Section 203. See DELAWARE HOUSE AND SENATE JUDICIARY COMMITTEE: HEARING ON SECTION 203 (Jan. 20, 1988) (statement of Joseph A. Grundfest, SEC Comm'r), reprinted in HAMERMESH & BALOTTI, *supra* note 95, at 144. A slightly lower threshold may be necessary today, compared to 1988, because our experience over the past 25 years has made clear that there is very little possibility of a coercive tender offer. While coercive tender offers are problematic for many reasons, see Guhan Subramanian, *A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill*, 23 DEL. J. CORP. L. 375, 378 (1998), it is this possibility that may have driven some shareholders in the 1980s to tender their shares.

purposes of the 85% calculation, 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' because 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 shares 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 shares held by all officers and directors.²⁵¹

Cleaning up the denominator would have the further benefit of avoiding an as-applied challenge to Section 203. As my co-authors and I further stated in our 2010 article: consider the example of David Duffield, founder and 7.6% owner of PeopleSoft.²⁵² 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.²⁵³) 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.²⁵⁴ As a result of just Duffield's shares, Oracle would have needed to get 92% 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,

²⁵¹For further detail on this point, see Subramanian, Herscovici & Barbetta, *supra* note 13, at 730 (footnote omitted); *see also* DEL. CODE ANN. tit. 8, § 203(a)(2)(i) (2011).

²⁵²*See* David Millstone & Guhan Subramanian, *Oracle v. Peoplesoft: A Case Study*, 12 HARV. NEG. L. REV. 1, 4, 8 (2007) (providing a brief history of *PeopleSoft*).

²⁵³*See id.* at 5.

²⁵⁴Quoting 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. . . ." *See id.* at 20-21. 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. I know it is little comfort, but I am extraordinarily proud of what we've accomplished. We have come so far under such trying circumstances over the past 18 months. . . . I offer my sincerest apologies for not figuring out a different conclusion to our 18-month saga." *See* Jessica Guynn, *PeopleSoft Workers Mourn Oracle Victory*, CONTRA COSTA TIMES (Walnut Creek, Cal.), Dec. 14, 2004.

Oracle would have needed 94.9% of the available shares in order to meet the 85% out—a virtually impossible hurdle.²⁵⁵ Section 203's unduly narrow exclusion made the hurdle higher than it was supposed to be [and, as such, the statute would have been vulnerable to an as-applied constitutional challenge]. In order to give bidders a cleaner, more realistic, and uniform target to shoot for, the denominator of the 85% calculation should exclude shares held by all directors [and officers].²⁵⁶

A final proposed amendment—which I assume would be friendly to even defenders of the existing Section 203—would be a clarification that the 85% hurdle, or proposed 70% hurdle, should apply to any subsequent offering period in a tender offer.²⁵⁷ This point was first made by Skadden, Arps partner, Eileen Nugent, in a thoughtful commentary to our original article.²⁵⁸ As Ms. Nugent points out: "This would give bidders an incentive to provide the subsequent offering period in hostile offers, and would allow straggler stockholders . . . one last chance to be paid in advance of the delayed back-end merger—and bidders would have a better chance of satisfying the 85% test."²⁵⁹ It is my impression that practitioners assume that the 85% out would be assessed as Ms. Nugent describes, if only because tender offers are regularly extended and it would make it even more difficult, if not completely impossible, to achieve 85% in an initial twenty-day offer period.²⁶⁰ However, the statute itself is not clear on this point, referring only to "the transaction."²⁶¹ A

²⁵⁵See Subramanian, Herscovici & Barbeta, *supra* note 13, at 749 (referencing a table that analyzes the actual hurdle needed to achieve the 85% out for various companies).

²⁵⁶*Id.* at 732-33. Section 203 excludes shares held by officer-directors from the denominator but not the numerator for purposes of the 85% calculation. See DEL. CODE ANN. tit. 8, § 203(a)(2) (2011). 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 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." *Id.* at 733 n.259.

²⁵⁷See Nugent, *supra* note 133, at 758-59 (responding to Subramanian, Herscovici & Barbeta, *supra* note 13).

²⁵⁸See *id.*

²⁵⁹*Id.* at 759.

²⁶⁰See 17 C.F.R. § 240.14e-1(d) (2013) (providing the rules that govern tender offer extensions which suggests that such extensions are a typical practice).

²⁶¹Section 203(a)(2) allows for an exemption from the three-year moratorium if: "Upon consummation of *the transaction* which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the

target might argue that "the transaction" refers to the initial tender offer, and not to a subsequent offering period, in order to create an even higher hurdle for a potential bidder.²⁶² Clarifying that "the transaction" applies to any subsequent offering period would eliminate this ambiguity.²⁶³

To summarize, I propose three amendments to Section 203: (1) changing the hurdle from 85% to 70% of outstanding shares; (2) cleaning up the denominator so that shares held by all officers and directors are excluded; and (3) clarifying that the hurdle needs to be met only after the close of any subsequent offering period(s). Of these three, the first proposed amendment is of course the most controversial. It is based on the overwhelming empirical evidence indicating that the 85% bar does not give bidders a "meaningful opportunity for success," as the federal district courts have held that the Williams Act requires.²⁶⁴ It is my opinion that these three amendments, if implemented, would give bidders a meaningful opportunity for success and, therefore, would eliminate the constitutional problem.

E. *Should Delaware Act?*

In my November 2013 Pileggi lecture presentation of this Article, which took place at the Hotel DuPont in Wilmington, Delaware, I closed by presenting three questions for discussion:

1. Is the constitutionality of Section 203 settled law?
2. If not, would a bidder be well-advised to challenge the constitutionality of Section 203 the next time it becomes a binding constraint in a takeover situation?
3. And if yes, what, if anything, should Delaware do to avoid this challenge?²⁶⁵

corporation outstanding at the time the transaction commenced . . ." DEL. CODE ANN. tit. 8, § 203(a)(2) (2011) (emphasis added).

²⁶²Cf. Nugent, *supra* note 133, at 758-59 (arguing that it would be easier for a bidder to overcome the 85% hurdle if "the transaction" encompassed the original tender offer as well as any subsequent offering period).

²⁶³*See id.*

²⁶⁴*See supra* Part III.A.

²⁶⁵*See* Guhan Subramanian, 29th Annual Francis G. Pileggi Distinguished Lecture in Law 18 (Sept. 7, 2013) (PowerPoint slides on file with the *Delaware Journal of Corporate Law*).

For reasons described in this Article, I believe that the answer to the first question is "no." Note that all it takes is some possibility of invalidation for the answer to be no because some possibility is all it takes for a bidder to challenge the statute. Many practitioners I have spoken to about this first question are eager to argue the merits of the constitutional claim—but the question is not whether Section 203 is constitutional; the question is whether the constitutionality of Section 203 is settled law. At the presentation of my Pileggi Lecture, I invited A. Gilchrist Sparks III to the podium to present a rebuttal to my Article. Sparks is a prominent and well-respected former-partner, now-Of Counsel, at Morris, Nichols, Arsht & Tunnell LLP in Wilmington, Delaware;²⁶⁶ was the Chair of the Corporate Law Council in 1988;²⁶⁷ and testified in favor of Section 203 before the Delaware Senate and House Judiciary Committees at the time.²⁶⁸ If there is a single person who can speak for Delaware on Section 203, it is Gil Sparks. I appreciate his thoughtful critique of my lecture.

Echoing his original critique of my *Business Lawyer* article,²⁶⁹ Sparks presented extensive data showing that hostile bids are sometimes completed as friendly deals.²⁷⁰ But this is irrelevant: even the most draconian antitakeover statute permits friendly deals, but can't possibly be constitutional for this reason. Consider a hypothetical state statute banning all hostile takeovers of companies incorporated in the state. Clearly this statute could not survive a Supremacy Clause challenge simply because it still permitted friendly deals. Consistent with this point, the three district courts focused explicitly on "hostile-to-the-end" offers for determining whether Section 203 provides bidders with a meaningful opportunity for success.²⁷¹ Indeed, because the "friendly deal

²⁶⁶See A. Gilchrist Sparks III, MORRIS, NICHOLS, ARSHT & TUNNEL LLP, <http://www.mnat.com/attorneys-62.html> (last visited Feb. 9, 2014).

²⁶⁷See *id.*

²⁶⁸See Subramanian, Herscovici & Barbeta, *supra* note 13, at 696-97.

²⁶⁹See Sparks & Bowers, *supra* note 155, at 764-66 (arguing that the evidence presented in Subramanian, Herscovici & Barbeta, *supra* note 13 under-represents the number of hostile bids that became friendly).

²⁷⁰See A. Gilchrist Sparks III, Delaware's Choice, Rebuttal at the 29th Annual Francis G. Pileggi Distinguished Lecture in Law (Sept. 7, 2013), <http://djcl.org/Pileggi.html> (stating he was Chair of the Counsel in 1988 and that his statistical study revealed that boards faced with a tender offer of more than 85% preferred to control the hostile takeovers process by seeking out a white knight or by using other defensive tactics).

²⁷¹See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 470 (D. Del. 1988) (footnote omitted) ("[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)); see also *RP Acquisition Corp. v. Staley Cont'l, Inc.*,

out" always provides an opportunity for success under Section 203(a)(1), it would be illogical to consider this route and then also investigate the viability of the 85% out.

Perhaps most importantly, even after factoring the friendly deal out in his analysis, Sparks concluded on the ultimate question: "I don't know if that's settled law or not, but it's pretty darn close to settled law."²⁷² Recall that all it takes is some possibility of invalidation for the answer to be no, because some possibility is all it takes for a bidder to challenge the statute. A careful listener to Sparks' rebuttal, then, would hear a no: the constitutionality of Section 203 is not settled law.

This then raises the second question: would a bidder be well-advised to challenge the constitutionality of Section 203 the next time it becomes a binding constraint in a takeover situation? For reasons described in this Article, I believe that the answer is "yes." Indeed, why wouldn't a bidder challenge the constitutionality of Section 203 in the next no-holds-barred, spare-no-expense hostile takeover contest in which Section 203 is an impediment? In my experience studying all hostile takeover bids since 1995 (n=252), and as an expert witness myself in several hostile takeover situations over the past fifteen years, a challenge to Section 203 would be far more plausible than many claims that are regularly brought in hostile takeover situations. In his rebuttal, Sparks did not answer this second question with respect to a bidder, but did acknowledge that "maybe some plaintiffs' lawyer does [bring a challenge]."²⁷³ Of course, for purposes of my analysis, it does not matter if the challenge comes from a bidder or from a plaintiffs' lawyer. Either way, the answer to this second question is yes.

This then raises the difficult question: what, if anything, should Delaware do to avoid this challenge? Specifically, should Delaware take a wait-and-see approach, or should Delaware get "out in front" of the issue by amending the statute to make it constitutionally secure? In the private sector, the answer to this kind of question would be self-evident. Should Apple take a wait-and-see approach with respect to the next generation smartphone, or should Apple try to get out in front of Samsung? The question answers itself. In the market for corporate law,

686 F. Supp. 476, 483 (D. Del. 1988) ("[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.'" (quoting *BNS*, 683 F. Supp. at 471)); *City Capital Assocs. v. Interco, Inc.*, 696 F. Supp. 1551, 1555 (D. Del. 1988) (stating a review of Section 203's "constitutionality might be warranted" if there is evidence to show that the statute prevents "a sufficient number of 'hostile to the end' tender offers").

²⁷²See Sparks, *supra* note 270.

²⁷³See *id.*

however, Delaware has no significant competitor at the state level;²⁷⁴ therefore, the question becomes more complicated.

