

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.

