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A NEW APPROACH TO TAKEOVER LAW AND REGULATORY COMPETITION

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ABSTRACT

The development of U.S. state takeover law in the past three decades has produced considerable — and quite possibly excessive — protection for incumbent managers from hostile takeovers. Although the shortcomings of state takeover law have been widely recognized, there has been little support for federal intervention because of the concern that such intervention might produce even worse takeover arrangements. This paper puts forward a novel form of federal intervention in the regulation of takeovers that would address these shortcomings without raising such a concern. Rather than mandating particular substantive takeover arrangements, this form of federal intervention would focus on increasing shareholder choice. "Choice-enhancing" federal intervention would consist of two elements: (i) an *optional* body of *substantive* federal takeover law which shareholders would be able to opt into (or out of) and (ii) a *mandatory process* rule that would provide shareholders the right to initiate and adopt, regardless of managers' wishes, proposals for opting into (or out of) the federal takeover law. We argue that such a federal role in takeover law cannot harm — and would likely improve —the regulation of takeovers. Moreover, by showing how federal law can be used to improve regulatory competition in the provision of takeover law rather than preempt it, our analysis lays the groundwork for a more general reconsideration of regulatory competition in the corporate law area.

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I. Introduction

This paper offers a new approach to two corporate law subjects that have been among the most intensively debated in the last quarter of a century — the competition between states in the production of corporate law and takeover regulation. During this period, state takeover law has provided incumbent managers substantial protection from hostile takeovers, and there are grounds for concern that this level of protection might be excessive. We identify in this paper a new form of federal intervention that can address this potential problem with state competition in the provision of takeover regulation without imposing any mandatory substantive arrangements. This "choice-enhancing" federal intervention would contain both an optional body of substantive takeover law and a mandatory process rule by which shareholders can opt into (and out of) this federal takeover regime. Because the optional federal takeover regime would provide less protection to incumbents than state takeover law, its availability would expand the set of choices shareholders have in a meaningful way. Choice-enhancing federal intervention cannot harm shareholders and it might well improve takeover regulation thereby benefiting shareholders. While our analysis is limited to the context of takeover regulation, choice-enhancing federal intervention could be employed more broadly and might warrant a more general reconsideration of regulatory competition in the corporate area.

Our proposal is made against the backdrop of a striking inconsistency in the views of many corporate law scholars.[1] This inconsistency arises from the firm, often passionate, contention of many legal academics that the freedom of corporations to choose where they will

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[1] For earlier discussions of these inconsistencies, see Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435, 1442-51 (1992); Lucian Arye Bebchuk & Allen Ferrell, Federalism and Corporate Law: The Race to Protect Managers from Takeovers, 99 Colum. L. Rev. 1168, 1193-99 (1999); Robert M. Daines & Jon D. Hanson, The Corporate Law Paradox: The Case for Restructuring Corporate Law, 102 Yale. L.J. 577, 584-89 (1992).

incorporate, among the fifty states, creates a so-called "race to the top." States providing the most efficient set of corporate rules, we are assured, are rewarded with the most corporate charters (incorporations).[2] The obvious implication is that the current regulatory treatment of takeovers in the United States, an area that has been largely left to the states, serves the interests of shareholders, at least within a tolerable range.[3] Even while proclaiming the benefits of state competition for corporate charters, however, some of the strongest supporters of such competition have also been critical of state takeover regulation as being overly protective of incumbent managers at the expense of shareholders.[4]

An important reason why some commentators who are concerned about state takeover law are nevertheless reluctant in supporting replacing it with mandatory federal rules is the fear that a federal takeover regulatory regime might be even more detrimental to shareholder interests. If the federal takeover regime turns out to be harmful to shareholder interests, corporations would have no hope of escape. Moreover, there is a dynamic as well as a static dimension to the problem of a monopoly regulator. A takeover regime, even if it were at first to

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[2] For arguments along these lines, see, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 212-227 (1991); Roberta Romano, The Genius of American Corporate Law 14-51 (1993); Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913 (1982); Roberta Romano, Competition for Corporate Charters and the Lesson of Takeover Statutes, 61 Fordham L. Rev. 843, 856-59 (1993); Ralph K. Winter, The "Race for the Top" Revisited: A Comment on Eisenberg, 89 Colum. L. Rev. 1526 (1989); Ralph K. Winter Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251 (1977) (articulating this line of argument fully for the first time); cf. Stephen J. Choi & Andrew T. Guzman, Portable Reciprocity: Rethinking the International Reach of Securities Regulation, 71 S. Cal. L. Rev. 903, 914-924 (1998) (discussing implications of issuer choice in the international securities context); Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale L.J. 2359, 2383-88 (1998) (advocating an expanded role for states in securities regulation).

[3] As Ralph Winter put it, the race to the top might actually be a leisurely walk. See Winter, The "Race for the Top" Revisited: A Comment on Eisenberg, supra note 2, at 1529.

