DELAWARE'S CHOICE

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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

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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

[1] *See infra* Figure 2.
[2] *See infra* Part II.C.
[3] *See infra* Parts II.A, II.C, IV.
[4] *See 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]

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[5]Lucian 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).

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

[7]*See infra* Parts II.B, II.C.

[8]*See infra* Part II.C.

[9]*See infra* Part II.C.

[10]*See infra* Part IV.

[11]*See 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

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

[13]Guhan Subramanian, Steven Herscovici & Brian Barbetta, *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

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[19] *See infra* Part III.D.
[20] *See infra* Part III.D.
[21] *See infra* Part III.D.
[22] *See supra* text accompanying notes 6-8; *infra* Part IV.
[23] *See infra* Part II.
[24] *See 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").

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[25]Bebchuk, 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).

[29]Bebchuk, 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

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[30]*See 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.

[31]Bebchuk, Coates & Subramanian, *supra* note 5, at 927-33.

[32]*Id.* at 933-35.

[33]*Id.* at 935-36.

[34]*Id.* at 936-39.

[35]Bebchuk, Coates & Subramanian, *supra* note 5, at 936-39.

[36]493 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).

[37]*See supra* text accompanying notes 34-35.

[38]Bebchuk, 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 *Yucapia*,[48] but then similarly concluded that he did not need to reach the ESB question:

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measure was reasonable in relation to the threat posed).

[41]Bebchuk, 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.").

[43]*See* 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.

[44]1 A.3d 310 (Del. Ch. 2010).

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

[46]*Id.* at 353-54.

[47]16 A.3d 48.

[48]1 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.
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> 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]

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[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.

[50]Section 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).

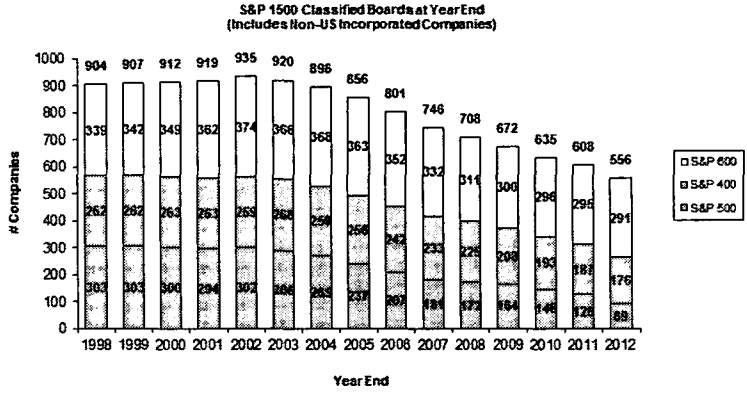
[51]Bebchuk, Coates & Subramanian, *supra* note 5, at 892, 948-49.

[52]These 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

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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:

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[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.

[54] Subramanian, *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

[55]E-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.'[156]

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.

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[56]E-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).

[57]*See supra* text accompanying note 55.

[58]*See supra* text accompanying note 56.

[59]In 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]

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[60]For 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.

[63]Bo 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 with-hold 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 campiagn could be "embarrassing").

[65]Stephen 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

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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.

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

[69] For 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/.

[70] For 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.").

[71] *See* Bebchuk, Coates & Subramanian, *supra* note 5, at 949-50.

[72] A 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

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[73]Neff, *supra* note 56.

[74]*Id.*

[75]*See* 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.

[76]Steven 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.

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

[78]Brown, *supra* note 75.

[79]*Id.*

[80]*See* 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

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

[82]It 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.

[83]In 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).

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

[85]*See 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]

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[86]E-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.*

[89]Peter 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,

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[90] *See supra* text accompanying note 88.

[91] *See* 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).

[92] *See* 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-avoice/?_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.").

[93] *See* 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

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[94]*See infra* Part III.

[95]*See* 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).

[96]457 U.S. 624, 646 (1982) (holding that an Illinois antitakeover statute, which was similar to the Delaware statute, was unconsitutional).

[97]481 U.S. 69, 93 (1987) (holding that Indiana's antittakeover 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*).

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

[99]*Id.* § 203(a)(2).

[100]*See, 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]

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[101]GOLDMAN & MCNALLY, *supra* note 95, at 62.

[102]*See* 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.").

[103]CTS 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)).

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

[105]*See* 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).

[106]*See 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.

[107]*See 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

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the court still found Section 203 constitutional).

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

[109]*See 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).

[110]*See* 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.

[112]Elliott J. Weiss, *What Lawyers Do When the Emperor Has No Clothes: Evaluating* CTS Corp. v. Dynamics Corp. of America *and Its Progeny—Part II*, 79 GEO. L.J. 211, 253 (1990).

[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

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[114]*See* 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).

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

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

[118]*See id.*

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

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

[121]*See 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).

[122]In 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.*

[123]DEL. 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

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[124]*See id.*

[125]*See* Subramanian, Herscovici & Barbetta, *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 Pikens). 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).

[126]Subramanian, Herscovici & Barbetta, *supra* note 13, at 805.

[127]Peter 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).

[128]RP 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

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

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

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

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

[133]Eileen 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" column[137] 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

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[134]O.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/corporatesecurity.unclebob.pdf (last visited Feb. 8, 2014).

[136]The 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.

[137]Lattman, *supra* note 127.

[138]Marcus, *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 Barbetta, *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.

[140]*See* 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,

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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.valuewalk.com/2013/06/commonwealth-reit-board-of-trustees-vote/ (stating that consent was only gained from 70% of the outstanding shares).

[141] *See supra* Part II.

[142] *See supra* Part II.

[143] Vito 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").

[144] Hayes, *supra* note 140.

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

[146] *See id.*

[147] *See* 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).

[148] *See supra* Part III.A.

