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Ronald J. Gilson

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UNOCAL FIFTEEN YEARS LATER
(and what we can do about it)

Ronald J. Gilson[*]

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A natural inclination to stocktaking accompanies the new millennium. Its coincidence with the fifteenth anniversary of the Delaware Supreme Court's announcement in *Unocal*[1] of a new approach to takeover law provides an appropriate occasion to step back and evaluate a remarkable experiment in corporate law – the Delaware Supreme Court's development of an intermediate standard for evaluating defensive tactics.

This experiment began with, and was surely a response to, an earlier and extremely controversial takeover wave. But these transactions were remarkable for more than just their scope, goal, and method. They also were remarkable as a social phenomenon, the studied indifference to which by sociologists remains a remarkable disciplinary failure. The emergence of junk bond financing – I prefer the period term

[*] Charles J. Meyers Professor of Law and Business, Stanford University, and Marc and Eva Stern Professor of Law and Business, Columbia University. An earlier version of this essay was presented as the 1999 Pelleggi Lecture at Widener Law School, and I have tried to retain the tone of that format, albeit adorned with footnotes. Since delivering the Pellegi Lecture I have had the benefit of collaboration with Alan Schwartz on a development of the views expressed in more preliminary form in my lecture. As will be obvious to those who both attended the lecture and read this article, the quality of the current effort plainly reflects Professor Schwartz's participation. I am grateful to the Widener Law School and the Wilmington bar for the hospitality I was offered during my visit. I am also grateful to Rob Daines, Jeffrey Gordon and Michael Klausner for their helpful comments on an earlier draft, and to Win Hwangbo for excellent research assistance.

[1] 493 A.2d 946 (Del. 1985).

"junk bond" to the more dignified label of "high yield" because the difference in the terms capture the distance in attitude that we've covered in the last 15 years – opened the market for corporate control to a range of acquirers who were hardly members of the corporate establishment. I was a reporter for the ALI Corporate Governance Project[2] and had special responsibility for the part of the project dealing with transactions in control. As I sat in what seemed an endless series of meetings, only part of the debate was about the right legal rules; the remainder, *sotto voce*, was over who – the new raiders or the ALI members' clients – were going to control some of the most significant actors in our economy.

Finally, and here we return to the realm of law from that of economics and sociology, the Delaware courts ultimately placed themselves at the center of the maelstrom. As de Touqeville noted about the United States some 175 years ago, lawyers are at the core of our economic and political life.[3] And in the 1980s the Delaware courts were squarely in the middle of the largest and most contentious business transactions in history.

We now have sufficient perspective, both on that takeover wave and on the Delaware courts' response, to reassess both the motivation and the efficacy of this effort at modernizing corporate law to cope with the emergence of hostile tender offers, a phenomenon which, both technically and conceptually, then existing corporate law was inadequate to address. While acknowledging the difficult circumstances in which the Delaware Supreme Court found itself in 1985, I will argue that *Unocal* ultimately has developed into an unexplained and, I think, inexplicable preference that control contests

[2] American Law Institute, Principles of Corporate Governance: Analysis and Recommendations (1994).

be resolved through elections rather than market transactions. In doing so, I will highlight the remarkable struggle between the Chancery Court and the Supreme Court for *Unocal*'s soul, a contest I will suggest the Supreme Court won only by fiat. I will also maintain that the current debate over shareholder-adopted bylaws that repeal or amend director-adopted poison pill plans provides a vehicle to reposition Delaware takeover law for a new millennium. In the end, takeovers are just an equilibrating mechanism that is triggered by changes in the real economic environment.[4] It is a noncontroversial prediction that the pace of change will continue to accelerate, and that transactional responses will continue to pressure corporate law. Delaware law's current pro-election, anti-market bias is not suited to meeting that challenge.

Finally, I will end my retrospective on a note of praise. Intertwined with the development of Delaware takeover jurisprudence is a reassessment and important expansion of the role of independent directors in corporate governance. There is no reason why this important development cannot be preserved if the Delaware Supreme Court chooses to otherwise restore balance to the law of takeovers.

A word about style before going forward with substance. The audience to which I address this essay needs no lengthy account of the last fifteen years of Delaware case law. For the judiciary and corporate bar, the takeover cases that stretch from 1985 to 2000 have dictated the path of their professional lives; they need no detailed itinerary from me

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[3] I Alexis deTouqueville, Democracy in America 272-80 (Bradley ed. 1987)("Scarcely any political question arises in the United States that is not resolved, sooner or later, into a judicial question.").

[4] For discussion of the equilibrating function of takeovers, see Ronald J. Gilson, The Political Ecology of Takeovers: Thoughts on Harmonizing The European Corporate Governance Environment, 61 Ford. L. Rev. 161 (1992).

to recall the journey. Thus, my argument is made at the edge, taking most of the trail for granted and focusing only on junctions that I believe were especially important.[5]

I. Setting the Stage

Over the last fifteen years the Delaware courts have been at the center of a process that was far larger than the law. Starting in the 1970s and accelerating through the 1980s, the United States has undergone one of the most remarkable industrial restructurings in our history. The organizational calm of the early 1970s was shattered by an unprecedented wave of hostile takeovers whose goal was quite explicit: to reshape the structure of American industry. Whether by dissipating the excess cash flow that oil companies were diverting to a bizarre range of diversification,[6] or by breaking up the 1960s' conglomerates,[7] these transactions drove an industrial stampede back to focus – a strategy based on specialization in industries whose demands fit a company's experience and skills.[8]

At the time, however, the industrial logic of the new takeover phenomenon was much less clear. The combination of the rate of change and the vehicle of change – hostile takeovers launched by a new class of entrepreneurs who until the application of junk bond financing to acquisitions had no access to the business arena in which their targets contended – generated an extreme reaction. Many prominent commentators,

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[5] For those who are interested in a more detailed description, see Ronald J. Gilson & Bernard Black, The Law and Finance of Corporate Acquisitions 801-95 (2d Ed. 1995), and the 1999 Supplement 72-97.
[6] See, e.g., Michael Jensen, The Takeover Controversy: Analysis and Evidence, in Knights, Raiders and Targets 314, 329-37 (J. Coffee, L. Lowenstein & S. Rose-Ackerman, eds., 1988).
[7] See, e.g., Andrei Shleifer & Robert Vishny, The Takeover Wave of the 1980s, 249 Sci, 745 (1990); Sanjai Bhagat, Andrei Shleifer & Robert Vishny, Hostile Takeovers in the 1980s: The Return to Corporate Specialization, in Brookings Papers on Economic Activity, Microeconomics 1 (1990).
[8] Robert Comment & Gregg Jarrell, Corporate Focus and Stock Returns (Bradley Policy Res. Center, Univ. of Rochester, WPMR 91-01, 1991).

some – like Martin Lipton[9] – with a stake in resisting the takeover movement, and others – like Peter Drucker[10] – who had no ax to grind, thought junk bond-financed, bust-up takeovers a threat to the very Republic. The Chairman of Deutsche Bank was rather more direct. In a hyperbole the extent of whose overstatement has been made clear by recent events in Russia, characterized the takeover wave simply as "gangster capitalism."