[4] See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 162-211 (1991); Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Roberta Romano, A Guide to Takeovers: Theory, Evidence and Regulation, 9 Yale J. on Reg. 119 (1992).

serve shareholders' interests well, might require modification over time. As business conditions and needs change, one might wonder whether federal regulations would adjust accordingly? Some commentators hold the view that a system where fifty states are constantly changing and experimenting with their corporate laws, and in which states can learn from incorporation decisions which bodies of law companies find attractive, will adjust better over time than a single monopoly regulator that has less room for experimentation and learning.

There is thus the apparent Hobson's choice between the current system of federal nonintervention in the provision of takeover law and mandatory federal takeover law. The choice, as currently framed, depends on weighing the costs arising from nonintervention with the costs of having mandatory federal takeover rules. One of us has taken the position in an earlier work that, with respect to takeover law, the costs of federal nonintervention are likely more severe than those created by a federal mandatory takeover regime.[5] Nevertheless, most corporate law commentators seem reluctant to support mandatory federal rules.[6]

This paper offers a third choice in addition to federal nonintervention and mandatory federal takeover law. We argue that the approach we will outline in this paper choice-enhancing federal intervention dominates federal nonintervention in the provision of takeover law. Accordingly, given this third possibility, there is no basis for supporting nonintervention. Choice-enhancing intervention would involve a federal role in the regulation of takeovers but not one that imposes mandatory substantive requirements. The role of the federal government, under this approach, is to facilitate the ability of shareholders to choose the type of takeover regime that best serves their interests. Federal intervention would do so both by expanding the set of

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[5] See Bebchuk, supra note 1, at 1499-1510.

[6] See, e.g., Roberta Romano, The Future of Hostile Takeovers: Legislation and Public Opinion, 57 U. Cin. L. Rev. 457 (1988).

choices that shareholders have and by providing shareholders the power to take advantage of these choices.

There are two main elements to this choice-enhancing federal intervention. First, federal law would offer a body of takeover law that provides less protection to incumbent managers from takeovers than state takeover law. This body of federal takeover law, however, would be optional rather than mandatory. This should appeal to those driven to embrace federal nonintervention due to the perceived costs of federal mandatory takeover rules.

But who would have the power to opt into (or out) of the federal takeover law? This leads to the second, and critical, element of choice-enhancing federal intervention. In sharp contrast to how a corporation currently reincorporates from one state to another, shareholders would be able to decide to have their corporation opt into the optional federal takeover regime even against the wishes of the corporation's managers. Having the option of choosing a takeover regime that does not extensively protect incumbents from takeovers, an option that not a single state has thus far offered, would add a meaningful and potentially valuable choice for shareholders. Under the choice-enhancing approach, no state would be allowed to prevent shareholders of the corporations incorporated in that state from opting for the federal takeover regime. Therefore, unlike the substantive federal takeover law, the process for opting into (and out of) the federal takeover regime would be mandatory on the states.

While choice-enhancing intervention is superior to federal nonintervention, it might not be superior, for reasons that shall be explained, to mandatory federal rules. We do not attempt to resolve in this paper which of these two approaches would be preferable. Our main aim is to put choice-enhancing federal intervention on the table for discussion -- and to show that, given this option, federal nonintervention in takeover law should be off the table.

Our analysis is organized as follows. Part II analyzes the problems of state takeover law. We argue that state competition provides states with incentives to restrict takeovers excessively,

and that the development of state takeover law has more than lived up to this expectation. States across the board, including Delaware, the leading corporate law jurisdiction, have given managers an expansive power to impede bids, and they have provided these protections to incumbent management in a way that has left shareholders little choice in the matter. It should be emphasized that, although we argue that states have incentives to restrict takeovers excessively and that they have actually done so, it is only necessary that the reader be convinced that a regime that offers less takeover protection to incumbents *might* be attractive to shareholders and *might* be selected by them if they had the choice.

Part III sketches what choice-enhancing federal intervention would look like. We outline the main elements of this approach: the optional federal takeover law, perhaps backed by a federal forum or agency for implementing and adjudicating this body of law, and the mandatory process rule governing opting into and out of this federal optional takeover law. We suggest that one promising way of meaningfully expanding shareholder choice would be an optional federal takeover law that establishes a regime, such as the one offered by the British City Code, in which managers are not provided protection against bids that shareholders find attractive. We show that choice-enhancing federal intervention would not be subject to the traditional objections to mandatory federal law: it cannot make things worse, it would enable experimentation and dynamic adjustment over time, and it would expand rather than restrict shareholder choice.

Part III also discusses why federal intervention is essential in expanding the choice set of shareholders so as to include a regime that provides incumbents with less takeover protection. It also discusses an alternative implementation of choice-enhancing intervention – a federal requirement that states allow shareholders to opt out of antitakeover arrangements – different from the one this paper focuses on. Following this discussion, the remaining sections take a brief look at the political economy considerations relevant in considering choice-enhancing intervention and how choice-enhancing intervention compares with federal mandatory rules. Part

III concludes with a discussion of how choice-enhancing federal intervention can be used to improve regulatory competition in corporate and securities law in general and not only in takeover regulation.