[149] *See 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.

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[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. Furlow 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.

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

[153] *See 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

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[154]Subramanian, Herscovici & Barbetta, *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.

[157]To 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

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

[160]Subramanian, Herscovici & Barbetta, *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).

[166]133 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:

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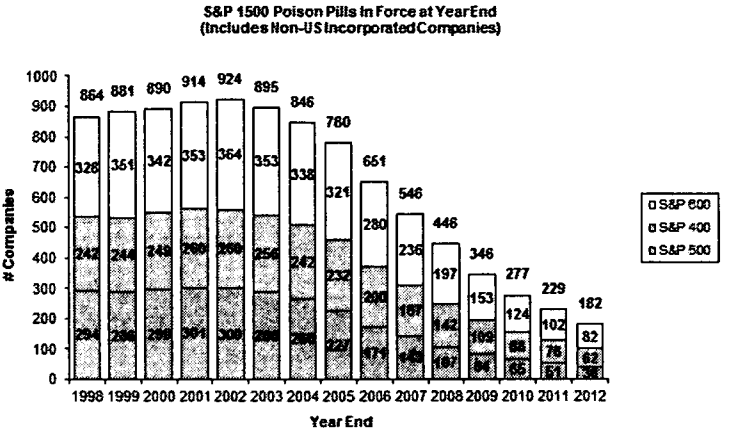
standard . . . .").

[168] *See* 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).

[169] One 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

[170]This 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.

[172]Most 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:

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

[174]*See id.*

[175]*See 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/.

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

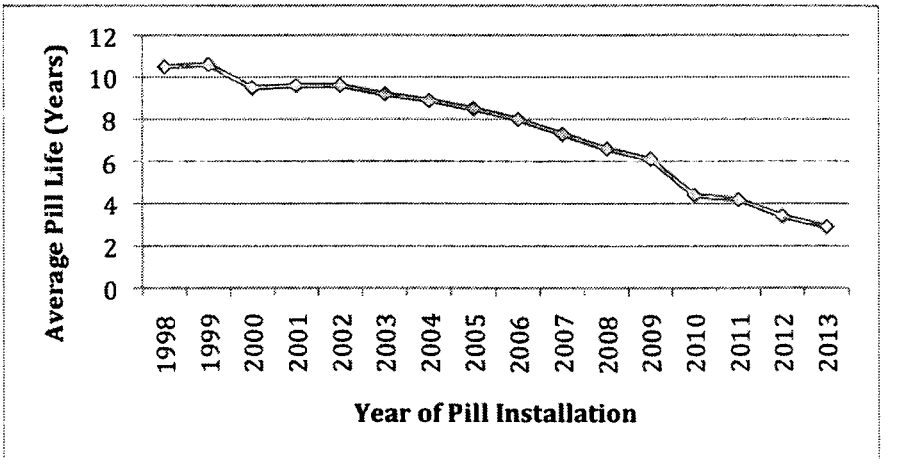
[177]Based on statistics from the end of 2013, of the 537 pills in effect, 286 pills are set to expire by 2016. Laide, *supra* note 170.

[178]*Id.*

[179]*Id.*

[180]David 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 Installation[181]



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]

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

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

[183]*See* 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.

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

[185]At 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

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[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_Poion_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 & Barbetta, *supra* note 13, at 733-34.

[193] Subramanian, Herscovici & Barbetta, *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

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[195]*See* Subramanian, Herscovici & Barbetta, *supra* note 13, at 705.

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

[197]*See 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).

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

[201]*See, 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).

[202]In 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 approval[210] 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).

[203]Subramanian, Herscovici & Barbetta, *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/05drug.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.

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

[210]*See id.* ch. 156B, § 50A.

[211]Robert 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

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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).

[212] *See supra* Part III.A.

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

[214] *See supra* note 136 and accompanying text.

[215] *See 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.

[216] *See* 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.

[217] IOWA 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).

[218] *See* 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.

[219] *See* 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' fees[226]—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

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

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

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

[223] *Id.* at 432.

[224] *Id.* at 433.

[225] *See, 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)).

[227] *See 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

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

[228] *See id.*

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

[230] *See id.*

[231] *See 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.*

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

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

[234] I 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.

[235] *See, 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

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[236] *See supra* Parts II.A-B.

[237] *See, 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).

[238] *See* 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).

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

[240] *See 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).

[241] *See id.*

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

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

[244] *Id.*

[245] *Id.*

[246] *See id.* at 66.

[247] I 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

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[248]The 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.")

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

[250]This 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,

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[251]For 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.

[254]Quoting David Duffield's e-mail to CEO Craig Conway after hearing the news that the Department of Justice had filed suit to block Oracle's acquisition of PeopleSoft on antitrust grounds: "I'd personally like to do something special for the independent directors. . . . It could be lavish like a really good watch (better than Rolex) or a trip to a resort . . . ." *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

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[255] *See* Subramanian, Herscovici & Barbetta, *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.

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

[258] *See id.*

[259] *Id.* at 759.

[260] *See* 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).

[261] Section 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]

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

[262] *Cf.* 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

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

[267]*See id.*

[268]*See* Subramanian, Herscovici & Barbetta, *supra* note 13, at 696-97.

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

[270]*See* 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).

[271]*See* 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,

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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").

[272] *See* Sparks, *supra* note 270.

[273] *See 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.

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

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

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

[277] *See 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 years[278] 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

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[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.

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[282] *Id.* at 735-36.

[283] *See* 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

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[287] *See* 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).

[288] *See* 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

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[289] Subramanian, Herscovici & Barbetta, *supra* note 13, at 688.

[290] COMPUSTAT DATABASE (downloaded July 16, 2009), *cited in* Subramanian, Herscovici & Barbetta, *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.