The Delaware courts had little choice but to intercede in this controversy. Only three institutions were in a position to act effectively in response to this good faith but overheated debate, but two were unlikely candidates. Congress seemed to have exhausted its energy a decade before with the Williams Act. And the Securities Exchange Commission increasingly voiced a decidedly pro-takeover position.[11] If there was to be a balanced assessment, which given the shrillness of the debate must have seemed attractive if only for its softer tone, it would have to come from Delaware.

Unfortunately, Delaware law was not then up to the task. As I have described the phenomenon elsewhere, the hostile takeover wave of the 1980s subjected the traditional structure of corporate law to the equivalent of a stress test. Driven by one of "the most significant corporate restructuring in history, serious doctrinal cracks appeared, the most important of which concerned allocating final decision rights in the face of a hostile tender offer."[12] Corporate law provided two general standards of review of management conduct: the business judgment rule which applied to claims that management violated its duty of care; and the intrinsic fairness test which applied to claims that management

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[9] Martin Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101 (1979).
[10] Taming the Corporate Takeover, Wall St,J,, Oct. 30, 1984, at 30, col.3 ("[A] good many experienced business leaders I know hold takeover fear to be a main cause of the decline in America's competitive strength in the world economy … [i]t contributes to the obsession with the short term."
[11] For example, the SEC filed an amicus brief in Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985), asserting the invalidity of the poison pill under Delaware law.
[12] Ronald J. Gilson, The Fine Art of Judging: William T. Allen, 22 Del. J.Corp.L 914, 914 (1997).

violated its duty of loyalty. Hostile takeovers drove in a wedge at their point of tangency, leaving a yawning doctrinal chasm. On the one hand, evaluating the desirability of a target's acquisition is the quintessential business judgment. On the other hand, target management faces an inherent conflict of interest in confronting a transaction that directly threatens both their positions and their egos. Deploying defensive tactics thus resembles an interested transaction that calls for review under the rigorous entire fairness standard. As a matter of corporate law, existing doctrine left wide open the critical functional question: who should make the decision concerning the outcome of a hostile takeover bid?[13] As a matter of public policy, the resolution of this question would significantly influence who would govern the largest and most powerful private institutions in our society.

Two contending interest groups advanced quite different answers with equal vigor. Takeover defense lawyers argued that board decisions with respect to tender offers should be treated like board decisions concerning any other acquisition proposal: the business judgment rule should operate to allocate the primary decision-making role to management.[14] Academics took a very different view, seeing tender offers as an important corporate governance device in their own right, and therefore urged that the shareholders be allocated the final decision-making role. In this view, the market for corporate control served to displace inefficient managers both directly through a particular transaction, and indirectly through the general deterrence resulting from the

[13] For a contemporaneous framing of the issue see Ronald J. Gilson: A Structural Approach to Corporations: The Case Against Defensive Tactics in Takeovers, 33 Stan. L.Rev. 819, 845-48 (1981).
[14] Martin Lipton advanced this position most effectively. Lipton, supra note 9.

threat of a takeover. Efficient operation of the market for corporate control necessitated that shareholders make the ultimate decision concerning the success of a hostile bid.[15]

Interestingly, the pro-management takeover defense lawyers and the pro-shareholder academics implicitly agreed on an important common premise: courts should not determine the outcome of the largest business transactions in history. Figure One illustrates the position of the contending groups on the identity of the proper takeover decision maker.

Figure One: Who Should Decide the Outcome of a Hostile Bid?

Interest Group	*Preferred Decision Maker*
Defense Lawyers	Independent Directors
No One	Courts
Academics	Shareholders

In *Unocal*, the Delaware Supreme Court chose the middle ground that had been championed by no one. The court unveiled an intermediate standard of review, somewhere between the duty of care and the duty of loyalty. What was especially notable about what came to be called the proportionality test – did the hostile offer present a threat and, if so, was the target's response proportional[16] – was the role of the court itself. In assessing the balance between threat and response, the court cast itself as an arbitrator of the substantive merit of target company behavior. As *Unocal* was

[15] See, e.g., Frank Easterbrook and Daniel Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Gilson, A Structural Approach, supra note13.
[16]See Ronald J. Gilson & Reinier Kraakman, Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review, 44 Bus. Law. 247 (1989).

originally framed, the court functions, in effect, as a regulatory agency, deciding for itself between *good* defensive tactics – those reasonable in relation to the threat – and *bad* defensive tactics, those that go beyond what the bid requires. Unusually for Delaware law, *Unocal* committed the court, in appropriate circumstances, to substitute its judgment for that of the board. And lest anyone doubt that the court had set itself up to regulate defensive conduct, the decision in *Household International,*[17] coming directly on the heels of *Unocal*, made matters absolutely clear. Despite the Supreme Court's quite activist stance in approving a board of directors' adoption of a poison pill without shareholder approval, it reserved to itself an intermediate level of review of a board's decision not to redeem the pill after an offer actually was made. The *court* – and plainly not the board in the exercise of its business judgment – would decide whether declining to pull the pill was a proportionate response.