II. The Trouble with State Takeover Law

A. *A Critique of State Takeover Law*

We start our discussion with a critique of state takeover law to show why it might be viewed as creating a regulatory regime that excessively restricts hostile takeovers at the expense of shareholders. Although this view is shared by many corporate law scholars, it is unnecessary for our thesis to establish that state law does in fact excessively restrict takeovers. Instead, all we wish to establish is the more modest proposition that this is a possibility warranting serious concern.

1. *State Regulation of Defensive Tactics*

The most important impediment to takeovers arises from the use by incumbent target management of various takeover defenses. It is on this topic that we focus our attention.

(a) *The Development of Incumbents' Power to Impede Bids*

While state law has always permitted the use of some defensive tactics, states have increasingly expanded the ease with which, and the generality of the circumstances under which, incumbent management can use such tactics to impede a bid. As the threat to incumbent management from hostile takeovers became greater and greater, state law responded by permitting more and more potent defenses. The evolution of the law of Delaware on the use of defensive tactics is reflective of this trend.

A useful baseline for assessing the development of Delaware's law governing the use of defensive tactics is the legal landscape in the mid-1980s. Looking at Dean Robert Clark's treatise on corporate law, which reflects the state of the law at this time, one finds that managers had the power to impede a hostile bid in some circumstances but not in others.[7] The Delaware Supreme Court introduced, in the groundbreaking case *Unocal Corp. v. Mesa Petroleum Co.*,[8] a test requiring courts to scrutinize incumbent managers' use of defensive tactics. Only a "proportionate" response to a legally cognizable "threat" to the acquisition target, arising from the tender offer, could justify the use of a defensive tactic. By employing judicial scrutiny of whether the use of a defensive tactic was justified, the Delaware Supreme Court signaled its willingness to guard against the possibility that incumbent boards, faced with a hostile tender offer, would act "solely or primarily out of a desire to perpetuate themselves in office."[9] Since judicial review in this context appeared to be more than an empty formality, commentators, picking up on where the court left off, scrambled to delineate the range of circumstances under which defensive tactics would pass judicial review.[10]

The most powerful tool to incumbents in impeding bids resulted from the invention of the poison pill.[11] The pill gave a way that is highly effective, easy, and costless for managers to

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[7] See Robert C. Clark, Corporate Law 579-588 (1986) (summarizing state takeover case law).

[8] 493 A.2d 946 (Del. 1985). See also Cheff v. Mathes, 199 A.2d 548 (Del. 1964) (subjecting greenmail payments to heightened judicial scrutiny).

[9] *Unocal*, 493 A.2d at 955.

[10] See, e.g., Ronald J. Gilson & Reinier Kraakman, Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 Bus. Law. 247, 256-260 (1989).

[11] Poison pills typically consist of stock warrants or rights that allow the holder to buy an acquirer's stock (the so-called "flip-over" poison pill) or the target's stock (so-called "flip-in" poison pills) at prices substantially below market price. They are triggered when a security purchaser, without the target board's approval, acquires a certain percentage of the target's stock. See Wachtell Lipton Rosen & Katz, The Share Purchase Rights Plans, *reprinted in* Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions (2d ed. 1998 Supp.) at 4-12 (setting forth terms of standard poison pills).

impede an unwelcome bid. Unlike other defensive tactics (such as a target company's defensive acquisition of other companies) that have some effect in the world other than stopping a bid, the pill is an artifice whose only upshot is impeding a bidder. Thus, there was initially some question as to whether this artificial being, whose creation gave managers unprecedented power (which no one prior to the invention of the pill contemplated they had), was valid. But the Delaware Supreme Court in *Moran v. Household International*[12] concluded that the adoption of a poison pill by a board was consistent with Delaware law.

Nevertheless, the *Moran* decision still seemed to signal that the use of poison pills would not be left unconstrained. The *Moran* court commented favorably on the mild nature of the pill and on the fact that it did not completely block the acquisition of control but only a second-step freezeout.[13] More importantly, the court explained that managerial decisions whether to redeem the pill when faced with a tender offer, separate from the decision to adopt the pill, would be subject to judicial scrutiny under *Unocal.* As Ronald Gilson and Reinier Kraakman explained at the time, the crucial question left after *Moran* was when a court would order managers to redeem a pill.[14] Chancellor Allen responded to the invitation issued by *Moran* to define when redemption would be ordered by concluding in *City Capital Associates v. Interco*[15] that the poison pill being used by the incumbent board to resist a non-coercive tender offer had to be redeemed. The use

[12] 500 A.2d 1346 (Del. 1985).

[13] The poison pill at issue in *Moran* was a poison pill with only "flip-over" provisions, generally a far less potent defense than a poison pill with "flip-in" provisions. See Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions, supra note 11, at 747 (describing the differences in effectiveness between flip-over and flip-in provisions in poison pills).