As is well-known to insiders but surprising to everyone else, the Council of Corporation Law, a group of 27 well-respected attorneys mostly from prominent Wilmington firms, proposes all amendments to the DGCL.²⁷⁵ The Council writes the corporate law of Delaware and, by extension, the country. Approval by the Council is a necessary and sufficient condition for approval by the Delaware legislature. This is not meant to say that the legislature is derelict in its duty. The Delaware legislature knows that it wants the very best corporate law in the country; therefore, it defers to the experts on the Council for precisely how to achieve this.

With great power comes great responsibility, and the Council has historically been cautious in proposing amendments to the DGCL. One of the themes that I heard in meetings with Council members is their underlying philosophy of "if it ain't broke, don't fix it." Lawrence Hamermesh, a Council member and professor at Widener University School of Law in Wilmington, has similarly described the "pervasive belief that the system of corporate law supplied by Delaware has worked pretty well, and that change should not be made unless it is apparent that there will be a significant benefit from it without any countervailing disruption."²⁷⁶ Under this philosophy, Delaware should take a wait-and-see approach to Section 203.

However, the problem with a wait-and-see approach is twofold: (1) the challenge is inevitable; and (2) the downside of losing the statute is severe. On the first point, consider the football analogy that a prominent attorney offered me with respect to the ISB proposal discussed in Part II: "[t]hey're used to riding things out. But they're playing a prevent defense in a game without a clock. . . ."²⁷⁷ For the uninitiated, a prevent defense prevents a long gain (say, forty yards), but it will readily give up short gains of five–ten yards. It makes perfect sense when the other team is on its own twenty-yard line and there are forty-five seconds left on the clock. In a game without a clock, the strategy serves no purpose because the other team will eventually, and inevitably, score.

²⁷⁴See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 553-55 (2002).

²⁷⁵See *About the Section of Corporation Law*, DEL. STATE BAR ASS'N, <http://www.dsb.org/sections-committees/sections-of-the-bar/corporation-law/> (last visited Feb. 9, 2014).

²⁷⁶See Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1772 (2006).

²⁷⁷See *supra* text accompanying note 88.

With respect to Section 203, of course, there is no clock. Practitioners have used the generally sluggish M&A marketplace over the past few years²⁷⁸ as evidence against the possibility of a Section 203 challenge. But all it takes is one sufficiently motivated bidder, someday, to bring the constitutional challenge. Regarding Section 203, a wait-and-see approach is the legislative equivalent to playing a prevent defense in a game without a clock.

Those who nevertheless advocate a wait-and-see approach argue that the Council could simply put in a replacement antitakeover statute, presumably with a lower threshold, if it were to lose the inevitable constitutional challenge. One prominent Delaware attorney suggested to me that the Delaware legislature would defer to the Council on a replacement statute, as it does on all other corporate law amendments. But this argument is incorrect because a state antitakeover statute is a fundamentally different animal than other amendments to the DGCL. A proposed replacement to Section 203 would trigger a national debate played out on the Delaware stage.²⁷⁹ The lobbying would shift from Wilmington (where most Delaware corporate law practitioners are based) to Dover (where the Delaware legislature sits). The Council would have much less control over a public process that played out 50 miles to the south. As Gil Sparks himself put it in his response to my Pileggi Lecture, a proposed replacement statute would be a "big, big deal, with an uncertain result."²⁸⁰

In signing Section 203 into law in 1988, Governor Mike Castle stated: "The legislation I am signing . . . is the product of the most intense debate that I can remember in twenty years in government."²⁸¹ The debate today would be even more fierce. Imagine the lobbying of ISS and activist investors—constituencies that were virtually nonexistent in 1988—against such a proposed statute. ISS, in particular, would "go to the mat" to oppose a new antitakeover statute, after having spent most of the past ten years beating back the pill. The idea that the Council

²⁷⁸ See, e.g., Andrew Ross Sorkin, *Frenzy of Deals, Once Expected, Seems to Fizzle*, N.Y. TIMES DEALBOOK (October 28, 2013), <http://dealbook.nytimes.com/2013/10/28/frenzy-of-deals-once-expected-seems-to-fizzle>.

²⁷⁹ Cf. DAVID A. DREXLER ET AL., DELAWARE CORPORATION LAW AND PRACTICE § 23.01, at 23-24 ("[Describing] a fervid campaign, which included full-page ads, mass mailings, radio commercials, national and local, editorials pro and con, and two full days of public legislative hearings at which all aspects were thoroughly aired, the proposal was adopted virtually unanimously by the Delaware General Assembly . . .").

²⁸⁰ Sparks, *supra* note 270.

²⁸¹ HAMERMESH & BALOTTI, *supra* note 95, at 257.

could simply recommend a replacement statute, which would then be adopted by the Delaware legislature, ignores both the historical experience and the political realities of today.

In the post-pill era, the lack of a replacement statute would mean Delaware companies would be left virtually defenseless. Boards of Delaware companies would reasonably contemplate reincorporation back to headquarters states that may have constitutionally more secure statutes, such as control share acquisition statutes, which are available in 27 states.²⁸² While Delaware has held a dominant position in the corporate charter marketplace for decades, its position is not unassailable.²⁸³ One recent study shows that Delaware's share of corporate law decisions involving Delaware companies has fallen from 80% to 31% over the past fifteen years,²⁸⁴ and the number of Delaware corporations is 15% below its peak in 2000.²⁸⁵

In a private-company setting, these market share numbers would set off alarm bells, accompanied by demands for fundamental re-examination of the overall strategy. Some prominent Delaware practitioners have observed to me, by way of illustration, that Delaware took a wait-and-see approach on proxy access: only moving to permit opt-in access after it became clear that Congress was going to move on the issue. Had Delaware instead been proactive on proxy access, these practitioners argued, Congress and the SEC would have been less likely to act.

Of course, in the end the SEC's Rule 14a-11 was invalidated by the D.C. Circuit,²⁸⁶ so federal encroachment on a central corporate law issue was thwarted after-the-fact by the *Business Roundtable's* challenge (not by Delaware). But the case nevertheless illustrates the dangers of a wait-and-see approach. In general, Delaware can wait and see on issues where the only threat comes from other states (e.g., majority voting, expense reimbursement for proxy solicitation). But when the threat comes from a more powerful actor (e.g., Congress, a hostile bidder, plaintiffs' lawyer, etc.), Delaware should be proactive. Section 203 clearly falls into the latter category.

²⁸²*Id.* at 735-36.

²⁸³See John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L. REV. 1345, 1363 (2012).

²⁸⁴*Id.* at 1354-55.

²⁸⁵*A New Judicial Boss*, ECONOMIST, Nov. 23, 2013, at 66.

²⁸⁶*Bus. Roundtable v. SEC*, 647 F.3d 1144, 1156 (D.C. Cir. 2011).

In my meetings with Delaware practitioners around the time of my Pileggi Lecture, one legitimate concern I heard was the signal that would be conveyed to the marketplace by any amendment to Section 203. Would the Council be conceding that Section 203 is unconstitutional? Or, even worse, would the Council be putting a "For Sale" sign on the door of every Delaware company by dialing back the potency of its antitakeover statute? The answer is no, if the message is framed properly. The Council could avoid any negative signal to the marketplace by emphasizing the policy benefits rather than the legal arguments for amending the statute. For example:

We firmly believe that Section 203 survives constitutional scrutiny, but the experience from the past twenty years clearly indicates that an 85% out does not give bidders a realistic bar to shoot for, contrary to our expectations in 1988. Accordingly, we are lowering the bar to 70%, so that bidders for Delaware companies are encouraged to put full value on the table. The amendment therefore represents good policy: facilitating high-premium offers that attract a supermajority of disinterested shares, but also providing companies with insulation against opportunistic low-ball offers.

Delaware has a well-known interest in maximizing its share of the corporate charter marketplace.²⁸⁷ Delaware could meet this interest by proactively making the 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 offers as an important "disciplinary" mechanism that improves allocational efficiency in the marketplace.²⁸⁸ 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

²⁸⁷See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 594 (2003) (pointing out that its corporate franchise tax brings in between fifteen and twenty percent of the state's budget, far larger than in any other state); see also Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2502 (2005) (remarking that Delaware must conduct its lawmaking to balance the interests and not simultaneously offend investors and managers, those who together control reincorporation decisions).

²⁸⁸See WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION ch. 12 (4th ed. 2012).

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.

F. *Beyond Delaware*

If a federal district court were to strike down Section 203, it would have implications for the thirty-two other U.S. states that also have business combination (freeze-out) statutes, including large states such as Connecticut, Illinois, Michigan, New York, Ohio, Pennsylvania, and Virginia.²⁸⁹ Taken together, business combination statutes cover 92% of U.S. corporations by number and 94% by market capitalization.²⁹⁰ Reacting to a draft version of this Article, a prominent Delaware attorney argued to me that it is precisely because invalidation of Section 203 would have such far-reaching consequences that a federal judge would be unlikely to strike it down. I know of no such principle in U.S. constitutional law.

I take no position, in this Article or in my earlier work, on whether the invalidation of Section 203 would be desirable as a policy matter. Although a thorough policy analysis is beyond the scope of this Article, it is my preliminary opinion that a mild antitakeover statute—by which I mean a statute that allows targets to maintain control of the process but still gives bidders a "meaningful opportunity for success"—would be desirable as a policy matter, particularly in view of the decline of the pill. Invalidation of Section 203, in an era of weak pills, would leave the market for corporate control uncomfortably open. All the more reason for Delaware to act.

IV. CONCLUSION

Delaware regularly faces choices in the development of its corporate law. Ten years ago, Delaware faced a choice regarding effective staggered boards. Delaware's inability, or unwillingness, to provide a compelling answer to the ESB problem led to the proliferation of unitary boards as shareholder activists gained more power. In my opinion, the shift from three-year to one-year terms for corporate directors will increase the problem of short-termism in corporate

²⁸⁹Subramanian, Herscovici & Barbeta, *supra* note 13, at 688.

²⁹⁰COMPUSTAT DATABASE (downloaded July 16, 2009), *cited in* Subramanian, Herscovici & Barbeta, *supra* note 109, at 734.

boardrooms. A better answer was available in the form of an ineffective staggered board, which would have given directors a three-year horizon in the ordinary course of business but would have also preserved the right of shareholders to consider an unsolicited offer for the company in a single, up-or-down referendum.

Today, Delaware faces a choice regarding Section 203 of its corporate code. As the poison pill continues to recede, Section 203 will come to the forefront as a binding constraint in hostile takeover contests. Delaware could take a wait-and-see approach to Section 203; in fact, doing nothing would be the path of least resistance. As one commentator put it to me in the staggered board context, Delaware could try to "ride things out," "playing a prevent defense in a game without a clock." But a simple cost-benefit analysis suggests that Delaware should act. The benefit would be a constitutionally secure statute, with little risk to the Delaware corporate charter base. What company would reasonably reincorporate out of Delaware so that its board could continue to reject an offer that 70% of the disinterested shares wanted to accept? The cost of not acting is some chance that Section 203 will be invalidated by a future court. In that scenario, putting in a replacement antitakeover statute would be politically far more difficult than it was in 1987. Delaware companies would be left virtually defenseless, leading boards to contemplate reincorporation back to headquarters states that may have constitutionally more secure statutes. With such a potential downside one does not need to attach a high probability of success to the constitutional claim in order to conclude that Delaware should act. I humbly urge the Delaware bar and the Delaware legislature to do so.

I TOLD YOU SO

BY JOSEPH A. GRUNDFEST*

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I. INTRODUCTION

I am informed by my betters, of whom there are many, that it is unseemly to say "I told you so."