II. The Chancery Court's Development of *Unocal*: Allocating Decision Making Roles Between Shareholders and Directors

At this point, the Supreme Court largely retired from the field, leaving the Court of Chancery to work out the profile of the new regulatory role implicit in the proportionality test. In deference to the traditional Delaware respect for the business judgment rule and the limited judicial role the business judgment role dictates, the Chancery Court responded by recasting *Unocal* in terms of an allocation of decision-making roles not between the board and the court, but between the board and the shareholders. And it was at this point in the drama that Reinier Kraakman and I wrote our Business Lawyer article out of the fear, well-placed as it turned out, that despite the bold words of *Unocal* and *Household International,* the Delaware Supreme Court could

[17] 500 A.2d 1346 (Del. 1985)

not sustain the regulatory function of directly assessing the merits of target company defensive tactics.[18]

Perhaps because it also doubted the Supreme Court's resolve, the Chancery Court in a series of cases highlighted by *Anderson, Clayton*,[19] *Interco,*[20] and *Pillsbury,*[21] developed a thoughtful doctrinal framework that focused not on judicial assessment of the wisdom of director decisions, but on allocating decision responsibility between shareholders and directors. In the face of a non-coercive hostile offer, directors could respond to a belief that the price offered was too low – "substantive coercion" in today's inaccurate use of the term[22] – by using a pill to secure the time to negotiate or seek a better offer. In the end, however, after time for negotiating and investigating alternatives, the directors could not "just say no" by declining to pull the pill, and thereby blocking the

[18] Gilson & Kraakman, supra note 16.
[19] A.C. Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. 1986).
[20] City Capital Associates v. Interco, Inc., 551 A.2d 787 (Del.Ch. 1988).
[21] Grand Metropolitan PLC v. The Pillsbury Company, 558 A.2d 1049 (Del. 1988).
[22] The term was coined in Gilson & Kraakman, supra n. 16, to refer to the claim by target management that target shareholders might accept an offer which, despite reflecting a substantial premium over market price, nonetheless understated the company intrinsic value. While Gilson and Kraakman acknowledged the concept, the article specified a detailed judicial inquiry into the factual basis for the belief; the simple assertion of underpricing was insufficient to establish substantive coercion:

> To support an allegation of substantive coercion, a meaningful proportionality test requires a coherent statement of management's expectations about the future value of the company. From the perspective of shareholders, substantive coercion is possible only if the management plausibly expects to better the terms of the hostile offer – whether by bargaining with the offeror, by securing a competitive bid, or by managing the company better than the market expects. To make such a claim requires more that the standard statement that a target's board and its advisers believe the hostile offer to be "grossly inadequate." In particular, demonstrating the existence of a threat of substantive coercion requires a showing of how – and when – management expects a target's shareholders to do better.

Id. at 268. Unfortunately, only the phrase and not the substance captured the attention of the Delaware Supreme Court; the mere incantation of substantive coercion now seems sufficient to establish a threat under *Unocal* without any inquiry into the facts or management's explanation for the market's under pricing of the company's shares. Much to Professor Kraakman's and my relief, Vice Chancellor Strine discusses the Delaware Supreme Court's misuse of the concept of substantive coercion in Cheasapeake Corporation v. Shore, Civ. Action 17626 (Feb. 7, 2000), slip opinion at 78-80.

shareholders from rejecting the board's strategy and accepting the hostile offer.

Chancellor Allen put the matter most clearly in *Interco*:

> To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of corporate governance as to threaten to diminish the legitimacy and authority of our corporate law.[23]

Chancellor Allen applied the same approach in *Time-Warner*, an opinion that warrants careful attention despite its ill treatment by the Delaware Supreme Court on appeal. Perhaps anticipating that the Supreme Court, one way or another, would allow Time to complete its acquisition of Warner regardless of shareholder preferences, the Chancellor allowed Time to go forward with the acquisition. Allen stressed, however, that, "because of the timing involved, the board has no need here to rely upon a self-created power designed to assure a veto on all changes in control."[24] And to eliminate any possibility that the point might be misunderstood, Allen appended a footnote stating that the outcome might well have been different if Time were relying on a poison pill – in Allen's words, "a control mechanism and not a devise with independent business purposes…."[25]

In short, the Chancery Court opinion in *Time-Warner*, at least with respect to the proportionality leg of *Unocal*, simply parallels *Interco*. In *Interco*, management was

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[23] 551 A.2d at 800.

[24] Paramount Communications, Inc. v. Time, Inc., 1989 WL 79880 (Del.Ch. July 14, 1989), reprinted in 15 Del. J.Corp. L. 700 (1990). Recall that Paramount could not close a tender offer for Time without securing local government approvals of the transfer of cable television franchises, a timing problem that did not impede Time's offer for Warner.

[25] Id. at n.22.

allowed to proceed with its sale of the Ethan Allen division even if the sale had the effect of blocking the hostile offer, as in fact it did, but the pill ultimately had to be pulled to allow shareholders to decide whether to accept the hostile offer. In *Time-Warner*, Time could proceed with its acquisition of Warner even if that had the effect of blocking Paramount's hostile offer; because Time did not rely on a pill, shareholders were free to decide whether to accept a hostile offer for the combined companies should one be made. As in *Interco*, managers pursued their business plan unchecked by the hostile takeover, and shareholders decided whether to accept an offer, albeit one that ultimately was withdrawn as in *Interco* or was never made as in *Time-Warner*.

And that brings us to the Supreme Court's development of *Unocal*, which I will argue has proven dramatically less successful than the approach taken by the Chancery Court. So that it will be clear where I am going with this, I have two points to make. First, we lack any coherent explanation of why the Supreme Court rejected the Chancery Court's carefully crafted allocation of decision-making authority between shareholders and management. In particular, the Supreme Court opinion in *Time-Warner* seems simply to have misunderstood the body of law the Chancery Court had created. Second, the Supreme Court's effort to articulate the *Unocal* standard, most explicitly in *Unitrin*,[26] collapses into an unexplained functional preference that changes of control should occur through elections rather than courts.