[14] See Gilson & Kraakman, supra note 10, at 247-48.

[15] 551 A.2d 787 (Del. Ch. 1988).

of a poison pill to defeat a non-coercive tender offer, the Delaware Court of Chancery concluded, was not proportionate to any legitimate threat posed by the tender offer.[16]

The Delaware Supreme Court struck back in *Paramount Communications v. Time*[17] by explicitly rejecting Chancellor Allen's approach in *Interco*. Much of the reasoning by the Delaware Supreme Court suggested that almost anything would be considered a legitimate threat justifying the use of potent defensive tactics. The court found that Time's incumbent management's self-serving characterization of the all-cash, all-shares tender offer by Paramount as "inadequate" was sufficient justification for denying their shareholders the opportunity to decide for themselves whether the offer was adequate or not.[18] Subsequent to *Paramount*, Delaware courts reviewing the use of poison pills went a long way, if not the entire distance, in allowing managers to "just say no" when faced with a hostile bid and hide indefinitely behind their poison pill defenses.[19]

To be sure, this line of cases left some safety valves. Given that courts would let a board maintain a pill indefinitely, a bidder that offers an attractive price could still initiate a proxy contest to replace the incumbent board with directors that would redeem the pill. As long as the board could be ousted in a proxy contest, the Delaware Supreme Court emphasized in the recent case of *Unitrin* v. *American General Corp.*,[20] the board should be allowed to take strong steps to impede bids. This implies that for a hostile bidder to acquire a target, the bidder must first gain

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[16] For other examples of the Chancery court reviewing, and prohibiting, the use of defensive tactics, see Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. Ch. 1989); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).

[17] 571 A.2d 1140 (Del. 1989).

[18] Id. at 1153.

[19] See Jeffrey N. Gordon, "Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Paper for Warren Buffett, 19 Cardozo L. Rev. 511, 522-30 (1997).

[20] 651 A.2d 1361 (Del. 1995).

control of the board in elections that would effectively serve as a shareholder referendum on the bid. Such a referendum might in fact be helpful in eliminating possible distortions of shareholder choice in takeovers.[21]

The problem is that in a very large number of companies, such a referendum is not accessible to a potential buyer for quite some time. According to the data, many companies do not give their shareholders the ability to call a special meeting or to act by written consent, so at a minimum, a bidder would have to wait until the next scheduled election to conduct a proxy contest.[22] Even more importantly, a large fraction of publicly traded companies have classified boards.[23] In such companies, the bidder might have to wait a very long period of time to replace the board, as all the directors' seats are not contestable at the same time. The ability by incumbent management to impose significant delays on a bidder in acquiring control of a company after a tender offer has been issued might serve as a significant deterrent to the making of bids in the first place.[24]

Thus, as Delaware law evolved, the incumbent management of many companies obtained the power to effectively veto an acquisition, at least for a significant period of time. There has not been a single reported case in which a bidder proceeded to purchase a target with an

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[21] See Lucian Ayre Bebchuk, The Sole Owner Standard for Takeover Policy, 17 J. Legal Stud. 197 (1988); Lucian Ayre Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 Harv. L. Rev. 1695 (1985); Bebchuk & Hart, Takeover Bids, Proxy Fights, and Corporate Voting, Working Paper (1999).

[22] Klausner and Daines, for example, report that 24.5% of all firms have provisions in their charters that limits shareholders' ability to call a special meeting or act by written consent. Klausner & Daines, Do IPO Charters Maximize Firm Value? Antitakeover Protections in IPOs, Stanford Law School Working Paper No. 184 (Table 2)

[23] Sixty-two percent of all companies have classified boards. See Alesandra Monaco, Corporate Governance Service 1999 Background Report CL Classified Boards, 1999 IRRC. A staggered board is a board where only a portion of its members is elected in any given year. Delaware law authorizes boards with two or three classes of directors. See Del. Code Ann. tit. 8, § 141 (1991).

[24] See generally John C. Coates IV, Measuring Variability, Working Paper (describing this deterrent effect).

unredeemed poison pill in place. The poison pill, backed by an entrenched management, is extremely formidable. Incumbent management can use this power to prevent an acquisition that they do not want for self-serving purposes (such as saving their jobs). They can also use this power to extract private benefits for themselves, perhaps diverted from what would have otherwise gone to the shareholders, in return for redeeming the pill and allowing the tender offer to proceed.

