EVIDENCE-BASED CORPORATE LAW

BY VICE CHANCELLOR J. TRAVIS LASTER*

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

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

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

---

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

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

[2]*Id.* at 27.

[3]*Id.* at 28-29.

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

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

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

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

---

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

[5] *Id.* at 513.

[6] *Id.*

[7] *Id.* at 515.

[8] 493 A.2d 946, 955 (Del. 1985) (placing burden on directors to prove that defensive measure was "reasonable in relation to the threat posed").

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

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

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

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

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