III. The Rejection of the Chancery Court's Approach

In the debate between the Chancery Court and Supreme Court in *Time-Warner*, the Supreme Court won only by fiat. The Supreme Court's response to the Chancery Court's *Unocal* jurisprudence came in a cryptic one-sentence reference. Responding to

Paramount's position that an all-cash, non-coercive offer was not a threat under *Unocal*, the Supreme Court stated:

> "To the extent that the Court of Chancery has recently [substituted its judgment for what is a 'better deal' for that of a corporation's board of directors] in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis. See, e.g., *Interco* and its progeny … .[27]

But *Interco* had nothing to do with substituting the court's judgment for that of the board. To the extent that *Interco* is about substitution at all, it involved substituting the shareholders' – not the court's – judgment for that of the directors'. *Interco* makes this point explicitly. Allowing directors, the court stated, "to deprive shareholders of the ability effectively … to accept a noncoercive offer … would be so inconsistent with widely shared notions of corporate governance as to … diminish the legitimacy … of our corporate law."[28] The decision-making conflict here is between the board and the shareholders; the court's judgment about "what is a 'better deal'" is beside the point, and so, it follows, was the concern voiced by the Supreme Court in *Time-Warner*.

IV. The Supreme Court Decision in *Unitrin*: The Preference for Elections over Markets

Time-Warner thus left us with the clear understanding that the Supreme Court had rejected whatever it conceived the Chancery Court to have crafted, but without giving us any sense of what it had in mind. That began to take form in *Unitrin*, decided some five years after *Time-Warner*. Under *Unitrin*'s elaboration of the proportionality test, a defensive tactic survives the intermediate standard of review if it is neither coercive nor preclusive and falls within a range of reasonableness. For present purposes,

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[26] Unitrin, Inc. v. American General Corp, 651 A. 2d 1361 (Del. 1995).
[27] Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (1990).
[28] 551 A.2d at 800.

the critical question is whether the defensive tactic is preclusive. But the preliminary question is preclusive of what? Refusing to redeem a poison pill will always preclude a tender offer. It will not, however, necessarily preclude a proxy fight to replace the target's directors with nominees who can be expected to conclude, after careful and informed deliberation, that the offer is in the shareholders' best interests and thereafter redeem the pill. Does the presence of a poison pill allow a target company to force a bidder to have the success of its offer determined by an election rather than a tender offer?

Without confronting the issue directly, the Delaware Supreme Court appears to have simply assumed that the availability of a proxy fight renders a poison pill non-preclusive, thereby shifting the focus to the circumstances under which the proxy fight would be conducted. The court acknowledged that "[w]ithout the approval of target boards, the danger of activating a poison pill renders it irrational for a bidder to pursue stock acquisitions above the triggering level."[29] Thus, a poison pill *is* preclusive of a tender offer. But under *Unitrin*, refusal to redeem the pill is not preclusive under *Unocal* unless a proxy fight is also precluded. On remand, the Supreme Court in *Unitrin* directed the Chancery Court to "determine whether Unitrin's Repurchase Program would only inhibit American General's ability to wage a proxy fight and institute a merger or whether it was, in fact, preclusive because American General's success would either be mathematically impossible or realistically unattainable."[30]

Thus, *Unitrin* at least identifies the circumstance when *Unocal* allows a target to block a tender offer by declining to "pull the pill" – if a proxy fight is not

[29] 651 A.2d at 1381.
[30] Id. at 1388-89.

"mathematically impossible" or "realistically unattainable." Because the poison pill has become ubiquitous – every public company either has adopted a pill or can adopt one if a hostile offer is made – the Delaware Supreme Court's analysis reduces functionally to a preference that control contests be resolved through an election, rather than a market: a target can block a tender offer so long as a stymied bidder can press its case through a proxy fight.[31]

My purpose here is not to criticize the court's doctrinal analysis, although that task commends itself. For example, one certainly would have thought that prior doctrine dictated a somewhat more rigorous limit on defensive action in response to a proxy fight than that the action not render the proxy fight mathematically or realistically unattainable. Rather, I will focus only on the wisdom of the court's apparent conclusion however opaquely reached: that proxy contests are preferable to tender offers as a means of resolving a control contest.

V. The Problems with a Preference for Elections

I see three serious problems with the Delaware Supreme Court's preference for elections. The first poses a simple process concern: the need for transparency in setting the rules by which important business transactions must be considered. The other two are substantive. First, markets are more efficient than elections at resolving control contests; the court's preference makes the process less effective. Second, the court's rule has had the predictable effect of shifting defensive energy into proxy contests; the *Unitrin* election preference thus serves to degrade the electoral process itself.

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[31] To be sure, the court in *Household International* justified the pill in part because shareholders retained access to the proxy mechanism, the court nonetheless reserved a review function under *Unocal* when the

A. The Obligation to Provide an Explanation

The process problem is that the court in *Unitrin* provides neither explanation nor justification for its preference for elections. A court's obligation to provide reasons for its action is more than a matter of professional craft; explaining the chosen outcome at least imposes the discipline of logic on the range of alternatives available to a court. As important, an explanation provides in equal measure not only a justification for the result in a particular case, but also guidance for the future. In *Unitrin*, the Delaware Supreme Court confronted an issue that it had managed to duck for 10 years – can a target company "just say no" by declining to pull the pill? A common law court – and most takeover law is common law and not statutory – has a professional obligation to clearly articulate its grounds of decision. Uncertainty may preserve a court's flexibility, as some commentators have suggested in defense of the studied ambiguity of important Delaware Supreme Court opinions,[32] but it comes at the expense of allowing parties to order their affairs. As a result, the court gets it precisely backwards: the point is to make things easier for actors in the economy to go about their business, not to make it easier for courts.

B. Markets are More Efficient than Elections at Mediating the Transfer of Control

The first substantive problem concerns the direct costs of preferring elections to markets: the preference is not justified. While this is not the time to work out the

target company refused a redemption request by a bidder.

[32] Charles Yablon, Poison Pills and Legal Uncertainty, 1989 Duke L.J. 54 (1989); Marcel Kahan., Paramount or Paradox: The Delaware Supreme Court's Takeover Jurisprudence, 19 J.Corp. Law 583 (1994).

argument more formally,[33] I think it is straightforward to show that elections at best can be the equivalent of markets in determining when it is efficient for control for a control change to go forward, but that under more realistic circumstances, elections will be significantly worse.[34]

The equivalency case involves making heroically simplifying assumptions of the sort common in most economic models. Assume with me that a bidder launches a tender offer that target management believes is substantively coercive. Further assume that because target management declines to pull the pill, shareholders are barred from accepting the tender offer unless the board of directors is replaced. In this hypothetical, however, we have an innovative election procedure. The shareholders cast their ballots for directors by checking a box on the letter of transmittal when they conditionally tender their shares. If the ballots are sufficient to replace the directors, then the pill is automatically pulled and the bidder can take down the shares.[35] Finally, assume that all shareholders are perfectly informed about both the merits of the competing positions and the detail of the target directors' good faith belief that the market undervalues the company's stock.