(b) *Opposition to Managerial Veto Power in the Policy Debate*

In assessing the evolution of state takeover law, in particular the trend of providing incumbent management with a greater and greater ability to block hostile bids, it is interesting to note that the course that state takeover law took did not have support in the policy discussion of that time.[25] There was a substantial literature on defensive tactics in the 1980s. Some commentators favored prohibiting defensive tactics altogether.[26] Other commentators were in favor of allowing defensive tactics in some limited circumstances.[27] Even Martin Lipton, the champion and inventor of the poison pill defense, did not at the time advocate allowing directors to use a pill to impede a bid indefinitely no matter what the circumstances. He only favored allowing defenses, and the pill in particular, to counter "abusive" bidder tactics.[28] So even the poison pill's most ardent advocate only envisioned the power to defend against a set of certain

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[25] Even as of 1986, with the *Unocal* standard still apparently requiring real judicial review of the use of defensive tactics, Delaware had already restricted hostile takeovers beyond the bounds justified by the existing policy literature. See Clark, supra note 7 , at 582.

[26] See, e.g., Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, supra note 4.

[27] See, e.g., John C. Coffee, Jr., Regulating the Market for Corporate Control, 84 Colum. L. Rev. 1145 (1984).

[28] See, e.g., Martin Lipton, Corporate Governance in the Age of Finance Corporatism, 136 U. Pa. L. Rev. 1, 28-35 (1987).

well-defined abusive tender offers. He never argued in favor of an unrestricted and indefinite right by incumbents to use poison pills to block tender offers.

Still, as participants in this policy debate, we wish to take a humble approach, and therefore do not presume that the policy literature got things right. Indeed, as opponents of federal regulation often point out, attempting to figure out the "right" answer is a difficult project that always involves the possibility for error. We are therefore willing to accept that perhaps commentators advocating real limitations on the use of defensive tactics were wrong and that the states chose the regime that was in fact best for shareholders. This leads us to our second, and perhaps more important, observation. The evolution of state takeover regulation towards ever greater restrictive arrangements appears to have proceeded in the face of what shareholders themselves wanted and in a way that left shareholders with little say or choice in the matter.

(c) *The Midstream Shift of Power to Incumbents*

As the Delaware Supreme Court itself put it, "the emergence of the 'poison pill' as an effective takeover device has resulted in . . . a remarkable transformation in the market for corporate control. . . ."[29] The introduction of the pill and the judicial acceptance of its use as consistent with state corporate law represented a fundamental and unanticipated shift in the relative power of management and shareholders. Shareholders who purchased stock in 1980, for example, could not have possibly conceived of the pill, its potency, or its widespread adoption a few years later. By 1990, 51% of all large-cap companies in the United States had poison pill plans.[30] More importantly, it is widely understood to all concerned that any company that does

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[29] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995).

[30] See Majority of Large U.S. Corporations Have Adopted Poison Pills, IRRC Finds [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 47, at 1659 (Nov. 30, 1990).

not have a poison pill in place can quickly, indeed within hours, adopt one if the need arises.[31] The development and implementation of the poison pill defense in the 1980s was a mid-stream change in the fundamental structure of the corporation that was accomplished not by shareholders approving the defense, but rather by state law giving management the unilateral power to do so regardless of what shareholders might have thought.

This was clearly not the only or the most sensible way of structuring such a fundamental change. There was no screening mechanism in place to ensure that such an important change was in fact in the interests of shareholders and not just incumbent managers. In other corporate law matters, Delaware, as well as other states, had followed an enabling approach—much praised by proponents of state competition—which merely afforded corporations the opportunity, with shareholder approval, to opt-into a new way of doing things.[32] In a similar vein, shareholders under Delaware law must approve such fundamental corporate transactions as mergers,[33] sales of substantially all of a corporation's assets,[34] and dissolutions.[35] And as we suggested in an earlier article, this enabling approach was the right thing to do in the poison pill context as well.[36]

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[31] See John C. Coates IV, The Contestability of Corporate Control: A Critique of the Scientific Evidence on Takeover Defenses, Harvard Law School Working Paper No. 265, 53-59 (1999) (explaining that the ability to adopt the pill, which virtually all companies have, and not the actual adoption of the pill is what matters).

[32] See generally Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416, 1416-18 (1989) (stating that corporate law provides participants in a corporation to select from varying levels of risk and opportunity); Winter, State Law, Shareholder Protection, and the Theory of the Corporation, supra note 2, at 252 (pointing out that state corporation laws do not place extensive mandatory restrictions upon management decision making); Romano, The Genius of American Corporate Law, supra note 2, at 85-91.

[33] Del. Code Ann. tit. 8, § 251(c) (Supp. 1998).

[34] Id. at § 271(a) (1991).

[35] Id. at § 275.

[36] See Bebchuk & Ferrell, supra note 1, at 1189-1190.

