

## A DELAWARE RESPONSE TO DELAWARE'S CHOICE

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

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

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

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

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

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

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

(1) in the 1980s, federal courts established the principle that Section 203 must give bidders a "meaningful opportunity for success" in order to withstand scrutiny under the Supremacy Clause of the U.S. Constitution;<sup>5</sup> (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.<sup>6</sup>

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

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<sup>4</sup>Hamermesh, *supra* note 3, at 1779.

<sup>5</sup>The precise language of Judge Schwartz's thoughtful opinion in *BNS Inc. v. Koppers Company, Inc.*, 683 F. Supp. 458, 469 (D. Del. 1988), is "The fair import of [three Supreme Court decisions] . . . is that even statutes with substantial deterrent effects on tender offers do not circumvent Williams Act goals, so long as hostile offers *which are beneficial to target shareholders have a meaningful opportunity for success.*" (emphasis added). Presumably under this test, hostile offers that are *not* "beneficial to target shareholders" are not weighed in the constitutional balance.

<sup>6</sup>Subramanian, *supra* note 3, at 4.

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

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

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

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

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

<sup>8</sup>*Id.* at 28.

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

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

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

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

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

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

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<sup>12</sup>Subramanian, *supra* note 3, at 46-47.

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

<sup>14</sup>*Id.* at 470.

<sup>15</sup>See Subramanian, *supra* note 3, at 40-41.

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

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

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

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

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

<sup>18</sup>Subramanian, *supra* note 3, at 46-50.

<sup>19</sup>*Id.* at 47.

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