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[33] Alan Schwartz and I attempt to show formally the comparative inefficiency of elections in Ronald J. Gilson & Alan Schwartz, Sales and Elections as Methods of Transferring Corporate Control (working paper, May 2000).

[34] For this purpose I will not rely on public choice problems with voting as applied to corporate law. Jeffrey Gordon, Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law, 60 U. Cin. L. Rev. 347 (1991).

[35] This process is only one step off of reality. While the Supreme Court in *Mentor Graphics* made clear that the newly elected directors must exercise their independent business judgment in evaluating the bidder's offer, Quickturn Design Systems, Inc. v. Mentor Graphics Corporation, 721 A.2d 1281 (Del.S.Ct. 1999), it is predictable that a careful record will be crafted to support their decision to let the offer go forward. Thus, the simplified procedure in the text assumes away only the choreography.

Under these quite restrictive assumptions – perfect information and an election structure identical to the tender offer – the election is tautologically equivalent to a non-coercive tender offer.

The equivalence disappears, however, once the simplifying assumptions are released and some reality intrudes on the analysis.[36] Most important, a proxy contest invites manipulation on the part of the target company to influence the outcome of the election. The risk remains that, under the second *Apple Bancorp* decision,[37] cooperation among parties in connection with a proxy contest will serve itself to trigger a pill. Further, target companies may succeed in manipulating the election by recourse to techniques for strategically delaying the timing of the shareholders' meeting through notice provisions, director qualification requirements, and limits on the calling and timing of special meetings. Finally, there remains the issue of staggered boards. For those companies who have won the defensive lottery by having a staggered board in place before institutional investors decided that, because of the interaction of staggered boards with poison pills, they would not vote for them, or for those companies who went public with a staggered board already in place,[38] the election route requires a minimum of two years to change control of the board. While one may question whether independent directors will continue the defense if the would-be bidder handily wins the first proxy

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[36] These assumptions might not be so unrealistic if the Delaware Supreme Court had not in Stroud v. Grace, 606 A.2d 75 (1992) collapsed *Blaisus*' requirement of a compelling justification for management interference with the electoral process into *Unocal* for purposes of a proxy contest associated with a tender offer.

[37] Stahl v. Apple Bancorp., Fed. Sec. L.Rep. (CCH) ¶95,412 (Del.Ch. 1990).

[38] See Robert Daines & Michael Klausner, Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs, Working Paper, Jan. 2000 (45% of companies undertaking an IPO between 1993 and 1998 had staggered boards). This paper is accessible through the Legal Scholarship Network at http://papers.ssrn.com/paper.taf?ABSTRACT_ID=187348.

fight[39], even a small possibility of a two-year delay can be of enormous significance in today's quickly moving product markets.

Thus, once we get real, elections clearly appear a poor second to markets in assessing the benefits of a contested control change. Of course, this should come as no surprise; the SEC directly confronted the issue of the comparative efficiency of elections and markets at mediating control changes in crafting Rule 19c-4. Then, it will be recalled, the issue was whether an election could be used to shift control of a company by means of a charter amendment creating two classes of voting common stock. Consistent with the case for requiring those seeking control to buy it rather than campaign for it,[40] the SEC adopted a rule that favored markets over elections. As adopted in July, 1988, Rule 19c-4 prohibited changing the voting rights of existing common stock by ballot, but allowed new issuances of common stock with lesser voting rights than the outstanding class of common stock.[41]

Despite the comparative efficiency of markets compared to elections, the court might have relied on the statute to justify its preference for elections. The problem, however, is that the statutory language itself provides no clear guidance. As the debate over the poison pill in *Household International* clearly demonstrates, statutory language often does not command a particular result, but is consistent with either of the conflicting

[39] See Ronald J. Gilson, The Case Against Shark Repellant Amendments: Structural Limitations on the Enabling Concept, 34 Stan. L.Rev. 775, 794 (1982)(Once the target company has lost the first proxy fight,"an independent director has not reason to fight a fall-back action in the face of both inevitable defeat and the ideology of majority rule.").
[40] The issue was posed in this fashion in Ronald J. Gilson, Dual Class Common Stock: The Relevance of Substitutes, 73 Va. L. Rev. 807 (1987).
[41] Rule 19c-4 was short-lived.. In The Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990), the SEC was found to have exceeded its statutory authority to regulate stock exchanges by adopting a rule that was largely concerned with corporate governance. Ultimately, the New York Stock Exchange, American Stock Exchange, and NASDAQ voluntarily adopted a rule that parallels Rule 19c-4, although not before those companies who most wanted to shift control through an election had already accomplished it and who

results urged by both parties. The statute, like a golem, requires an animating principle to come alive. In *Household International*, the principle was the Delaware Supreme Court's commitment to review the actual operation of the pill under *Unocal* when a takeover arose. But *Unitrin*'s effective abandonment of *Unocal*'s regulatory function brings us back to the need for an animating justification: why should the court prefer elections to markets? And on this issue, *Unitrin* simply leaves us hanging.

C. The Supreme Court's Election Preference Serves to Degrade the Election Process

The second substantive problem with preferring elections to markets in mediating changes in control is indirect: the impact of the Supreme Court's preference for elections on the integrity of the electoral process itself. The predictable result of *Unitrin* has been a quickly escalating level of board-implemented barriers to contested elections. And, to be frank, judicial efforts to constrain this process have not been up to the task.

The portion of the Chancery Court's opinion in *Mentor Graphics* that concerned the defensively adopted bylaw illustrates the problem.[42] The bylaw, adopted by target directors to buy time in the face of a proxy contest that they believed the company could not win, authorized the directors to delay the holding of a shareholder called meeting for 90 to 100 days after it determined the validity of the initial request. The Vice-Chancellor concluded that the "the 90 to 100 day interval chosen by the target board, although it may arguably approach the outer limit of reasonableness, struck a proper balance in this specific case." It is not unfair to the Vice-Chancellor to note that there is no real discussion of why 90 days is necessary. And it is certainly to the Vice-Chancellor's

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were grandfathered under the voluntary rule. Jesse Choper, John C.Coffee, Jr. & Ronald J. Gilson, Cases and Materials on Corporations 571 (5th ed. 2000).