Given that states could not be sure that the new defensive arrangements that managers were adopting were actually in the interests of shareholders and not just incumbent managers, they could have enabled companies to have pills if and only if shareholders ratify the pills or, alternatively, if shareholders approve a charter provision allowing such pills. In this way, states could have ensured that if shareholders want the pills, they will have them, and if they do not then they will not. Alternatively, states could have allowed managers to adopt pills but ensured that when shareholders no longer want to have a pill in place, they would be able to get rid of them. One easy way to do this would have been to allow shareholders to adopt amendments to a corporation's by-laws eliminating or restricting the use of poison pills. Indeed, shareholders have attempted to do just that.[37] Such an arrangement would go far to ensure that pills are available if and only if they are viewed by shareholders as serving their interests.[38]

States have chosen, however, to go in a way that deliberately avoided safeguards that would ensure that pills have shareholder support. States have consistently allowed managers to adopt pills without shareholder approval. Indeed, when some courts decided that pills could not be adopted by managers, state statutes were changed to negate such rulings and explicitly provide for such management power.[39]

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[37] See Moore Corp. v. Wallace Computer Servs., 898 F. Supp. 1089 (D. Del. 1995) (considering proxy solicitation for a binding bylaw requiring target board to redeem its poison pill under certain defined circumstances); Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos., No. Civ-96-1650-A, 1997 U.S. Dist. LEXIS 2980 (W.D. Okla. Jan. 24, 1997), *aff'd*, International Bhd. Of Teamsters Gen. Fund v. Fleming Cos., 173 F.3d 863 (10th Cir. Okla 1999) (considering binding bylaw amendment that nullified existing poison pill and required shareholder approval of any future poison pill).

[38] For this reason, whether shareholders will be allowed to adopt shareholder rights by-laws has been described by some commentators as the critical issue for the future vitality of the takeover market. See Jonathan R. Macey, The Legality of the Shareholder Rights By-Law in Delaware: Preserving the Market for Corporate Control, 10 Applied Corp. Fin. 63 (1998).

[39] See Eric Robinson, John C. Coates IV & Mitchell S. Presser, State Takeover Statutes: A Fifty State Survey (1989) (finding that in every state where the courts prohibited the use of poison pills, the state legislature overturned the decision). For examples of states where the legislatures went out of their way to pass statutes that explicitly provide managers with the power to implement poison pills, see, e.g., Ind.

Furthermore, states have started to impede shareholders from restricting the use of poison pills through the use of binding amendments to a corporation's by-laws. One state has even enacted a statute that places in the board of directors the "sole discretion" in setting the terms and conditions of a rights plan.[40] There has been no definitive ruling in Delaware on whether shareholders can adopt binding by-laws restricting the use of poison pills. While the outcome is by no means clear, some legal observers suggest that Delaware will ultimately decide that such by-laws are not permitted.[41] Our prediction is the same. Based on what we have seen of the development of state takeover law over the years, it would be surprising if the Delaware Supreme Court, or the Delaware legislature, would allow shareholders to opt-out of management's favorite and most powerful defense against hostile takeovers.

It is worth noting that most classified boards were adopted prior to 1990, before it became clear that courts would almost always allow managers to keep a pill in place indefinitely as long as they are not kicked out of office. This is important given that poison pills are especially powerful when combined with classified boards. The evisceration of *Unocal* judicial review has thus forced upon shareholders of all companies with classified boards an arrangement that they did not necessarily anticipate or approve of, and which they do not have the ability to get out of.

The approval of a classified board in the absence of a poison pill (or a poison pill with significant restrictions on its use) is a very different matter from approving a classified board in

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Code Ann. §§ 23-1-35-1, 23-1-26-5 (Michie 1999); Ohio Rev. Code Ann. §§ 1701.06, 1701.13(f)(7) (Anderson 1997 & Supp. 1999).

[40] See Maryland, 1999 Michie 2-201 (Gen. Laws).

[41] See Charles F. Richards & Robert J. Stearn, Jr., Shareholder By-Laws Requiring Boards of Directors to Dismantle Rights Plans are Unlikely to Survive Scrutiny under Delaware Law, 54 Bus. Lawyer 607 (1999). See generally John C. Coffee, Jr., The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?, 51 U. Miami L. Rev. 605 (1997) (reviewing the legal issues involved). Another, less probable, possibility is that Delaware will allow shareholders to enact binding by-laws but allow the board, in turn, to amend the by-laws after the shareholders have acted.

the presence of a poison pill that management can use at will.[42] As has already been explained, the only way for a hostile bidder to have a pill redeemed is to replace the board of the target company, which could take an unacceptable amount of time if the board is classified.[43] By the time the scope of managerial power over the pill became clear, it was "too late" for shareholders of many existing companies. Shareholders cannot by themselves redeem unwanted pills. And shareholders cannot change the charter to eliminate the board classification because changes to the charter require initiation by the board.[44] Thus, in companies in which shareholders had approved classified boards in the 80's or earlier, management was given powerful protection against hostile bidders regardless of whether such protection was in fact desired by the shareholders.

(d) *Evidence of Shareholders' Preferences*

Even though states unilaterally imposed the current regulatory regime on shareholders, it is possible, of course, that this is the regime that shareholders actually prefer. The manner in which the existing defenses were made available to incumbent management, however, provides no assurances on this score.

There are reasons to believe that many shareholders are not happy with the current regulatory regime, and if given a chance, would opt-out. Tellingly, while many companies that

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[42] See Coates, supra note 31, at 59-66.