But, I told you so.

Back in 1988, a mere quarter of a century ago, when Delaware's legislature was debating the merits of Section 203, and while I had the privilege of serving as a Commissioner of the United States Securities and Exchange Commission, I wrote a series of three letters to the Corporate Law Section of the Delaware State Bar Association.¹ All three letters sought to make a single, simple point: Section 203's exemption threshold that was originally proposed be set at 90%, and that was later reduced to 85%, was far too high. Based on the empirical data available as of 1988, it was highly improbable that bidders would, in any material number of cases, be able to

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¹Letter from Joseph A. Grundfest, Commissioner, United States Securities and Exchange Commission, to David B. Brown, Esq., Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987) (on file with author) [hereinafter "December 10 Letter"]; Letter from Joseph A. Grundfest, Commissioner, United States Securities and Exchange Commission, to David B. Brown, Esq., Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 18, 1987) (on file with author) [hereinafter "December 18 Letter"]; Letter from Joseph A. Grundfest, Commissioner, United States Securities and Exchange Commission, to David B. Brown, Esq., Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 22, 1987) (on file with author) [hereinafter "December 22 Letter"].

achieve those thresholds. A more realistic, though still ambitious threshold might, I suggested, be set at 75%.

Professor Subramanian's important article² picks up the story from 1988 and makes the point that Section 203's exemptive threshold has indeed been set at a level that has made it impossible for any transaction to qualify. He ably documents that "between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203."³ He also documents that the empirical evidence on which courts have previously relied in judging the constitutionality of Section 203 is fatally flawed, and that when subject to careful examination actually underscores the historic impossibility of achieving Section 203's 85% exemption threshold. From these observations, Professor Subramanian argues that Section 203 could well be unconstitutional⁴ and suggests that to avoid such a finding, Delaware consider amending Section 203 to lower the exemptive threshold to 70%.⁵

In commenting on Professor Subramanian's insightful analysis, I will initially take a historical perspective and then follow that up with a *realpolitik* analysis of the policy implications that follow from the data. As readers will observe, my conclusion is that even if Professor Subramanian's empirical analysis is precisely correct, as I believe it is, the probability that Delaware will *sua sponte* amend Section 203 is quite low, and the probability that courts will rule Section 203 to be unconstitutional is subject to a set of legal judgments that are difficult to predict on the current record.

II. THE LOGIC OF AN ENABLING PROVISION

In 1988, my primary objection to Section 203 was not based on the empirical debate over the percentage of votes cast that should trigger Section 203's exemption. It was instead over the statute's mandatory nature. I observed that many of the concerns over Section 203's effects "would be ameliorated if the statute is recast as an enabling provision that allows stockholders, acting by majority vote, the opportunity to elect to be governed by the provisions of proposed Section 203."⁶

As I explained, "If managements desire protections equivalent to Section 203, but have not sought to adopt them through the charter amendment process because they expect that stockholders would reject such

²Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1 (2014).

³*Id.* at 22.

⁴*Id.* at 21-31.

⁵*Id.* at 45.

⁶December 10 Letter, *supra* note 1, at 2.

proposals, then legislation would impose upon stockholders a restriction that they would not voluntarily adopt. Such an approach is inconsistent with Delaware's traditional reliance on an enabling approach that looks to stockholder ratification as an important safeguard in the decision to delegate authority to management."⁷

The salience of this observation regarding the value of an enabling approach is underscored by Delaware's recent, and very different, approach to the proxy access debate. Section 112 of the Delaware General Corporation Law, adopted in 2009, states that "[t]he bylaws may provide that if the corporation solicits proxies with respect to an election of directors, it may be required . . . to include in its proxy solicitation materials . . . in addition to individuals nominated by the board of directors, 1 or more individuals nominated by a stockholder"⁸ subject to conditions defining the eligibility of the nominee and of the nominating stockholders. Note that the legislature neither mandated nor prohibited proxy access. Instead, it simply made clear that bylaws could include provisions allowing for proxy access. Further, because Delaware law provides authority for stockholders to propose and vote on bylaw provisions on their own initiative, without the requirement of prior board approval,⁹ a majority of a corporation's stockholders has the ability to act on its own to implement a proxy access regime even over the unanimous objection of the corporation's board.

Why such a difference in the approach that the Delaware legislature took to Section 203 and to Section 112? The answer lies neither in logic or principle. It lies in politics, and that fact should neither surprise nor disappoint anyone involved in the takeover debate.

Legislation is a political process, and each provision of the Delaware General Corporation Law can be viewed as the result of a decision that was politically optimal as of the time that it was made, and that remains politically optimal for as long as the provision is not repealed. If a large number of these political decisions happen to be consistent with an enabling philosophy of corporate law, we should not delude ourselves into believing that these provisions were adopted because they reflect an enabling philosophy of corporate law. That is not the direction of the causality. Instead, the *realpolitik* of the matter is that the enabling philosophy was the

⁷*Id.* at 6.

⁸DEL. CODE ANN. tit. 8, § 112 (2011).

⁹*Id.* § 109(a) ("After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.").

politically optimal approach for Delaware to adopt and maintain for a large portion of its corporation code, but not for all of the code.

Whenever it is politically optimal for Delaware to diverge from an enabling approach to corporate law, it will do so. Section 203 was an example of just such an instance. The political pressure of corporate managements at the time to respond to the threat of takeovers was sufficiently powerful that Section 203 could be proposed and adopted as a mandatory provision that could be imposed over the potential objection even of a large super-majority of the corporation's stockholder base. To be sure, Section 203 allows for corporations to amend their charters so as to opt out of its strictures,¹⁰ but the charter amendment process requires an affirmative vote of the corporation's board followed by a stockholder vote.¹¹ A management that wants to abandon Section 203's protections is thus perfectly free to do so, but no amount of stockholder support for opting out of Section 203 can force a management to opt out. Instead, stockholders would have to mount a proxy contest to change the board, or assert other forms of pressure through "just vote no" campaigns in order to persuade the board to decide to make such a change.¹²

To the best of my knowledge, stockholders have yet to mount campaigns designed to persuade boards to opt out of Section 203. This state of affairs is in stark contrast to the large-scale efforts to persuade boards to de-stagger¹³ and to abandon poison pills.¹⁴ It is entirely possible that, as the governance debate evolves, and as stockholders come to recognize that Section 203 can act as a binding constraint once a pill is no longer in place, an increased amount of activism will revolve around proposal to opt out of

¹⁰*Id.* § 203(b)(3).

¹¹*Id.* § 242(b)(1).

¹²Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 903-08 (1993).

¹³"Among the S&P 500, staggered board incidence has gone from 60% in 2002 to 18% by 2012." Subramanian, *supra* note 2, at 2.

¹⁴*Id.* at 5 ("88% of S&P 1500 companies do not currently have pills, and in recent years 59% of companies without pills have not put them in when a bid is brought."); *see also id.* at 31-38 (discussing the decline of the pill); Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics 2* (University of Penn., Institute for Law & Econ Research Paper No. 14-6, 2014) ("One of the most common shareholder proposals asks boards to redeem a poison pill or to submit it to a shareholder vote."); Mark D. Gerstein, Bradley C. Faris & Christopher R. Drewry, *The Resilient Rights Plan: Recent Poison Pill Developments and Trends*, at 3 (Apr. 2011), available at <http://webcache.googleusercontent.com/search?q=cache:guxcFIJ2ZrUJ:www.lw.com/thoughtLeadership/recent-poison-pill-developments-trends-april2011+&cd=1&hl=en&ct=clnk&gl=us&client=firefox-a> ("[A]n increase in the number, and success of, shareholder proposals to redeem rights plans . . .").

Section 203, or to adopt provisions that provide for lower exemption thresholds.

III. THE EMPIRICAL DEBATE AS OF 1988

Once it is clear that Section 203 is, at its root, a political response to a political demand, it becomes equally clear that an exception based on a threshold that could be reasonably obtained in a material number of takeover battles would not constitute a politically attractive alternative for the legislature precisely because it would leave a material number of managements vulnerable to hostile takeover attacks. Indeed, all other factors equal, the stronger the opposition to any given management team, the more likely it is that a reasonable exemption target could be reached. Accordingly, the strongest support for a high, and effectively unobtainable exemption trigger would rationally emanate from the managements most threatened by the prospect of a takeover, and they would rationally lobby for a mandatory version of Section 203 with an exception trigger set so high that it could never be invoked. And that is precisely what happened.

As I explained at the time, a "comprehensive examination by the SEC's Office of the Chief Economist of all hostile offers between 1982 and 1987 (144 offers) has found not a single case in which a hostile bidder received over 90% of the outstanding shares."¹⁵ This observation then stimulated a debate over the probability that hostile bids would, in the future, be able to reach the 90% threshold. In response to this debate I submitted further evidence documenting: (1) the distribution of blocking coalitions held by managements and boards at various threshold exemption levels; (2) the percentage of stockholders who tend to be non-responsive and who therefore effectively constitute a blocking coalition preventing a hostile bid from reaching the exemption's trigger level; and (3) management's ability to place shares in friendly hands so as to prevent a hostile bid from reaching the exemption's trigger level.¹⁶

¹⁵December 10 Letter, *supra* note 1, at 7-8.

¹⁶December 18 Letter, *supra* note 1, at 2-9. I also observed that "[t]here 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." Testimony of Joseph Grundfest, SEC Commissioner, before Delaware General Assembly House and Senate Judiciary Committees (Jan. 20-21, 1988), *reprinted in* LAWRENCE A. HAMERMESH & R. FRANKLIN BALOTTI, *THE NEW DELAWARE TAKEOVER STATUTE 144* (1988). I also offered to have the SEC collect additional relevant data within two months but in the rush to pass something this offer was never taken up by the Delaware legislature. *See* INVESTOR RESPONSIBILITY RESEARCH CENTER, *STATE TAKEOVER LAWS* (2003), at Delaware-6.

There was, in my view, substantial empirical evidence to support the prediction that Section 203's exemption triggers, initially proposed at 90% and enacted at 85%, would rarely if ever be reached. Professor Subramanian's article documents the accuracy of that prediction.

IV. THE EMPIRICAL DEBATE AS OF 2014

As Professor Subramanian ably demonstrates, "between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203."¹⁷ Not to dwell on the point, but at the same time that I reserve the right to whisper, "I told you so," I might also whisper "and what did you expect?" The fact that not a single bidder was able to achieve the 85% threshold over a span of two decades demonstrates that the legislation worked perfectly as planned, given the political forces that animated its adoption. Indeed, it demonstrates the political skill of the drafters in initially proposing a 90% threshold that, in a display of apparent (but not necessarily real) reasonableness, could be dropped to 85% without adversely affecting the legislation's deterrent effect one whit.

Indeed, as Professor Subramanian points out, the evidence that federal courts have relied upon to conclude that the 85% exemption provides bidders with a "meaningful opportunity for success" and therefore does not make Section 203 vulnerable to Constitutional challenge as inconsistent with the Williams Act "was seriously flawed—so flawed, in fact, that even this original evidence supports the opposite conclusion: that Section 203 did not give bidders a meaningful opportunity for success."¹⁸ The careful case-by-case examination conducted by Professor Subramanian demonstrates that, of the seventeen instances in which expert testimony asserted that bidders were able to achieve the 85% threshold, none actually fit the standard. In five cases the bidders held more than 15% of the outstanding equity at the time of the offer, which would have disqualified them from taking advantage of the 85% exemption; in two cases the bids were competing offers, again disqualifying them from the 85% exemption; four bids were friendly from initiation; three were approved by the target board before the bidder reached the 85% threshold; and in three instances the target boards were "formally neutral or passive on the offer, and so these bids were also not hostile in the traditional sense."¹⁹ Thus, the data presented to the court showed not a single instance in which a hostile bidder overcame the 85% threshold test.