[42] Mentor Graphics Corporation v. Quickturn Design Systems, C.A. Nos. 16584 & 16588 (Del. Ch. 1998).

credit that he was quite clearly aware of the risk that approving a 90 to 100 day delay without an animating principle that might serve to cabin the opinion's predictable expansive drift, would encourage ever more extreme measures. After all, the worst that could happen to an overly aggressive target management is that the bylaw would be struck down.

Recognizing the incentive in favor of aggressive defensive behavior, the Vice-Chancellor explicitly warned that "attorneys who represent corporate boards would best serve their clients well by counseling caution and restraint in this area, rather than seeking continually to push the time-delay envelope outwards to test its fiduciary duty limits."[43] But while the impulse to lecture counsel on their duties is both laudable and continues the Chancery Court's useful technique of instructing counsel through dicta,[44] the simple fact is that the opinion – and the Delaware courts' approach in this area – operates to encourage attorneys to push the envelope precisely because there is no principle guiding the outcome. What factors would counsel against a delay of 90 days, said by the court to be potentially unreasonable "in other circumstances"? If, as the court suggests, "it is impossible to draw a line that categorically separates mandatory delay periods which have a basis in reason, from those that so manifestly burden or impede the election process that they can be characterized as intended to entrench the incumbent board," then how can the ambiguity do other than encourage clients "continually to push the time-delay envelope outwards…," precisely the behavior we have observed with the poison pill. Certainly, respected counsel's assistance in the adoption of slow-hand and dead-hand pills gives one little reason to anticipate professional self-control.

[43] Id.

Nor should the onus be placed entirely on the Chancery Court. The standard on remand in *Unitrin* – that a tactic not render a proxy fight "mathematically impossible or realistically unattainable" – itself invites extreme measures since the formulation implies that the process can be drastically skewed in management's favor so long as it is not impossible for a bidder to win the proxy fight.

In the end, the absence of a guiding principle restricting director manipulation of election contests is the greatest irony of all. While the Delaware courts plainly recognize that elections are all that legitimate directors' power over assets that belong to others, the shifting of control contests into the electoral process has served to degrade the electoral process itself. It is rather hard to imagine an electoral process that can both confer legitimacy on the victor and still leave the incumbent very substantial discretion to manipulate the process. Debate over the timing of this year's Peruvian presidential election starkly illustrates the problem.

VI. Is There a Way Out? The Shareholder Adopted Bylaw Debate

However trenchant, criticism is made constructive only by providing a solution to the problem. How can the Delaware Supreme Court ameliorate the electoral bias created in *Unitrin*[45] without simply reversing 15 years of common law development?[46] I think

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[44] See Gilson, William T. Allen, supra note 12, at 917-18; Edward Rock, Saints and Sinners: How Does Delaware Corporate Law Work?, 44 U.C.L.A.L.Rev. 109 (1997).

[45] Vice-Chancellor Strine recently commented with refreshing candor that "Delaware's doctrinal approach [to defensive tactics] is premised on the assumption that the world can be viewed simultaneously wearing three pairs of eye glasses with different prescriptions (*Unocal*, business judgment, and entire fairness. It is not apparent that this approach works any better in the law than it does in the filed of optics." In re Gaylord Container Corporation Shareholders' Litigation (Del.Ch. 2000)

[46] Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del.S.Ct. 19994), suggests that the current Delaware Supreme Court is oversensitive to admitting it had made a mistake. In *QVC* the Supreme Court rejected the formulation of the *Revlon* trigger it announced in *Time-Warner* in favor of the "change in control" test originally proffered by the Chancery Court in *Time-Warner* (which the Supreme Court had rejected in that case in order to base its decision on "different grounds)." 571 A. 2d at 1150. When confronted by Paramount counsel's claim in *QVC* that Paramount had complied with the standard the Supreme Court announced in *Time-Warner*, the Court responded by stating that "[t]he Paramount

such an avenue exists and, indeed, in the context of an issue that the Delaware courts will certainly confront: the validity of shareholder-adopted bylaws to redeem poison pills.

Taken to its conclusion, my analysis calls into question not merely *Time-Warner*, in which the Supreme Court lifted the Chancery Court's more erosion-resistant allocation of decision authority between directors and shareholders, but also *Household International,* which provided the mechanism by which the erosion subsequently occurred. Fifteen years experience with *Unocal* teaches that shareholders ought to decide whether to accept an offer made to them, subject to the board's efforts to secure for them a better alternative. As the Chancery Court explained in *Interco*, the legitimacy of our corporate law and, we now have seen, the legitimacy of the electoral process as well, depends on the shareholders' ultimate decision-making role. With the benefit of hindsight, the pill in *Household International* should have been struck down for the very reason that it was expedient to management: the absence of shareholder approval.

But what do we do now? I start with the widely shared view that the genius of Delaware corporate law and of American corporate law generally is that it is for the most part enabling – it gives the parties the freedom to choose their governance structure rather than imposing an outcome upon them. The Delaware courts' sympathetic treatment of the pill, understandably caught up in the frenzy of the 1980s, lost sight of that fact. The attraction of the pill to target management is that it can be imposed without shareholder approval, and shareholders cannot remove it without incurring the cost, in resources and opportunity, of replacing a board of directors that might in all other respects be doing an

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defendants have misread the holding of *Time-Warner*. … The Paramount defendants' argument totally ignores the phrase 'without excluding other possibilities.'" 637 A. 2d at 48. Put differently, counsel should have known that the Court had its fingers crossed in *Time-Warner.* It would have been more excellent job. That is hardly an enabling approach; as Chancellor Allen pointed out in *Blasius*, directors are not Platonic guardians.[47] Rather, it reflects the sense of the times, incorrect to be sure but an understandable accommodation in that moment of perceived crisis, that shareholders could not be trusted to vote for sensible defensive measures.

We are past that point now. Institutional investors quite routinely approve sensibly drafted pills, and even some not-so-sensibly drafted pills that are proposed by trusted, well performing management. In this calmer time, it would be appropriate to return to an enabling approach that allowed shareholders to choose their governance regime, including whether to have a poison pill. But how to accomplish this without entirely replanting a path now worn clear by 15 years' experience?