[43] Another technique that managers have tried to use to eliminate the effectiveness of a proxy contest to unseat the incumbent directors is the so-called "dead-hand" poison pill, which limits the power to redeem the poison pill to those directors who were members of the board at the time of the pill's adoption. These were prohibited by the Delaware Chancery Court in Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998), at least if the articles of incorporation do not include authorization for their adoption. Id. at 1191. The importance of this ruling in freeing up the market for corporate control is limited by the availability of frustrating a proxy contest through the use of a classified board or perhaps even less extreme forms of the "dead-hand" poison pill at issue in *Carmody*.

[44] Del. Code Ann. tit. 8, § 242 (Supp. 1999)

have gone public in the 1990s have classified boards, many do not.[45] This suggests that for many companies that had classified boards before the advent of the poison pill and the *Paramount* decision, it might be the case that their shareholders found themselves with a more restrictive takeover regime than they would have otherwise liked.

Concerns are further heightened by the fact that those companies that did not already have classified boards at the start of the 1990s have found it practically impossible to get the necessary shareholder approval of any charter amendment adopting a classified board.[46] This is in sharp contrast to the situation in the mid-80s where shareholders virtually always agreed to board classification.[47]

Unfortunately for shareholders, when it comes to removing existing board classifications or limiting the use of the poison pill defense, they are largely limited to proposing advisory shareholder resolutions. Nevertheless, in companies that already have classified boards, shareholders often vote in large numbers for advisory resolutions to repeal them.[48] The same story holds for poison pills. Shareholders often vote in significant numbers in proxy contests in favor of the board redeeming its poison pill.[49] These proposals have garnered this support despite

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[45] See Klausner & Daines, Value-Maximizing Charters: An Empirical Analysis of Antitakeover Provisions, Working Paper.

[46] Reflecting this reality, the number of management proposals to shareholders to classify the board dropped 90% between 1988 and 1998 for a total of a mere nine such proposals in 1998. Institutional Investor Research Center, Corporate Governance Bulletin.

[47] See Coates, supra note 31, at 35 n. 83.

[48] See John C. Coates IV, Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations, 24 J. Corp. L. 837, 861 Chart 5 (1999) (measuring the steady increase in shareholder votes for precatory poison pill redemption proposals and proposals to remove classified boards).

[49] Institutional investors such as CalPERS have been leading the charge in forcing these votes. See Jesse H. Choper, John C. Coffee, Jr., & Ronald J. Gilson, Cases and Materials on Corporations 525-26 (4th ed. 1995). Prior to 1987 there were no shareholder proposals to rescind poison pills. Between 1987 and 1993 there were a total of 193 such proposals, constituting 12% of all corporate governance proposals during that period. The average percent of votes for these proposals has increased from 29.47% in 1987

management routinely ignoring any successful proposal to redeem the pill or reclassify the board.[50] Support for such shareholder proposals might have been even greater had shareholders' preferences been binding on the board.

All of this does not prove that poison pills, when combined with other antitakeover protections such as classified boards, provide more antitakeover protection than is desired by shareholders. But the actions of shareholders do suggest that this is at least a real possibility in a significant number of instances. Since states have deliberately proceeded in a way that did not leave shareholders with a say in the adoption of these defenses or a way to opt-out, there is reason to be concerned that the shareholders of many companies might prefer to have, but cannot get, a body of arrangements less protective of managers.

2. *State Regulation of Bidders*

States have also regulated the takeover process by imposing restrictions on what hostile bidders may do. There have been several waves of state antitakeover statutes, enacted over the last twenty-five years, restricting in various ways the activities of hostile bidders.[51] We will not dwell on these statutes as they do not substantially add to the ability of incumbent management to block hostile bids given the widespread availability of extremely powerful defensive tactics. The various restrictions imposed on hostile bidders by state antitakeover statutes, and the added

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to an impressive 44.21% in 1993. Institutional Responsibility Research Center Annual Reports (1987-1993).

[50] See, e.g., Council for Institutional Investors, Council Research Service Report (1999) (reporting that three companies that the council had targeted for binding poison pill resolutions had ignored majority votes in previous poison pill proposals).