¹⁷Subramanian, *supra* note 2, at 4.

¹⁸*Id.* at 29.

¹⁹*Id.* at 24 (quoting Guhan Subramanian, Steven Herscovici & Brian Barbeta, *Is*

V. WILL DELAWARE AMEND SECTION 203 AS A "SELF-HELP" REMEDY?

Professor Subramanian suggests that "instead of waiting for a constitutional challenge, Delaware could engage in self-help by amending Section 203 in ways that would put the statute on firmer constitutional footing."²⁰ To achieve this form of self-help, Professor Subramanian suggests that the 85% threshold be reduced to 70%, a level that, according to his data, would have allowed 12% of post 1989 bidders to avoid Section 203's strictures.²¹ Professor Subramanian also suggests refinements to the calculation of the denominator in the calculation,²² and clarifications as to the time period during which Section 203 might apply.²³

While, as a matter of public policy, I might be eager to support each of these proposals, the probability that Delaware will act of its own initiative to amend Section 203 in light of an amorphous threat of an uncertain judgment that Section 203 is unconstitutional is, as a practical matter, vanishingly small. Viewed most generously from Professor Subramanian's perspective, even if legislators agreed that there is a material risk that the provision is unconstitutional, they might argue that it makes no sense to try to guess how to amend the provision in order to render it constitutional. The prudent measure from this perspective would be to await a final judgment that would give the legislature clarity as to remedial measures required to save the provision from constitutional doom. More aggressively, it is easy to see the majority of the legislature arguing that, even if the facts presented by Professor Subramanian are correct, it is far from clear that Section 203 is unconstitutional. The proper step would be litigating the provision's validity and respond when, as, and if necessary to any court's final judgment.

In any event, there is no observable political pressure to amend Section 203. Isaac Newton's First Law of Motion, suggesting that a body at rest will stay at rest until an external force acts on it²⁴ is just as accurate in the political world as it is in the world of physics. There is simply no force at work strong enough to dislodge the current equilibrium before the Delaware legislature, and the threat of such a force is unlikely to be effective in this context. In Newtonian mechanics, it takes an actual external force,

Delaware's Antitakeover Statute Unconstitutional? Further Analysis and a Reply to Symposium Participants, 65 BUS. LAW. 799, 803-05 (2010)).

²⁰*Id.* at 42.

²¹*Id.*

²²*Id.* at 42-45.

²³*Id.* at 44-45.

²⁴SIR ISAAC NEWTON & JOHN MACHIN, *THE MATHEMATICAL PRINCIPLES OF NATURAL PHILOSOPHY* 19 (1729) ("Every body perseveres in its state of rest, or of uniform motion in a right line, unless it is compelled to change that state by forces impress'd thereon.").

like a judicial determination, to move the body from a state of rest, and a threat of an external force will not suffice. The same law holds true here, I would suggest. This then brings us to the ultimate question:

VI. IS SECTION 203 CONSTITUTIONAL?

As described by Professor Subramanian, Section 203 is constitutionally infirm because "under the Supremacy Clause, state laws cannot 'frustrate the purpose' of federal law; and the Williams Act passed by the U.S. Congress in 1968, provided disclosure and procedural requirements that were intended to 'place[] investors on an equal footing with the takeover bidder.'²⁵ A state antitakeover law that tilted the playing field too far toward target companies risked 'frustrating the purpose' of the Williams Act, thereby running afoul of the Supremacy Clause of the U.S. Constitution."²⁶ Section 203, with an exemption that has never been achieved in a quarter of a century, arguably tilts the balance too far and is thus vulnerable to Constitutional challenge.

The constitutionality of Section 203 was, however, last litigated in three cases decided in 1988.²⁷ Much water has flowed over the dam and under the bridge since those cases were decided. To be sure, Shapiro and Shapiro conclude that Section 203 "would be declared unconstitutional . . . if Professor Subramanian's factual findings were presented today."²⁸ But as they themselves recognize, this conclusion cannot rest on the firmest of foundations. To the extent that any such reasoning relies on the U.S. Supreme Court's decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), invalidating an Illinois takeover statute, Shapiro and Shapiro recognize that the court's decision there was "a plurality opinion based on federal preemption and a concurring opinion based on a medley of commerce clause rationales."²⁹ Moreover, to the extent that the Court's decision in *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987), upholding Indiana's "second generation" takeover statute, enters the analysis, Shapiro and Shapiro concede that CTS takes no position with regard to Edgar's preemption

²⁵Subramanian, *supra* note 2, at 21.

²⁶*Id.*

²⁷*See* BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988); RP Acquisition Corp. v. Staley Cont'l, Inc., 686 F. Supp. 476 (D. Del. 1988); City Capital Assocs. Ltd. P'ship v. Interco Inc., 696 F. Supp. 1551 (D. Del. 1988); *see also* Subramanian, *supra* note 2, at 22-23 (discussing cases).

²⁸Stephen M. Shapiro & Dorothy H. Shapiro, Commentary, *Time to Amend the Delaware Takeover Law*, 39 DEL. J. CORP. L. 77, 78 (2014).

²⁹*Id.*

analysis, and simply "distinguished *Edgar* and based the majority opinion on general commerce clause principles."³⁰

It is far from clear that either of these two cases would be identically decided if presented to the Supreme Court today. The composition of the Supreme Court has changed dramatically,³¹ as has its view of the relationship between the federal government and the states across a broad range of regulatory matters.³² The Court's views regarding pre-emption have also evolved,³³ as has the court's views regarding the Commerce Clause.³⁴ Thus,

³⁰*Id.*

³¹Today, the Supreme Court is composed of the following nine justices: Elena Kagan, Sonia Sotomayor, Samuel Alito, John Roberts, Stephen Breyer, Ruth Bader Ginsburg, Clarence Thomas, Anthony Kennedy, and Antonin Scalia. Only two of the current Supreme Court justices, Anthony Kennedy and Antonin Scalia, were also serving in 1988. The 1988 Court was otherwise composed of the following seven justices: Sandra Day O'Connor, William Rehnquist, Harry Blackmun, Thurgood Marshall, John Paul Stevens, Byron White, and William Brennan, Jr. See *Members of the Supreme Court of the United States*, SUPREMECOURT.GOV, <http://www.supremecourt.gov/about/members.aspx> (last visited March 10, 2014).

³²See Benjamin Beiter, *Beyond Medellín: Reconsidering Federalism Limits on the Treaty Power*, 85 NOTRE DAME L. REV. 1163, 1171 (2010) ("In the past two decades, the Supreme Court has shown a renewed interest in judicial enforcement of federalism limits, striking down laws for exceeding the enumerated powers of Congress for the first time since the New Deal. In *United States v. Lopez*, [514 U.S. 549 (1995)], the Court struck down the Gun-Free School Zones Act for not having sufficient relation to interstate commerce. Following the *Lopez* analysis, *United States v. Morrison* [529 U.S. 598 (2000)] invalidated provisions of the Violence Against Women Act, making clear that courts would defer less to legislative findings when the regulated activities were within the traditional police powers of the state."); Blake Hudson, *Climate Change, Forests, and Federalism: Seeing the Treaty for the Trees*, 82 U. COLO. L. REV. 363, 407-08 (2011) ("The new federalism that arose in the 1990s included a number of cases where the Supreme Court, for the first time since 1937, limited the scope of Congress's domestic powers and correlatively protected states' rights and the traditional subjects of state regulatory authority under the Tenth Amendment. The Supreme Court invoked federalism principles to strike down federal statutes in *New York v. United States*, [505 U.S. 144 (1992)], *United States v. Lopez*, [514 U.S. 549 (1995)], *City of Boerne v. Flores*, [521 U.S. 507 (1997)], *Printz v. United States*, [521 U.S. 898 (1997)] and *United States v. Morrison*, [529 U.S. 598 (2000)].").

³³See William W. Buzbee, *Does the Earth Belong to the Living? Property and Environmental Law Perspectives on the Rights of Future Generations*, 77 GEO. WASH. L. REV. 1521, 1572 (2009) (discussing "recent Supreme Court federalism precedents that erect presumptions against federal laws impinging on areas of traditional state regulation."); Christina Ma, *Hybridizing Federal and State Regulation of Clean Taxis Introduction*, 42 ENVTL. L. REP. NEWS & ANALYSIS 10840, 10840-41 (2012) ("[A] line of cases involved the Supreme Court's decisions in *Altria Group Inc. v. Good*, [129 S. Ct. 538 (2008)] and *Wyeth v. Levine*, [129 S. Ct. 1187 (2009)] which, when taken together, evidenced a shift in the Court's preemption doctrine analysis. Under this shifted preemption framework, the Court emphasizes the importance of congressional intent rather than agency interpretation, and of the need to invoke a presumption against preemption, particularly in areas of traditional state police power.").

³⁴See Oona A. Hathaway et. al, *The Treaty Power: Its History, Scope, And Limits*, 98 CORNELL L. REV. 239, 262 (2013) ("In the last twenty years, the Supreme Court has, for the first time since the New Deal, held that legislation exceeded the scope of the federal government's

even if one agrees whole-heartedly with Professor Subramanian's empirical analysis, it does not follow that courts sitting in judgment on the matter today would easily and inevitably conclude that Section 203 is unconstitutional because it does not allow bidders a "meaningful opportunity for success."

Indeed, Professor Subramanian recognizes that the question of Section 203's constitutionality is "not settled law."³⁵ There is a horse race to be run here, and as recent history suggests, it can be difficult to anticipate how the federal courts might decide these cases, if and when the question is presented.

VII. CONCLUSION

The facts are, in my view, quite clear, and Professor Subramanian's analysis marshals them with precision and vigor. Section 203 is a real impediment to takeover activity, and the binding force of that impediment can only become more apparent as the effectiveness of the poison pill declines. But this is, as I have suggested, precisely the outcome desired by the legislature. As to whether that impediment rises to the level of a constitutional infirmity, I express no view and recognize that learned counsel can, in good faith, express competing perspectives as to how that question might be resolved on the current record. As to whether Delaware will adopt a "self-help" strategy and amend Section 203 in order to address potential constitutional infirmities, I think the probability is low that any such action will be taken. The reality is that if Section 203 is to be amended, there will likely have to be litigation challenging the provision's constitutionality. Only if a court rules that the provision is in fact unconstitutional will Delaware's legislature have an incentive to amend Section 203 as best it can. The shape of any such amendment will, moreover, likely be contingent on the analysis

authority under the Commerce Clause"); James R. May, *Healthcare, Environmental Law, and the Supreme Court: An Analysis Under the Commerce, Necessary and Proper, and Tax and Spending Clauses*, 43 ENVTL. L. 233, 248 (2013) ("[T]he Court's evolving heightened-scrutiny Commerce Clause jurisprudence"); Lainie Rutkow & Jon S. Vernick, *The U.S. Constitution's Commerce Clause, the Supreme Court, and Public Health*, 126 PUB. HEALTH REP. 750, 751-52 (Sept.-Oct. 2011) (recognizing general trend of Supreme Court decisions limiting federal authority to regulate under the auspices of the Commerce Clause); see also *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2587 (2012) ("Construing the Commerce Clause to permit Congress to regulate individuals precisely because they are doing nothing would open a new and potentially vast domain to congressional authority. . . . Allowing Congress to justify federal regulation by pointing to the effect of inaction on commerce would bring countless decisions an individual could potentially make within the scope of federal regulation, and—under the Government's theory—empower Congress to make those decisions for him." (emphasis in original)).