Shareholder adopted bylaws are now working their way up the judicial process toward a determination of their fit under Delaware law. As I understand it, the standard response among many thoughtful Delaware lawyers, especially after *Mentor Graphics*, is that such bylaws violate § 141(a)'s grant of managerial authority to the board of directors.[48] However, § 141(a)'s grant of authority is qualified by the phrase "except as otherwise permitted in this chapter or in the certificate of incorporation." Section 109(b) – obviously in "this chapter" – authorizes shareholders to adopt bylaws containing "any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and the rights and powers of its stockholders, directors, officers, or employees."

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straightforward for the Court simply to acknowledge that it had changed its mind and was adopting the Chancery Court's formulation.

[47] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del.Ch. 1988).

[48] Professor Hamermesh surveys professional opinion on the validity of shareholder-adopted bylaws to repeal a poison pill. Lawrence A. Hamermesh, Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?, 73 Tulane L. Rev. 409 (1998).

As my colleague Jeffrey Gordon has perceptively noted, the broad grant of management authority to the directors in §141(a), referring to the "business and affairs of the corporation," juxtaposed with the equally broad grant of authority for shareholder-adopted bylaws in §109(b), referring to "the business of the corporation [and] the conduct of its affairs," should call to mind the Delaware doctrine of "equal dignity" or "independent legal significance."[49] This doctrine, which lets corporate participants choose among different statutory alternatives for dealing with precisely the same functional activity, is the very embodiment of Delaware's enabling approach. The board manages pursuant to §141(a); the shareholders adopt bylaws pursuant to § 109(b). Under the equal dignity doctrine, the fact that the two sections cover the same ground results not in a conflict, but in alternative approaches to the same problem.

Allowing shareholders to redeem poison pills or replace them with less expansive versions by means of a bylaw allows the Delaware Supreme Court to back off with grace from the extreme position to which they were driven by the turmoil of the 1980s and the failure of any other institution, most notably the United States Congress, to give the governance of takeovers more than superficial attention. In particular, shareholder-adopted bylaws largely (but not entirely) returns to shareholders the decision making role with respect to tender offers that *Household International* transferred to the board of directors, and allows shareholders to reverse *Time-Warner* by reinstating only an *Interco*-style constrained pill.

[49] Jeffrey Gordon, "Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet, 19 Cardozo L.Rev. 511 (1997). The most familiar application of the equal dignity doctrine in Delaware has been its deployment to defeat the defacto merger doctrine. The statutory conflict between functionally equivalent acquisition techniques only one of which accords target shareholders appraisal rights, is ignored by according each technique independent legal significance; i.e., allowing the parties to the transaction to choose whether to accord appraisal rights. See Hariton v. Arco Elecs., Inc., 188 A.2d 123, 140 (Del. Ch. 1933); R. Gilson & B. Black, supra note 5, at 674-87.

While the shareholder bylaw route still leaves the balance between shareholders and management tipped toward management – absent *Household International*, it would be better to require the directors to seek shareholder approval to impose a pill in the first instance rather than requiring the shareholders to seek repeal because of our rules for who bears the cost of proxy initiatives[50] – it is a workable way out of an outcome that, because it encourages managerial manipulation of the electoral process, genuinely degrades the legitimacy of Delaware corporate law.

To be sure, one can undertake a more technical interpretive analysis concerning how the conflicting language of Sections 109(b) and 141(a) might be rationalized. While it can be argued that the language of § 109(b) was hardly intended for this function, *Household International* itself provides the response. Responding to the same objection with respect to its broad reading of §157, the Supreme Court quoted *Unocal*:

> [O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation law is silent, as to a specific matter does not mean that it is prohibited."[51]

Stretching § 157 correspondingly stretches § 109(b).

Professor Coffee takes the problem more seriously, providing a careful and quite plausible exegesis of alternative approaches to cabin the breadth of shareholder initiative under § 109(b), and thereby minimize the conflict with director authority under § 141(a), while still allowing shareholders to repeal poison pills.[52] In contrast, Professor

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[50] R. Gilson & B. Black, supra note 5, at 1337n28 (Speaking with respect to the same issue in connection with a corporation opting out of a state antitakeover statute, "[i]f the statutes were structured to require a charter amendment to opt in to the statute, management would still be able to use corporate funds to propose the amendment and solicit votes in its favor, but shareholders would at least have the opportunity to reject it.").

[51] 493 A.2d at 1352 (quoting *Unocal*, 493 A.2d at 957.

[52] John C. Coffee, Jr., The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?, 51 U. Miami L. Rev. 605 (1997).

Hamermesh concludes after a lengthy analysis that traditional and non-traditional tools of statutory interpretation, the public choice problems associated with shareholder voting, and especially the difficulty of identifying of defining a "poison pill," counsel in favor of stopping Section 109(b) short of poison pill repeal.[53]

My goal here is not to resolve the scope of § 109(b) as a matter of technical interpretation beyond expecting the Delaware Supreme Court to hew to their equal dignity canon,[54] in no small measure because I am enough of a realist to be skeptical both of the power of technical arguments to drive as opposed to rationalize outcomes,[55] especially in Delaware, and of a coherent explanation that distinguishes under Delaware

[53] Hamermesh, supra note 48.

[54] The most direct argument is that the Delaware Supreme Court's decision in *Mentor Graphics* invalidates any incursion on the board of directors' authority to manage the corporation. See Dennis J. Block & Simon C. Roosevelt, Further Implications of the *Mentor Graphics* and *Fleming* Decisions for Shareholder Bylaws, 7 Corporate Governance Advisor 18 (issue 2, March/April 1999). Read more narrowly, and consistent with an equal dignity approach, *Mentor Graphics* holds only that § 141 prevents a board of directors from acting to limit the power of future boards of directors to manage the corporation. It does not extend to limitations imposed by the shareholders under express statutory authority. The Chancery Court's comment in General DataComm Industries, Inc. v. State of Wisconsin Investment Board, 1999 WL 66953 (Del. Ch. Feb. 1, 1999), suggests this narrower interpretation. Considering the validity of a shareholder adopted bylaw prohibiting the board from repricing outstanding stock options without shareholder approval, the court framed the issue nicely:

> "It may be that [the company] is correct in stating that the Repricing Bylaw is obviously invalid under the teachings of [*Mentor Graphics*]. But the question of whether a shareholder-approved bylaw that can potentially be repealed at any time by the [company's] board of directors exercising its business judgment, is clearly invalid under the teaching of a case involving a board-approved contractual rights plan precluding, by contract, a new majority from redeeming the rights under the plan until six months after election seems to me to be a question worthy of careful consideration."

