Widener University School of Law
Delaware Journal of Corporate Law

presents the

29th Annual Francis G. Pileggi Distinguished Lecture in Law

Delaware's Choice

Professor Guhan Subramanian
Joseph Flom Professor of Law & Business, Harvard Law School
Douglas Weaver Professor of Business Law, Harvard Business School

Friday, November 22, 2013

8:00 a.m. Breakfast; 8:45 a.m. Lecture

Hotel DuPont, du Barry Room
11th and Market Street
Wilmington, Delaware 19801

Encore presentation 11 a.m.
Widener University School of Law—Delaware Campus

One substantive CLE credit in Delaware and Pennsylvania.

History of Pileggi Lecture

In 1985, Francis G.X. Pileggi, who was then the Internal Managing Editor for the *Delaware Journal of Corporate Law*, envisioned creating a forum where practitioners, judges, and academics, distinguished in the area of corporate law, could speak directly to those most responsible for setting policy on corporate law in the United States—the Delaware bench and bar. Through his efforts and the generosity of his father, Francis G. Pileggi, the idea turned into reality. It continues today through the members of the *Delaware Journal of Corporate Law* and the continued generosity of Francis G. Pileggi, a founding attorney of Pileggi & Pileggi.

One substantive CLE credit in Delaware and Pennsylvania.

Registration: Contact Rose E. Callahan at 302-477-2014 or recallahan@widener.edu
Registration form available at law.widener.edu/CLE

Contact Rose E. Callahan at least one week in advance for accessibility and special needs requests.

Widener Law

Professor Guhan Subramanian is the Joseph Flom Professor of Law and Business at the Harvard Law School and the Douglas Weaver Professor of Business Law at the Harvard Business School. He is the first person in the history of Harvard University to hold tenured appointments at both HLS and HBS. At HLS he teaches courses in negotiations and corporate law. At HBS he teaches in several executive education programs, such as *Strategic Negotiations, Changing the Game, Making Corporate Boards More Effective*, and the *Advanced Management Program*. He is the faculty chair for the JD/MBA program at Harvard University and the vice-chair for Research at the Harvard Program on Negotiation. Prior to joining the Harvard faculty he spent three years at McKinsey & Company.

Professor Subramanian's research explores topics in corporate governance and negotiations. He has published articles in the *Stanford Law Review,* the *Yale Law Journal*, the *Harvard Business Review,* and the *Harvard Law Review,* among other places. His work has been featured in the *Wall Street Journal*, the *New York Times,* the *American Lawyer*, *The Deal*, and *Corporate Control Alert*. His book *Dealmaking: The New Strategy of Negotiauctions* (W. W. Norton 2011) synthesizes the findings from his research and teaching over the past decade. This book has been translated into Chinese (Mandarin), German, Japanese, Portuguese, and Spanish. He is also a co-author of *Commentaries and Cases on the Law of Business Organization* (Aspen 4th ed. 2012), a leading textbook in the field of corporate law.

Professor Subramanian has been involved in major public-company deals such as Oracle's $10 billion hostile takeover bid for PeopleSoft, Cox Enterprises' $9 billion freeze-out of the minority shareholders in Cox Communications, Exelon's $8 billion hostile takeover bid for NRG, and BankofAmerica's $4 billion acquisition of Countrywide. He also advises individuals, boards of directors, and management teams on issues of dealmaking and corporate governance.

Over the past 10 years he has been involved as an advisor or expert witness in deals or situations worth over $100 billion in total value. He is a director of LKQ Corporation (NASDAQ: LKQ), the leading supplier of recycled auto parts in the U.S., Canada, and the U.K.

Professor Subramanian holds degrees in law, economics, and business from Harvard University.

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Guhan Subramanian— Joseph Flom Professor of Law and Business at the Harvard Law School and the Douglas Weaver Professor of Business Law at the Harvard Business School

Preliminary and Incomplete—Do Not Cite Without Permission
September 7, 2013

Over the past ten years, corporate America has largely given up staggered elections for the board of directors. Among the S&P 500, staggered board incidence has gone from 60% in 2002 to 18% by 2012. This massive shift 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. The result is that we live in a world today in which the vast majority of corporate directors are elected each year.

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 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. 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. But this middle-ground approach was never endorsed by the Delaware courts, nor was it unilaterally adopted by boards.

And so the unwillingness of corporate America to adopt a middle-ground solution led to an extreme outcome, once shareholder activists gained more power. The irony is that most commentators today believe that boards are more vigilant in policing 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 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.

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 board rooms. As a director of a Delaware public company, an advisor to corporate boards, a teacher to public-company directors in Harvard Business School executive education programs, and a regular consumer of analyst reports, I have witnessed this pressure for short-term results firsthand. The consequences will play out in the global marketplace, against foreign companies that are structurally situated to have a longer-term perspective in the boardroom.

All of this is troubling, as a public 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 corporate code. 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. We concluded from our analysis that the constitutionality of Section 203 was unclear, at best.

While critics of our article argued vehemently that we were wrong, none of them challenged these four basic facts. 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. In its 2011 hostile bid for Casey's General Stores, Couche-Tard cited our study as the basis for its challenge to Iowa's antitakeover statute, which is structured similarly to Section 203. Delaware Chancellor Bill Chandler, in his seminal *Airgas* opinion, agreed with our assessment that an 85% threshold was virtually impossible to achieve. But in the three years since we published our study, the challenge has not yet come in Delaware. For those who believe that Section 203 is dominated by the 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 45% of companies without pills have not put them in when a bid is brought (and both of these percentages are higher when only Delaware companies are considered).

So Delaware has a choice. As with staggered boards, Delaware could put its head in the sand and 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.

If all of this sounds like Chicken Little, it has happened before: Delaware rescinded its prior antitakeover statute in 1987 due to constitutionality concerns, and replaced it just months later with a constitutionally more secure statute. Delaware reacted slowly to the constitutional problem that time (acting five years after the U.S. Supreme Court's decision in *Edgar v. MITE Corp.*) but at least it acted. If Delaware were to lose its antitakeover statute, involuntarily this time, it is my prediction that Delaware companies would contemplate reincorporating to other states that provide more constitutionally secure antitakeover protections.

Of course, Delaware can avoid this all-or-nothing showdown by amending Section 203. 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. 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 shareholders, but also providing companies with reasonable insulation against opportunistic low-ball offers. Unlike the staggered board question, it is not too late for Delaware to act. I would humbly urge the Delaware bar and the Delaware legislature to do so.

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