³⁵Subramanian, *supra* note 2, at 47.

that leads to the finding of unconstitutionality. Further, because any such finding could well be far in the future, and because the political environment at that indeterminate future time is impossible to predict, any current legislature could easily conclude that the prudent step is simply to wait and see how this issue plays out in the courts.

So, now we wait to see how this issue plays out in the courts.

EVIDENCE-BASED CORPORATE LAW

BY VICE CHANCELLOR J. TRAVIS LASTER*

John Maynard Keynes is said to have observed, "When the facts change, I change my mind. What do you do, sir?" In *Delaware's Choice*, Professor Subramanian argues that the facts underlying the constitutionality of Section 203 have changed. Assuming his facts are correct, and the Professor says that no one has challenged his account to date, then they have implications for more than Section 203. They potentially extend to Delaware's jurisprudence regarding a board's ability to maintain a stockholder rights plan, which becomes a preclusive defense if a bidder cannot wage a proxy contest for control of the target board with a realistic possibility of success. Professor Subramanian's facts may call for rethinking not only the constitutionality of Section 203, but also the extent of a board's ability to maintain a rights plan.

The central fact supporting Professor Subramanian's article is the following: Between 1990 and 2010, not a single bidder in a hostile-to-the-end offer obtained tenders from 85% of the target corporation's shares.¹ This result stems from "some combination of 'dead' shares that never vote or tender (estimated to be 5–10% of the outstanding shares at most widely held companies) and rational shareholder apathy due to the general disappearance of structurally coercive offers."² Professor Subramanian uses this fact to challenge the findings made by three federal courts in 1988 to the effect that Section 203 gave bidders a "meaningful opportunity for success" and therefore was not pre-empted by the Williams Act.³

As Chief Justice Strine explained in an article written while he was serving as a Vice Chancellor, outcomes in corporate law cases frequently turn "on common law rules founded on empirical assumptions about human behavior."⁴ When deciding whether a particular defensive response is

*Vice Chancellor, Court of Chancery of the State of Delaware.

¹Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1, 22 (2014). As discussed in Professor Subramanian's article, the denominator for the percentage calculation excludes the shares of directors who are also officers of the target corporation. For brevity and simplicity, this comment dispenses with repeated references to the modified denominator.

²*Id.* at 27.

³*Id.* at 28-29.

⁴Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 502 (2002). The Chief Justice's article credits other scholars and several of his Court of Chancery colleagues with making this point, including then-Vice Chancellor, now Justice, Jack B. Jacobs and then-Chancellor William B. Chandler, III. *See id.*

preclusive, a judge relies on beliefs about "how the world works."⁵ Those beliefs "necessarily involve[] empirical assumptions."⁶ Chief Justice Strine argued that "[w]hile judges should not become easily enamored with academic fads, it is, on balance, well worth it for judges to seek out knowledge and test their instincts against the relevant social science literature."⁷

Professor Subramanian's article offers the type of information about "how the world works" that is essential to prudent lawmaking, whether of the legislative or judicial variety. He argues that his dataset warrants a legislative change in Section 203, but it also could affect how judges apply common law rules. For example, under the enhanced scrutiny test created in *Unocal Corp. v. Mesa Petroleum Co.*,⁸ as refined through subsequent Delaware Supreme Court decisions,⁹ a rights plan or a combination of defensive measures that includes a rights plan cannot make a bidder's ability to succeed in a proxy contest "realistically unattainable."¹⁰ If success in a proxy contest is realistically unattainable, then the defense becomes preclusive and can be enjoined in equity. The concept of success in a proxy contest being realistically attainable seems fairly congruent with the constitutional concept of a meaningful opportunity for success that Professor Subramanian addresses.

Whether a bidder has the ability to succeed in a proxy contest is a question of fact that turns on the evidence presented in a given case on issues such as the corporation's stockholder profile, voting behavior, the ability of the bidder to assemble a meaningful stake, and the combined effect of the target corporation's defensive measures.¹¹ If the combined effect of a rights

at 500 n.2, 503 nn.9-10.

⁵*Id.* at 513.

⁶*Id.*

⁷*Id.* at 515.

⁸493 A.2d 946, 955 (Del. 1985) (placing burden on directors to prove that defensive measure was "reasonable in relation to the threat posed").

⁹*See, e.g.,* *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1367 (Del. 1995) (holding that when applying enhanced scrutiny, the trial court should first determine whether defensive measures are "draconian, by being either preclusive or coercive," and, if not, then determine whether the defensive measures fall "within a range of reasonable responses").

¹⁰*Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010).

¹¹*See id.* at 605 (affirming the Court of Chancery's factual finding that a classified board plus a rights plan with a 5% threshold did not constitute a preclusive defense in light of factors that included the issuer's stockholder profile); *Unitrin*, 651 A.2d at 1382-83 (holding that combination of rights plan, supermajority voting requirement, and repurchase program did not render success in proxy context realistically unattainable in light of stockholder profile and other facts in case); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354-55 (Del. 1985) (affirming the Court of Chancery's factual finding that a classified board plus a rights plan with a 20% threshold did not constitute a preclusive defense); *Chesapeake Corp. v. Shore*, 771 A.2d 293, 340-41 (Del. Ch. 2000) (holding on facts of case that success in proxy contest was realistically unattainable).

plan and other defensive measures would force a bidder to obtain support from 85% or more of the outstanding shares, then Professor Subramanian's research strongly suggests that the defensive combination could be preclusive, absent case-specific facts supporting a contrary conclusion.

Doctors speak of practicing evidence-based medicine. Other clinical fields similarly speak of evidence-based practices. In my view, corporate law should do the same. Professor Subramanian's study provides the type of evidence that can be used by legislators to enact better laws. His data likewise can be used by judges to craft better decisions when evaluating the particular facts of a given case against a background of "how the world works."

A DELAWARE RESPONSE TO DELAWARE'S CHOICE

BY LAWRENCE A. HAMERMESH & NORMAN M. MONHAIT*

We very much appreciate Professor Guhan Subramanian's courtesy in inviting us to comment on *Delaware's Choice*.¹ We approach the topic as lawyers who have practiced and taught corporate law in Delaware for many years, both before and after the adoption of Section 203 of the Delaware General Corporation Law. With that background, we are called upon from time to time to evaluate and sometimes draft proposals to amend that body of statutory law, and our experience in doing so informs our reaction to *Delaware's Choice*. We emphasize preliminarily, however, that our comments here are not the product of deliberation by the Council of the Delaware State Bar Association Corporation Law Section (the "Council"), and they do not reflect the position of the Council or the Bar Association; they merely represent our initial reactions to Professor Subramanian's legislative proposal.²

Our comments fall into two very distinct categories. The first involves the general, philosophical approach of the Council, and the Delaware General Assembly, to amending the General Corporation Law. In a 2006 article describing that approach, one of us observed that major substantive amendments to that Law are rare, due to "a pervasive belief that the system of corporate law supplied by Delaware has worked pretty well, and that change should not be made unless it is apparent that there will be a significant benefit from it without any countervailing disruption."³ In that same article, it was observed that Section 203 itself was an outlier in this regard, emerging "as an aberrational response to an unusual confluence of

*Respectively, the Ruby R. Vale Professor of Corporate and Business Law at Widener University School of Law, and shareholder, Rosenthal, Monhait & Goddess, P.A., Wilmington, Delaware. Mr. Monhait is currently the Chair, and Prof. Hamermesh is a member (and former Chair), of the Council of the Corporation Law Section of the Delaware State Bar Association.

¹Professor Subramanian extended this invitation through the offices of the *Delaware Journal of Corporate Law*.

²We are not opining on whether a threshold other than 85% would be "better" for target shareholders, bidders, or target directors. As we understand the argument of *Delaware's Choice*, it is that the potential constitutional infirmity of Section 203 should motivate legislative reaction, and we are responding to that argument. Whether or not the 85% hurdle should be lowered as a matter of corporate law policy is a different question, and one we do not purport to address.

³Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1772 (2006). Professor Subramanian correctly anticipates our view of the importance of this perspective. See Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1, 48-49 (2014).

competitive pressures."⁴ Taken together, these two observations suggest to us that Section 203 is not a subject which the Council or the Delaware General Assembly is likely to wish to revisit, in the absence of persuasive indication that Delaware's primary corporate constituencies—stockholders and managers—will collectively benefit, through greater efficiency and predictability in corporate affairs, or by avoiding reasonably likely disruptions and inefficiencies.

With that perspective, we turn to our second, and more directly responsive, category of observations. We begin with what Professor Subramanian describes as "four basic facts" that, he says, have remained unchallenged:

(1) in the 1980s, federal courts established the principle that Section 203 must give bidders a "meaningful opportunity for success" in order to withstand scrutiny under the Supremacy Clause of the U.S. Constitution;⁵ (2) federal courts upheld Section 203 at that time, based on empirical evidence from 1985–1988 purporting to show that Section 203 did in fact give bidders a meaningful opportunity for success; (3) between 1990 and 2010, not a single bidder was able to achieve the 85% threshold required by Section 203, thereby calling into question whether in fact Section 203 has given bidders a "meaningful opportunity for success;" and (4) perhaps most damning, the original empirical evidence that the courts relied upon to conclude that Section 203 gave bidders a "meaningful opportunity for success" was seriously flawed—so flawed, in fact, that even this original evidence supports the opposite conclusion: that Section 203 did *not* give bidders a meaningful opportunity for success.⁶

Taken together, these assertions persuade Professor Subramanian that, as he most aggressively puts it, the constitutionality of Section 203 is "up for

⁴Hamermesh, *supra* note 3, at 1779.

⁵The precise language of Judge Schwartz's thoughtful opinion in *BNS Inc. v. Koppers Company, Inc.*, 683 F. Supp. 458, 469 (D. Del. 1988), is "The fair import of [three Supreme Court decisions] . . . is that even 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.*" (emphasis added). Presumably under this test, hostile offers that are *not* "beneficial to target shareholders" are not weighed in the constitutional balance.

⁶Subramanian, *supra* note 3, at 4.

grabs"⁷ or "in play."⁸ He is appropriately cautious here: he acknowledges that the constitutional test articulated in the 1988-vintage challenges to Section 203—the "meaningful opportunity for success" test—might no longer reflect how Section 203's constitutionality would be evaluated today.⁹

For that reason alone, the caution and conservatism traditionally embraced in matters of amending the Delaware General Corporation Law lead us to be skeptical of a need to amend Section 203 because of some looming constitutional problem with it.

More importantly, we are not convinced that Professor Subramanian's "four basic facts" are truly unchallenged, or at least that they cover the necessary territory. In particular, we have not seen a convincing response on his part to the observation by our colleague at the Delaware Bar, A. Gilchrist Sparks, III, about important data missing from Professor Subramanian's analysis. Specifically, in evaluating the existence of a "meaningful opportunity for success," we do not believe it is appropriate to exclude from the data set tender offers that begin as hostile but morph into friendly deals.¹⁰

If a target board of directors perceives that a bid is likely to garner tenders of over 85% of the shares, it is likely to become motivated to negotiate with the offeror; put another way, offers that would satisfy Section 203's 85% hurdle are reasonably likely to end with target cooperation, and there will be no opportunity to count how many shares would have been tendered had the process continued on a hostile basis. But the absence of that count doesn't mean that the offers never would have cleared the 85% hurdle, or that the statute eliminated a "meaningful opportunity for success." In short, as Sparks and Bowers pointed out, Professor Subramanian's data set can fairly be seen as inappropriately skewed.¹¹

⁷*Id.* at 25 (quoting Guhan Subramanian, Steven Herscovici & Brian Barbeta, *Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1998–2008*, 65 BUS. LAW. 685, 729 (2010)).