Both Professor Coffee, supra note 52, and Professor Hamermesh, supra note 48, discuss possible resolutions to the problem of recursive bylaw adoptions by shareholders and director action, first repealing and then reinstating poison pills. For present purposes, it is sufficient to note that even this circularity is better than the present situation. At least when shareholders are allowed to act, the board must overtly overrule the shareholders. As Professor Coffee has noted, this is costly to directors, presumably more so than taking no action at all in response to precatory resolutions, as is the case now. Coffee, supra note 52. Even in a system of Burkean representation, there are repercussions when a representative's judgment differs from those of her constituents.

[55] Karl Llewellyn makes the point emphatically in his classic illustration that for every canon of statutory interpretation there is an equal and opposite canon. Karl N. Llewellyn, The Common Law Tradition: Deciding Appeals 521-35 (1960).

law when the conflict between statutory provisions must be respected – the equal dignity move – and when the conflict is explained away through interpretation. Nonetheless, two rather practical points are worth making. First, defining a poison pill presents at worst no greater difficulty than defining a defensive action under *Unocal*, a task that has been largely uncontroversial. To paraphrase a response to a different interpretative problem, the Delaware courts have known defensive tactics when they have seen them, and will know a poison pill when they see one.[56] Second, the interpretive problem is of no grander scale than the Delaware Supreme Court's assessment in *Household International* of whether the broad language of Section 157 encompassed poison pills. The outcome requires a theory of the mechanisms that govern the shifting of corporate control, an animating structural principle for the bones of the statute.[57] *Unocal* was to provide the theory that *Household International* lacked, but the lesson of *Unocal*'s first fifteen years is that the Delaware Supreme Court's march toward an unarticulated and unjustified preference for elections over markets, however understandable in its original motivation, has proven to be a failure. The Chancery Court had the animating principle right in the first place: the ultimate decision makers concerning a tender offer should be the shareholders. However realistic the threat of a tidal wave of junk bond financed, two-tier, bust-up takeovers, assisted by unthoughtful shareholders, may have appeared to the Delaware courts in 1985, we know now that it was a chimera. Between bidder and target

[56] The line drawing problem may involve no more than identifying whether the power to block a tender offer has been given to the board or to a third party. If the former, the device is a poison pill; if the later, it may raise *Revlon* problems but may not be a pill.
[57] Gilson, A Structural Approach, supra note 13. It is odd that Professor Hamermesh invokes public choice problems associated with voting in order to limit the breadth of shareholder approved bylaws. The result of his argument is to petrify the Delaware Supreme Court's shift of control contests from markets to elections which, given his concerns about voting, he must recognize as an inefficient transfer. So long as a court can recognize a poison pill, so as to cut off the slippery slope that concerns him, Professor Hamermesh should switch sides on this issue.

now stand large sophisticated shareholders with carefully considered views of corporate governance. Shareholder initiated bylaws provide an imperfect, but realistic, way to turn back the clock.

VII. In the End, a Silver Lining

So far, I have been quite negative in my assessment of the fifteen-year *Unocal* experiment. However, no cloud is without a silver lining, and in this case the silver lining is substantial even if accidental.

Given the decision to take on the task of distinguishing between good and bad defensive tactics, the manner in which the Delaware courts have carried out that charge is interesting. A fair reading of the Supreme Court's intermediate standard decisions, buttressed by the Chancery Court's and especially Chancellor Allen's repeated dicta about the critical role of independent directors in management buyouts, is that independent directors are expected to be the controlling parties in a target company's conduct of its defense. Only when the directors appear to have abdicated their role to management – think of *Van Gorkum*,[58] *Macmillan*,[59] and *QVC* – will the court intervene.[60]

As I have made clear to this point, I think this is the wrong approach; evaluating target board conduct misses the question of who should be making the decision in the first place. But, it seems to me, there has been at least one beneficial, if unintended, consequence of this focus on director performance. The role the Delaware Supreme Court has assigned independent directors in connection with takeovers is quite different

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[58] Smith v. Van Gorkim, 488 A.2d 858 (Del.S.Ct 1985).
[59] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del.S.Ct. 1989).
[60] Rock, supra note 44; Kahan, supra note 32.

than the role directors assigned to themselves prior to the turbulent 1980's.[61] At least in the takeover arena, independent directors, the Delaware courts have stated pointedly, are not merely advisers to management, who have no stake in whether their advice is followed. In the takeover arena, independent directors must be the *real* decision-makers and courts will expect them to play a central role in conducting the target's response to a hostile or competing offer.

That change in assigned role is quite significant, especially because I believe it cannot be and has not been tightly cabined to the takeover arena. Once directors internalize the norm that they are the central decision-makers with respect to the most critical issue in the target company's existence, it is hard to imagine that the generals will return to the barracks in less pressing circumstances. Thus, I am convinced that the high profile board firings of CEO's in a series of large corporations such as Good Year, Allied Signal, Tenneco, General Motors, American Express and Westinghouse, reflected the expansion into other areas of the new role for independent directors that the Delaware Supreme Court put forward in its takeover jurisprudence.

This is no small improvement, and I suppose one might argue that the systemic benefits of a newly invigorated board of directors may outweigh the costs of a dysfunctional takeover regime; given that the proper corporate governance response to problems depends on the nature of the problem, the tradeoff hinges on what conditions the company is actually facing.[62] However, as my analysis of the shareholder bylaw phenomenon suggests, we are not doomed to suffer the tradeoff. Directors are now

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[61] See, e.g., Myles Mace, Directors: Myth and Reality (1971).
[62] See Randall Morck, Andrei Shliefer & Robert Vishny, Alternative Mechanisms for Corporate Control, 79 Am. Econ. Rev. 842 (1989)(Board action responds to poor performance compared to competitors, but third party intervention is necessary to respond to industry wide problems.).

energized. We need no longer continue paying the price of takeover rules that, however well meaning and driven by circumstances, we can now recognize are far less than optimal.