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Flawed Academic Challenge to Constitutionality of Delaware's Anti-Takeover Law

Academic empirical legal analysis, when not coupled with a clear understanding of both fundamental corporate law principles and practical takeover market dynamics, can lead to meaningless data and misleading conclusions. This appears to be the case with a recent article by Harvard Law School Professor Guhan Subramanian and two consultants from Analysis Group Inc. that purports to raise constitutional concerns about Delaware's anti-takeover statute, 8 *Del. C.* § 203. Under Section 203, a 15% or greater shareholder can avoid a three-year waiting period for a back-end merger by obtaining either (i) board approval prior to crossing 15%, (ii) more than 85% ownership (excluding certain shares) in the same transaction in which it became a 15% shareholder, or (iii) approval by the board and by holders of two-thirds of the shares not owned by the bidder.

The authors premise their argument on a series of U.S. District Court decisions from 1988 that upheld the constitutionality of Section 203. Those decisions made clear that the Williams Act does not preempt all state regulation of tender offers; state law may regulate and even deter tender offers in the name of protecting shareholders so long as tender offers have some "meaningful opportunity for success." In rejecting the challenge to Section 203, the courts relied—in part—on empirical data demonstrating that bidders could and did reach 85% ownership in their tender offers. Professor Subramanian and his co-authors have endeavored to arm new challengers to the statute with updated data. They conclude that no hostile bidder for a Delaware corporation in the last nineteen years has been able to go from less than 15% ownership to over 85% in a single hostile offer. They also assert that while fiduciary obligations may compel a board to redeem a rights plan, they cannot compel a board to waive the statutory protections of Section 203. Consequently, they argue, Section 203 is a "show stopper" for hostile bids, with the 85% threshold offering no meaningful opportunity for success.

The authors' description of Delaware law is simply wrong. It is clear that a board's decision whether or not to waive Section 203 is subject to its fiduciary duties. *See In re Digex, Inc. S'holders Litig.*, 789 A.2d 1176 (Del. Ch. 2000). In any situation where fiduciary duties might compel a board to redeem a rights plan, they would also likely compel a board to waive Section 203's waiting period.

More importantly, the authors' methodology is fatally flawed. The authors mistakenly treat the percentage of shares tendered as of some interim expiration date prior to the withdrawal of the hostile bid or the target's acceptance of a deal as a definitive measure of whether the bidder could avoid the limitations under Section 203. However, if the bidder would not have been able to purchase tendered shares even if the 85% threshold were satisfied at that expiration date (because of other material tender offer conditions that were not then satisfied, including the redemption of any poison pill), shareholders recognize that there is no economic significance in whether 85% of the shares were tendered at such time. On the other hand, it is quite common that over 90% of the outstanding shares are tendered when bidders have satisfied their other conditions and are prepared to purchase the tendered shares, including most of the hostile bids in the authors' database that were completed as negotiated transactions.

Indeed, far from Section 203 having served as a "show stopper," we are not aware of a single hostile takeover bid that satisfied all of its other tender offer conditions but nevertheless failed because the bidder did not satisfy its Section 203 condition. Take Exelon's recent hostile takeover bid for NRG Energy that the authors use as a case study for the supposed "renewed significance of Section 203 as a takeover defense": when Exelon dropped its bid in July 2009 after it lost a proxy fight for a partial board slate and received only 12% of the shares tendered to its offer, Exelon recited a litany of unsatisfied tender offer conditions, including failures to obtain federal and state regulatory approvals, NRG preferred stockholder approval, Exelon stockholder approval, and the 51% minimum tender condition. The failure to satisfy its Section 203 condition was the least of Exelon's problems. The minor skirmishing between Exelon and NRG over Section 203 was a sideshow that the authors mistakenly elevate to the main event.

"Expiration dates" during the early stages of a hostile takeover bid—at a time when the bidder cannot actually buy any tendered shares because of a myriad of unsatisfied conditions—serve simply as straw polls. The bidder announces the percentage of shares tendered following each "expiration date," usually in conjunction with the bidder's extension of its offer to the next "expiration date," and hopes that the poll results provide a shareholder-signaling mechanism to the target's board that may facilitate its bid. Some shareholders may tender to encourage the target's board to put the company up for sale. Some shareholders who want a takeover may withhold tendering at that time to encourage the bidder to increase its price. And some shareholders may choose not to participate in straw polls altogether, choosing to wait until the bidder satisfies some of its other closing conditions first, be they financing, regulatory approvals, or a successful proxy fight or court battle to redeem a pill and waive Section 203, and make a tender decision only when it has economic substance.

Ascribing constitutional significance to the outcome of these tender polls is like declaring the winner of the Iowa Republican straw poll held in August to be the winner of the Iowa primary five months later.

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