⁸*Id.* at 28.

⁹*Id.* He is less cautious, we believe, in stating that a constitutional challenge to Section 203 is "inevitable." *Id.* at 48. "Possible," yes, but certainly not "inevitable."

¹⁰A. Gilchrist Sparks, III & Helen Bowers, *After Twenty-Two Years, Section 203 of the Delaware General Corporation Law Continues to Give Hostile Bidders a Meaningful Opportunity for Success*, 65 BUS. LAW. 761, 764-67 (2010).

¹¹Professor Subramanian also notes former Chancellor Chandler's recognition of his prior critique of Section 203 in *Air Products and Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 120 n.474 (Del. Ch. 2011). See Subramanian, *supra* note 4, at 8-9. That recognition, however, was something less than a full embrace: finding that the absence of any instance in which a hostile bidder had achieved a 67% stockholder vote to remove directors "must mean something," Chancellor Chandler cautiously cited Professor Subramanian's critique for the limited assertion that it "at least in part, essentially corroborated" the belief that such a victory was not "realistically attainable." *Id.* After citing Professor Subramanian's work, however, the Chancellor carefully added: "*But see* [Sparks & Bowers, *supra* note 10]."

Professor Subramanian's response is that "data showing that hostile bids are sometimes completed as friendly deals" are "irrelevant," because only "hostile-to-the-end" offers are relevant in evaluating the existence of a "meaningful opportunity for success."¹² We do not find that response persuasive. The constitutional standard *Koppers* posits is whether "hostile offers which are beneficial to target shareholders have a meaningful opportunity for success."¹³ If it is not uncommon that a hostile offer looks as if it will elicit sufficient tenders to reach 85%, or come close to that, and the target's board of directors therefore resolves to negotiate a sale to the bidder, that phenomenon strikes us as meaningful evidence that Section 203 "does not prevent an appreciable number of hostile bidders from navigating the statutory exceptions."¹⁴

We note two other data points. First, we are unable to find any reported decisions in this century referencing a challenge to Section 203's constitutionality. While *Delaware's Choice* speculates on the reasons for the absence of litigation,¹⁵ it seems to us that if the statute were as great a barrier to hostile tender offers as Professor Subramanian perceives, someone in the last fourteen years would have advanced such a claim. Second, in our experience when corporate practitioners perceive DGCL provisions as creating impediments to goals their clients desire to achieve, they convey those concerns to Delaware lawyers they know. We can recall no instance in the last dozen or so years of any member of Council having conveyed a suggestion from a professional colleague that Section 203 bears reexamination because it unduly hampers beneficial hostile takeover bids. Again, if the statute were the practical problem Professor Subramanian perceives, we would expect to have heard such a concern.

Thus, we do not presently see that the available data compel a concern about potential constitutional infirmity of Section 203 sufficient to warrant recommending a legislative response. We conclude, however, with one somewhat different thought. Suppose all of Professor Subramanian's concerns ripen into the reality that Section 203 is challenged and found constitutionally defective, and that boards of directors therefore lack appropriate takeover defenses because the poison pill is no longer viable.¹⁶

¹²Subramanian, *supra* note 3, at 46-47.

¹³BNS Inc. v. Koppers Co., 683 F. Supp. 458, 469 (D. Del. 1988). In another passage, *Koppers* says that Section 203 "will be constitutional . . . so long as it does not prevent an appreciable number of hostile bidders from navigating the statutory exceptions." *Id.* at 469-70.

¹⁴*Id.* at 470.

¹⁵See Subramanian, *supra* note 3, at 40-41.

¹⁶Without going into great detail, this last element seems most implausible to us: as much as public companies have done away with "standing" poison pills, there is virtually no evidence of

Assume further that reducing the statutory tender threshold to 70% would avoid the presumed constitutional infirmity. Would it be too late at that point (or at some point in the litigation process) for the General Assembly to step in and enact the amendment for which Professor Subramanian advocates? Certainly quick action is not beyond that legislature's powers; when the need has arisen, as with the original adoption of Section 203, the General Assembly has shown itself amply capable of very prompt action.¹⁷ Revisiting Section 203 is not, as previously noted, something that the Council or the General Assembly would engage in eagerly; but we are confident that, if necessary, revisions to Section 203 could and would be addressed promptly, despite what Professor Subramanian reasonably anticipates would be a replay of much of the contentiousness associated with Section 203's original enactment.¹⁸

The Council and the General Assembly have often subscribed to what Professor Subramanian fairly describes as "a wait-and-see approach,"¹⁹ proposing and enacting, respectively, amendments to the DGCL only when there are persuasive reasons to do so. Subsequent developments may well prove us wrong in the reasoning and predilections noted above, but in our experience reticence to initiate legislative action has rarely harmed Delaware's status as the leading state of business organization in the country.²⁰ From where we stand now, we would not advocate the initiative urged in *Delaware's Choice*.

which we are aware that many public companies have lost the ability to adopt a poison pill at the slightest whiff of a hostile bid. Adopting a time-limited (one year duration) poison pill is, in our primitive judgment, unlikely to be something that boards of directors will be too scared to do in the face of a hostile bid.

¹⁷See Hamermesh, *supra* note 3, at 1781 (describing the rapid adoption in 2003 of amendments to Section 103 of the Delaware General Corporation Law).

¹⁸Subramanian, *supra* note 3, at 46-50.

¹⁹*Id.* at 47.

²⁰We take strong issue with the suggestion, in fact, that "[h]ad Delaware instead been proactive on proxy access, these practitioners argued, Congress and the SEC would have been less likely to act." *Id.* at 50. Our disagreement involves a story far longer than one footnote would support, but we can say with great confidence that most members of the Council believe that the timing and content of Delaware's actions in relation to proxy access—a field in which the SEC now has only a secondary role, and private ordering under state law predominates—were entirely felicitous. In any event, it can scarcely be argued that Delaware has been harmed, on that front.

TIME TO AMEND THE DELAWARE TAKEOVER LAW

BY STEPHEN M. SHAPIRO & DOROTHY H. SHAPIRO*

As Professor Subramanian demonstrates with cogent statistical evidence, now is the time for the courts to put Section 203 in the dock and examine its constitutional merits. Better still, the Delaware legislature should clean house and amend this provision's criteria. In practical effect, it forbids a competitive tender offer, injuring shareholders who benefit from tender offer premiums, and the national economy, which benefits from the gravitation of industrial resources to their highest-valued uses.

Following the U.S. Supreme Court's decision in *Edgar v. MITE Corp.*,¹ which invalidated an Illinois takeover statute, the federal district court in Delaware routinely enjoined application of the 1977 version of the Delaware takeover law at the commencement of tender offers. But uncertainty followed the Supreme Court's decision in *CTS Corp. v. Dynamics Corp.*,² sustaining Indiana's so-called "second generation" tender offer statute. As Harvey Pitt once said, students of the Supreme Court tend to hear the "mood music" of opinions, sometimes glossing over specific rulings; the mood music in *Edgar* was martial, while the music in *CTS* was soothing. Some surmised that second- and third-generation takeover laws were invulnerable provided the legislature tinkered with their mechanism after *Edgar*.

Looking more carefully at this issue, Delaware district court judges have disabused lawyers of that misunderstanding. The *BNS*, *Staley*, and *City Capital* cases cited by Professor Subramanian make clear that Section 203 would violate the federal constitution if it foreclosed a "meaningful opportunity" for bidders to make a successful tender offer by promising a generous premium to investors.³ Now, it appears, under Delaware corporate law there is not only no "meaningful opportunity for success"—there is no opportunity at all. Can anyone refute the statistical facts Professor

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¹457 U.S. 624 (1982).

²481 U.S. 69 (1987).

³Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1, 22-26 (2014).

Subramanian sets forth? The silence is deafening. The situation described in *BNS* in fact has come to pass: "an appreciable number of hostile bidders" have not "navigat[ed] the statutory exceptions." That means "reconsideration of the statute's congruence with the Williams Act will be warranted."⁴

Professor Subramanian asks: "If these arguments are correct, why hasn't the challenge come?" In the midst of any major corporate acquisition, a hundred people run in a hundred directions. They have little time to ponder the meaning of *Edgar* and *CTS*, much less contemplate lengthy litigation in the district court, the court of appeals, or the Supreme Court. Ordinarily, the deal rises or falls long before litigation finishes its course. For its part, the SEC has little opportunity to formulate a position as amicus curiae. The Supreme Court did not help matters in *Edgar* by issuing a plurality opinion based on federal preemption and a concurring opinion based on a medley of commerce clause rationales. For its part, the *CTS* opinion did not agree or disagree with the preemption analysis of Chief Justice Burger and Justices Blackmun and White in *Edgar*. It simply distinguished *Edgar* and based the majority opinion on general commerce clause principles. After *CTS*, eight new Justices have joined the Supreme Court. The time is ripe for clarification.

What would federal courts think of the Delaware statute if Professor Subramanian's factual findings were presented today? In our view, the statute would be declared unconstitutional. Both *Edgar* and *CTS* concur on the governing principles. As Judge Schwartz stated in the *BNS* case: "preemption scrutiny of the Delaware Act must begin with the proposition that the power of the states to regulate tender offers does not extend to complete eradication of hostile offers."⁵

The constitutional problem with the Illinois takeover statute was threefold: the statute discouraged tender offers by requiring a twenty-day precommencement waiting period (which invited managerial maneuvers to stymie offers), by requiring a hearing with no time limit before the offer could commence, and by requiring the secretary of state to decide whether the offer was "equitable." Shareholders could not decide for themselves. This frustrated a core purpose of the federal Williams Act. As Justice White explained: "Congress intended for investors to be free to make their own decisions."⁶ The Illinois law was unconstitutional because, under its

⁴*BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 470-72 (D. Del. 1988).

⁵*Id.* at 468.

⁶*Edgar v. MITE Corp.*, 457 U.S. 624, 639 (1982).

inhibiting provisions, "[s]hareholders are deprived of the opportunity to sell their shares at a premium."⁷

CTS upheld the Indiana takeover statute not because the Court disagreed with the legal principles laid down in *Edgar*, but rather, as Justice Powell said, because "[t]he Indiana Act differs in major respects from the Illinois statute"⁸ As for the preemption analysis in *Edgar*, Justice Powell stressed that "[w]e need not question that reasoning."⁹ The Indiana statute avoided invalidation because, unlike the Illinois law, it allowed investors "to make their own decisions."¹⁰ The decision to accept or reject the tender offer was not made by a government official or by corporate directors, but rather by the shareholders themselves rendering a collective judgment with an ordinary majority vote. Through this collective voting process, the Indiana statute protected shareholders from coercion—a stampede triggered by the bidder in a two-step acquisition culminating in a freeze-out merger. The law thus allowed "shareholders to vote as a group" and "protects them from the coercive aspects of some tender offers."¹¹ The Indiana statute also operated within the time frames of federal law and did not discourage offers because the bidder could "make a conditional tender offer, offering to accept shares on the condition that the shares receive voting rights within a certain period of time. The Williams Act permits tender offers to be condition[al]"¹² In short, the "Indiana Act avoids the problems the plurality discussed in *MITE*"¹³ It "allows shareholders to evaluate the fairness of the offer collectively."¹⁴

The Indiana Takeover Act ultimately passed muster because, the Supreme Court concluded, the bidder's "contention that the Act will limit the number of successful tender offers" was *factually unsupported*: "There is little evidence that this will occur."¹⁵ As three dissenting Justices explained in *CTS*, evidence of that sort should be dispositive. Such a limiting effect would "substantially interfere[] with this interstate market" and "conflict[] with the Commerce Clause" while subverting the goals of the Williams Act.¹⁶

⁷*Id.* at 643.

⁸*CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 80 (1987).

⁹*Id.* at 81.

¹⁰*Id.*

¹¹*Id.* at 83.

¹²*CTS*, 481 U.S. at 84.

¹³*Id.* at 83.

¹⁴*Id.* at 84.

¹⁵*Id.* at 93.

¹⁶*CTS*, 481 U.S. at 101.

How does Section 203 square with these Supreme Court precedents? Alas, it conflicts with the rationale of both of them. Shareholders do not get to decide whether to accept lucrative tender offer premiums. For the last quarter century, that option has been taken away from them by the Delaware legislature. This constitutional infirmity deeply concerns securities law scholars.¹⁷ It is true that *Amanda Acquisition Corp. v. Universal Foods Corp.*,¹⁸ upheld a Wisconsin takeover statute also imposing a three-year moratorium. But the court there did not have before it the factual information now proffered by Professor Subramanian. Nor did it apply the preemption test recognized in the Delaware district court opinions cited by Professor Subramanian—the court that will actually decide this issue. The Seventh Circuit believed that the legislature could "block beneficial transactions" so long as it did not "tinker[] with any of the procedures established in federal law."¹⁹ That narrow view of conflict preemption, however, is out of line with the views advocated by the Department of Justice and the SEC in *Edgar*, which stressed that the states may not "tip the balance of advantage in favor of the subject company's incumbent management" or undermine "Congress' adoption of a 'free market' approach

¹⁷See, e.g., 1 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, FUNDAMENTALS OF SECURITIES REGULATION 880-81 (6th ed. 2011):

[T]he New York and Delaware statutes vest existing managers with the power to block tender offers, and thus appear to be inconsistent with the Williams Act purpose of ensuring investor choice with respect to accepting or rejecting a tender offer and the more general policy "to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids." While the 50-day delay in the Indiana statute is within the 60-day congressional limit, a moratorium of three or five years obviously exceeds it. The purpose of corporate voting or staggered board terms can be stated in terms unrelated to tender offers, the purpose (or inevitable effect) of a successful moratorium statute, however, is to deter tender offers. . . . These acts seriously tilt in favor of incumbent management and jeopardize what SEC Chairman Ruder termed "the free transferability of securities." . . . Given the magnitude of target shareholder premiums that state moratorium statutes may block, and the likelihood that this money would be recirculated back into the economy, there is a real possibility that the more significant state laws do more harm than good. At the very least the moratorium statutes may significantly tilt the balance in favor of target management. At a certain point the price of federalism comes too high.

As Professors Loss, Seligman and Paredes put it in the bible of federal securities law, lengthy moratorium periods are "clearly intended to frustrate hostile takeovers." 5 LOUIS LOSS, JOEL SELIGMAN & TROY PARADES, SECURITIES REGULATION 195 (4th ed. 2010); see also 3 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 420-31 (6th ed. 2009) (discussing state tender offer statutes, the Commerce Clause, the preemption problem and United States Supreme Court case law addressing those issues).

¹⁸877 F.2d 496 (7th Cir. 1989).

¹⁹*Amanda Acquisition Corp.*, 877 F.2d at 504.

to tender offer regulation."²⁰ "Achievement of the goals of a federal statute often depends on adherence to deliberately selected limitations on the scope of regulation. . . . In such cases, preservation of the line between what the law regulates and what it leaves alone may be essential to the success of the statutory strategy."²¹

It would be perverse for defenders of the Delaware statute to invoke the opinion of Judge Easterbrook. He made clear that "[i]f our views of the wisdom of state law mattered, Wisconsin's takeover statute would not survive. . . . [W]e believe that antitakeover legislation injures shareholders."²²

That is a timely message for the Delaware legislature. Judge Easterbrook's narrow conception of federal preemption, focusing on procedural inconsistency with federal rules, also does not accord with broader "conflict preemption" principles advocated by the SEC and endorsed in numerous Supreme Court opinions.²³ In Judge Easterbrook's view "[i]nvestors have no right to receive tender offers."²⁴ But once a corporation issues shares and creates a free interstate market in securities, management cannot switch on and off a three-year moratorium period to stymie a disfavored tender offer. That would be contrary to the "overriding concern" of Congress in the Williams Act, which was to avoid tipping the balance of advantage "to favor management against offerors, to the detriment of shareholders."²⁵

Applying the conflict preemption standard laid down by the Supreme Court in both *Edgar* and *CTS*, the First Circuit granted injunctive relief against a Massachusetts takeover statute in *Hyde Park Partners v. Connolly*,²⁶ issuing a panel opinion joined by now-Justice Breyer and Judges Coffin and Bownes. The statute there at issue imposed a far less significant deterrent than the Delaware law. It merely imposed a five-day precommencement notice requirement on the bidder. If the bidder failed to make that simple disclosure, it was forbidden to consummate the merger for one year. But like the Delaware law, which imposes an 85% acceptance requirement and a three-year moratorium, this burden could be switched on

²⁰Brief for the Securities and Exchange Commission as Amicus Curiae at 7, *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), 1981 WL 389721, at *4.

²¹*Id.* at 8, *Edgar*, 457 U.S. 624, 1981 WL 389721, at *7.

²²*Amanda Acquisition Corp.*, 877 F.2d at 500.

²³*See, e.g., Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) (explaining preemption arises to the extent that "state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 (1941))).

²⁴*Amanda Acquisition Corp.*, 877 F.2d at 504.

²⁵*CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 81-82 (1987) (citing legislative history).

²⁶839 F.2d 837 (1st Cir. 1988).

and off by the target company's management. This, the First Circuit explained, violates a fundamental purpose of the Williams Act because it tips the balance of advantage between bidder and target and thereby discourages hostile tender offers to the detriment of shareholders. The First Circuit found that the statute operated to the detriment of shareholders—contrary to the preemption standards laid down in both *Edgar* and *CTS*—given the "deterrent to tender offers caused by the disclosure" ²⁷ The precommencement notice "likely will discourage takeover attempts to a much greater extent than that envisioned by Congress." ²⁸ And "[b]y giving management the option of effectively waiving the disclosure and penalty provisions . . . the Massachusetts Act lets management decide for investors instead of letting investors decide for themselves." ²⁹ The same is true of the more draconian 85% requirement and three-year moratorium prescribed in the Delaware law.

What is to be done? First, sound the tocsin as this article does. Second, bidders and their counsel should consult with policy makers, economists, and regulators of tender offers at the SEC. At least on regulatory issues (as opposed to liability issues), the lower federal courts and the Supreme Court still defer heavily to the SEC. The plurality opinion followed the SEC's recommendations on preemption in *Edgar*, and in *CTS* the SEC again argued in favor of invalidation of the state takeover statute. The federal government's concern about investor harm resulting from such laws has been consistently expressed by the SEC, Federal Trade Commission, and Department of Justice. Although it is true that the Roberts Court shows more deference to state law than the Burger Court, the Justices can be expected to adhere to prior precedent of the Court itself, reaffirming the investor autonomy principles laid down in both *Edgar* and *CTS*. Bidders testing the statute in the federal district court in Delaware can quote prior district court opinions noted above, and show that the facts now demonstrate that bidders have "no meaningful opportunity" to offer premiums to investors given the straitjacket of Section 203. A successful challenger on both commerce clause and preemption grounds could earn a substantial fee. ³⁰

In addition to providing amicus support, the SEC could also issue a new regulation with preemptive force. ³¹ It should consider doing so because,

²⁷*Id.* at 850.

²⁸*Id.* at 852 (evaluating legislative history discussed in *Edgar* and *CTS*).

²⁹*Id.* at 852-53.

³⁰*See Dennis v. Higgins*, 498 U.S. 439 (1991); *Maher v. Gagne*, 448 U.S. 122, 132 n.15 (1980) (recognizing that fees should be awarded because the plaintiffs advanced some claims under the Commerce Clause).

³¹*See Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) ("Federal

as former SEC Chief Economist Gregg Jarrell has said, Professor Subramanian has "proven statistically what practitioners already know: Section 203 killed the hostile tender offer. . . . In short, eliminating Section 203 would bring back the hostile tender offer as the most important feature of the market for corporate control."³² That is a national market, not a state market, and its healthy performance has profound importance for the sluggish national economy. No individual state should attempt to freeze the national market in corporate control.

Should the Delaware legislature await this development on the theory that sleeping dogs are best left undisturbed? The answer, we believe, is no. It was an embarrassment in the 1980s to see Delaware takeover law enjoined in case after case. The unfortunate impression this created was that Delaware corporate legislation was out of step with modern constitutional law, if not part of a "race to the bottom." Many years passed between the decision in *Edgar* and the enactment of a new version of the statute that has continued to impose an unconstitutional burden on nationwide tender offers.

Revising the statute to prescribe a lower standard of shareholder approval—the Indiana statute upheld in *CTS* required only a "majority vote" of shareholders—would satisfy the constitution while leaving management reasonable latitude to oppose misguided or inadequate offers and negotiate better deals from "white knights." The legislature would win applause by increasing shareholder wealth, contributing to economic progress, and leaving directors room to protect their companies through debate on the merits of acquisition proposals and exercise of sound negotiation skills.

regulations have no less pre-emptive effect than federal statutes.").

³²Gregg A. Jarrell, *A Trip Down Memory Lane: Reflections on Section 203 and Subramanian, Herscovici, and Barbeta*, 65 *BUS. LAW.* 779, 779, 787 (2010).

DELAWARE'S CHOICE: A BRIEF REPLY TO COMMENTATORS

BY GUHAN SUBRAMANIAN

I am grateful to the six commentators on my *Delaware's Choice* article—they bring a range of perspectives and backgrounds to the question of Section 203's constitutionality, and what if anything should be done about it. Stephen Shapiro, who writes with his co-author Dorothy Shapiro, served as Deputy Solicitor General in the Reagan Administration, argued *Edgar v. MITE* before the U.S. Supreme Court, and now runs one of the most prominent appellate litigation practices in the country. If there is anyone who understands the substantive constitutional law issue regarding Section 203, it is he. Joe Grundfest was a Commissioner at the SEC in the 1980s, was heavily involved in the debates leading to the enactment of Section 203, and has been a longtime professor at Stanford Law School. He brings an invaluable combination of historical perspective, academic analysis, and practicality to the table. Vice Chancellor J. Travis Laster sits on the Delaware Court of Chancery, which plays referee to many of the takeover contests in which Section 203 is a relevant factor. His perspective from the bench is a welcome addition to the mix. Professor Larry Hamermesh of Widener University School of Law and Norm Monhait of Rosenthal, Monhait & Goddess, P.A. are (respectively) the past and current chairs of the Council of the Corporation Law Section of the Delaware bar. They are the choosers, and thus the intended audience for the amendments proposed in *Delaware's Choice*. I am grateful to all of these commentators for their thoughtful insights.

Shapiro & Shapiro fill an important gap in my writing on Section 203 by examining the substantive constitutional law claim. Here they offer a simple conclusion: "What would federal courts think of the Delaware statute if Professor Subramanian's factual findings were presented today? In our view, the statute would be declared unconstitutional."¹ In addition to providing a detailed description of the background constitutional law that leads them to their conclusion, Shapiro & Shapiro cite Loss, Seligman & Paredes on securities law, who declare that Section 203 "appear[s] to be inconsistent with the Williams Act purpose of ensuring investor choice," and Hazen's criticism of the "highly questionable freeze-out statutes."² These

¹Stephen M. Shapiro & Dorothy H. Shapiro, Commentary, *Time to Amend The Delaware Takeover Law*, 39 DEL. J. CORP. L. 77, 78 (2014).

²*Id.* (citing 3 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 420-31 (6th ed. 2009); 5 LOUIS LOSS, JOEL SELIGMAN & TROY PARADES, SECURITIES REGULATION 195 (4th ed.

definitive securities law treatises indicate that Shapiro & Shapiro have good company in their assessment of the substantive constitutional claim.

Joe Grundfest's appropriately titled "I Told You So" takes no formal view on the substantive constitutional claim, but notes instead that: "There is a horse race to be run here, and as recent history suggests, it can be difficult to anticipate how the federal courts might decide these cases, if and when the question is presented."³ On the empirical evidence, Professor Grundfest is not only unsurprised ("[W]hat did you expect?", he says⁴), but goes further to argue that an insurmountable barrier is exactly what the Delaware legislature intended. This account would certainly explain why the Delaware legislature declined Professor Grundfest's offer to collect the relevant data back in 1987.⁵ But if correct, it would also contribute to the constitutional claim, because a state legislature that deliberately attempted to shut down hostile takeovers would seem to run afoul of the Williams Act. My one quibble with Professor Grundfest is in his prediction that the Delaware legislature will have no incentive to act until the current Section 203 is declared unconstitutional. I explain why in my assessment of Professor Hamermesh & Mr. Monhait's commentary below.

In his commentary, Vice Chancellor Laster urges what he calls "evidence-based corporate law:"

Doctors speak of practicing evidence-based medicine. Other clinical fields similarly speak of evidence-based practices. In my view, corporate law should do the same. Professor Subramanian's study provides the type of evidence that can be used by legislators to enact better laws.⁶

While I of course applaud the Vice Chancellor's approach, it raises the question of what constitutes "evidence" in corporate law. With respect to Section 203, for example, the Vice Chancellor qualifies his opinion with the assumption that my four basic facts, as described in my original article, are correct.⁷ Hamermesh & Monhait imply that they are not:

[W]e are not convinced that Professor Subramanian's 'four basic facts' are truly unchallenged, *or at least that they cover*

2010)).

³Joseph A. Grundfest, Commentary, *I Told You So*, 39 DEL. J. CORP. L. 55, 64 (2014).

⁴*Id.* at 60.

⁵*Id.* at 59 n.16.

⁶Vice Chancellor J. Travis Laster, Commentary, *Evidence-Based Corporate Law*, 39 DEL. J. CORP. L. 67, 69 (2014).

⁷*Id.* at 67.

the necessary territory. In particular, we have not seen a convincing response on his part to the observation by our colleague at the Delaware Bar, A. Gilchrist Sparks, III, about important data missing from Professor Subramanian's analysis. (emphasis added)

Hamermesh & Monhait do not specify which of my four basic facts they disagree with, though they imply that the Sparks data refutes one or more of these facts. In fact, the Sparks data does not challenge my four basic facts; instead, it provides an alternative means by which a future federal district court could find that Section 203 does provide bidders with a "meaningful opportunity for success." I discuss the point in more detail below, but for present purposes the example illustrates how the complexity of corporate law can allow obfuscation about what is really "evidence," on which judges like Vice Chancellor Laster can reasonably rely.

Contrary to Shapiro and Shapiro, Grundfest, and Laster, who are generally sympathetic to the empirical evidence and conclusions presented in my article, Hamermesh & Monhait are critical. In their commentary they make four arguments as to why Delaware should not amend Section 203: (1) the statute is likely constitutional, in view of the "friendly deal out;" (2) Delaware practitioners are not clamoring for change; (3) if Section 203 were not constitutional, a challenge would have been brought by now; and (4) Delaware could always amend the statute quickly if a constitutional challenge were to emerge.⁸ Except for (2), I have addressed these arguments in my earlier writing, so I will only briefly comment on each of them here.

First, Hamermesh and Monhait argue that Section 203 is likely constitutional in view of the friendly deal out,⁹ citing statistics from Gil Sparks showing that many hostile deals are eventually completed as friendly deals. I have addressed this argument repeatedly in my prior writing, but obviously Hamermesh and Monhait are not persuaded. Sparks' logical move, which Hamermesh and Monhait now endorse, is nothing more than an effort to distract: "Pay no attention to the relevant data! Look over here at

⁸In a footnote, Hamermesh & Monhait state: "Whether or not the 85% hurdle should be lowered as a matter of corporate law policy is a different question, and one we do not purport to address." Lawrence A. Hamermesh & Norman M. Monhait, Commentary, *A Delaware Response to Delaware's Choice*, 39 DEL. J. CORP. L. 71, 71 n.2 (2014). If the Corporate Law Council concluded—based either on historical experience, common sense, or the empirical data—that the 85% out constituted an insurmountable barrier, would it not represent sound public policy to lower the threshold to something that does provide a "meaningful opportunity for success," whether the Constitution requires it or not?

⁹*Id.* at 73.

this other data!" To explain why, one last time, consider the scenario where Delaware changes the 85% out to a 100% out (or, for good measure, a 105% out). Clearly this statute would not fly under the Williams Act. But Hamermesh and Monhait would presumably defend it on the grounds that it still allows friendly deals. This argument was explicitly rejected by the three district courts that considered the statute; it ignores the legislative history of Section 203, which focused squarely on the viability of the 85% out for permitting hostile-to-the-end offers; and it would lead to the absurd result that even a statute that effectively barred hostile takeovers is constitutional.¹⁰

Second, Hamermesh & Monhait point out that Delaware practitioners are not clamoring for change:

[I]n our experience when corporate practitioners perceive DGCL provisions as creating impediments to goals their clients desire to achieve, they convey those concerns to Delaware lawyers they know. We can recall no instance in the last dozen or so years of any member of Council having conveyed a suggestion from a professional colleague that Section 203 bears reexamination because it unduly hampers beneficial hostile takeover bids.¹¹

What kind of expression of concern are Hamermesh and Monhait waiting for? Perhaps it is this: "My client is making a fully-financed, all-cash, high-premium offer for a Delaware company and sees Section 203 as an impediment." To which the Council member would reasonably respond: "*That's the point of Section 203.*" I simply do not understand what "concerns" Hamermesh and Monhait expect practitioners to raise with respect to Section 203 that would then prompt the Council into action. Perhaps the fact that every hostile bid is conditioned upon the inapplicability of Section 203 would provide some indication of buy-side views.

Third, Hamermesh and Monhait argue that if Section 203 were not constitutional, a challenge would have been brought by now: "[I]t seems to us that if the statute were as great a barrier to hostile tender offers as Professor Subramanian perceives, someone in the last fourteen years would

¹⁰In addition, the argument assumes the viability of the proxy contest out, which is an incorrect assumption against an effective staggered board. See Lucian Ayre Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 STAN. L. REV. 887, 950 (2002).

¹¹Hamermesh & Monhait, *supra* note 8, at 74.

have advanced such a claim."¹² This version of the that-can't-be-a-\$20-bill-lying-on-the-ground argument ignores the detailed description in my article of how the pill has been the binding constraint for the past twenty years but has receded dramatically in recent years, making Section 203 more likely to be a binding constraint.¹³ Moreover (even if this historical account were not correct), in a recent working paper arguing that the poison pill too may be on shaky constitutional footing, Professors Lucian Bebchuk and Robert Jackson offer a powerful example of how an unconstitutional statute can survive for decades without constitutional challenge:

[F]or decades well-counseled corporations defended claims under the Alien Tort Statute based on events occurring outside the United States without arguing that the statute did not confer jurisdiction over such claims. Yet the Supreme Court recently declared that the ATS does not provide jurisdiction over such claims—an argument that was not raised by either the corporations or the courts involved in these prior cases. Similarly, companies have been defending ATS suits for many years without arguing that the statute does not reach the conduct of private corporations. Yet the Second Circuit, home to many such suits, recently held that corporations cannot be held liable under the statute at all.¹⁴

Shapiro and Shapiro offer a practitioner perspective on how an unconstitutional statute can go unchallenged:

In the midst of any major corporate acquisition, a hundred people run in a hundred directions. They have little time to ponder the meaning of *Edgar* and *CTS*, much less contemplate lengthy litigation in the district court, the court of appeals, or the Supreme Court.¹⁵

Shapiro and Shapiro's observation on the practical realities of corporate practice brings us to the last of Hamermesh and Monhait's claims, that

¹²*Id.*

¹³Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1, 31-34 (2014).

¹⁴Lucian A. Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill* 5-6 (Columbia Pub. Law Research Paper No. 14-386, 2014) (citations omitted), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2401098.

¹⁵Shapiro & Shapiro, *supra* note 1, at 78.

Delaware could always amend the statute if a constitutional challenge appeared: "[W]e are confident that, if necessary, revisions to Section 203 could and would be addressed promptly, despite what Professor Subramanian reasonably anticipates would be a replay of much of the contentiousness associated with Section 203's original enactment."¹⁶ I will not comment on the wisdom of this strategy, other than to say that measured debate would seem generally preferable to gun-to-the-head legislative action.

I will observe, however, that just last year the Maryland legislature declined to act on proposed amendments to its corporate code, at least in part because the amendments were steamrolled through the legislative process,¹⁷ did not get reviewed by the Maryland bar association,¹⁸ and changed the rules of the game in the middle of a hostile takeover bid.¹⁹

It is also unclear what trigger event Hamermesh and Monhait are waiting for. Filing of litigation from a determined bidder? Oral arguments that seem to favor the plaintiffs? Denial of summary judgment to defendants? With each hurdle that passes, Delaware loses leverage with ISS and its allies, because any reactionary move would signal concern about the substantive claim, and therefore some possibility of no antitakeover statute whatsoever. Far better to act on a clear day, as a policy matter, than to act in response to a potential change in the law.

Hamermesh & Monhait conclude with a disclaimer:

Subsequent developments may well prove us wrong in the reasoning and predilections noted above, but in our experience reticence to initiate legislative action has rarely harmed

¹⁶Hamermesh & Monhait, *supra* note 8, at 75.

¹⁷*Corporations and Real Estate Investment Trusts—Miscellaneous Provisions: Hearing on H.R. 882 Before the Judicial Proceedings Committee of the Senate of the Maryland General Assembly 17-18* (Md. 2013) (statement of Sen. Jamin B. Raskin) ("[O]ne of the problems here is the very late introduction of the amendment. We understand the importance of the issue to a lot of different parties, but why wasn't this introduced as legislation so we could have followed all the way through the normal legislative process?").

¹⁸*Id.* at 21 (statement of Sen. Joseph M. Getty) ("Has the Bar Association Business Law Committee taken a look at this amendment and taken a position on it?"); *id.* (statement of Jennifer Clark, General Counsel for Commonwealth REIT) ("My understanding is that they've not taken a position on it because they didn't have ample time to vet it in whatever their usual process is.").

¹⁹*Id.* at 30 (statement of Sen. Christopher B. Shank) ("Are we not sending a very counter message to markets that, hey, you've got to watch Maryland because, you know, somebody tries to do something in Maryland and[—]then they'll just change the rules in the middle of the game. And that doesn't sound . . . very predictable.").

Delaware's status as the leading state of business organization in the country.²⁰

Doing nothing is certainly the easy choice. Only time will tell if it is the right choice.

²⁰Hamermesh & Monhait, *supra* note 8, at 75.