[51] There have been a number of different types of statutes, from the so-called "control share" statute to the "business combination" statute, to the "fair share" statute, as well as the "disclosure" statute. See generally John H. Matheson & Brent A. Olson, Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation, 59 Geo. Wash. L. Rev. 1425, 1438-52 (1991).

protection they provide to incumbent management, pale in significance when measured against the total inoculation to a hostile takeover provided by an unredeemed poison pill. In order to defeat the poison pill defense, a hostile bidder would have to replace the incumbent board and have the new board redeem the pill. If the bidder is able to accomplish this, it can also have the friendly board opt-out of the state antitakeover restrictions as well as redeem the pill.[52]

Nevertheless, the near universal adoption by all states of antitakeover statutes—some forty-nine states have one in one form or another[53]—does indicate the strong interest that states across the board have had in providing protection to incumbent management. This collection of statutes has no policy rationale in common, such as targeting coercive two-tier bids or the pressure to tender problem.[54] Indeed, many of these statutes received little if any support in the academic literature as there was no attempt by state legislatures to tailor them to address any identifiable failure in the takeover process. The only underlying motivation that is discernable is the consistent desire to make takeovers more difficult[55] — a desire that is consistent with the

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[52] Most state antitakeover statutes' restrictions on bidders apply only if the target board wishes to block the bid. See, e.g., Del. Code Ann. tit. 8, § 203 (1991) (conditioning various restrictions on business combinations between a bidder and a target on the lack of the target board's approval); Ind. Code. Ann. §§ 23-1-42-5 (Michie 1999) (allowing directors to adopt by-laws which opt out of Indiana's antitakeover statute which restricts bidders' activities); N.Y. Bus. Corp. Law § 912 (McKinney 1986) (conditioning various restrictions on business combinations between a bidder and a target on the lack of the target board's approval).

[53] See Matheson & Olson, supra note 51, at 1439.

[54] The legally cognizable "threat" recognized by the *Unocal* court was a coercive two-tier hostile bid. See *Unocal*, supra note 9, at 956. If state takeover statutes had been tailored to address this potential failure in the takeover process, they would have received support from a number of commentators. See Bebchuk, supra note 21.

[55] Other commentators have made similar observations. See, e.g., Stephen Bainbridge, Redirecting State Takeover Laws at Proxy Contests, 1992 Wisc. L. Rev. 1071, 1073; Alan E. Garfield, Evaluating State Anti-takeover Legislation: A Broadminded New Approach to Corporation Law or "A Race to the Bottom"?, 1990 Colum. Bus. L. Rev. 119, 126 (stating that "the statutes serve only one purpose: to entrench current management in power"); Jonathan R. Macey, State Anti-Takeover Legislation and the National Economy, 1988 Wis. L. Rev. 467, 468-69 (observing that these statutes all "share the common feature of serving to consolidate the ability to respond to tender offers in the hands of the incumbent managers . . ."); John H. Matheson, Corporate Governance at the Millennium: The Decline of the Poison

theory, discussed in Section B, that states might have incentives to place excessive restrictions on takeovers.

3. *Comparison to British City Code*

State regulation of takeovers—across all fifty states—stands in sharp contrast with the regulatory arrangement created by Great Britain's City Code on Takeovers and Mergers.[56] The City Code contains a sweeping prohibition on the use of defensive tactics unless shareholders' consent is obtained, while protecting shareholders against coercive tender offers. The British regulatory system is an example of a national system of regulation that allows shareholders to decide whether a tender offer is in their interests. The current system of state competition in the United States as it has developed, on the other hand, has failed to produce a single state regulatory regime that constrains defensive tactics to the extent done by the City Code.

Of course, such a regime might not be in shareholders' interests, and, therefore, nothing is lost by its absence. However, there is the possibility, given our earlier observations, that if shareholders had a choice, they *might* want something closer to the City Code approach. No one can be absolutely sure. But it is clear that the states were not interested in finding out.

B. *The Incentives Produced by State Competition*

While many commentators share the view that state takeover law excessively restricts takeovers, there is far less agreement on why that has happened. One view, which is generally

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Pill Antitakeover Defense, 22 Hamline L. Rev. 703, 711-13 (1999) (explaining that "[t]he popularity of these statutes likely stems from the fact that they are the only variety of protectionist legislation upheld by the United States Supreme Court" and that "[t]hey demonstrate how far legislatures have gone toward bolstering the pro-management antitakeover landscape").

[56] See generally 1 P.F.C. Begg, Corporate Acquisitions and Mergers (1998).

held by those supportive of state competition, and which we discuss in Subsection 1 below, is that state takeover law is just an aberration of a competitive process that, on the whole, has produced desirable results. However, in our view,[57] which we discuss briefly in subsection 2 below, state competition produces a systematic tendency for states to protect incumbent managerial excessively from takeovers. We believe that existing state takeover law is not an aberration, but a powerful example of this systematic bias. As should be emphasized, however, one need not come firmly down on one side or another of this debate in order to accept our argument in Part III that federal nonintervention in takeover law should be replaced.

Before discussing the traditional sides of this debate, it is worth bearing in mind that recent work has suggested that regulatory competition between the states is imperfect whether or not the incentives created by that competition, to the extent they exist, are desirable.[58] Some of these commentators have pointed out that given its dominant position, Delaware has significant market power and that the force of competition, whether good or bad, is therefore weaker than it would otherwise be. We share this view.[59] Competition between states for corporate charters is far from textbook perfect. There is still the question, however, of the direction in which state competition pushes, however strongly. It is to this question that we now turn.

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[57] See Bebchuk, supra note 1, at 1458-84; Bebchuk & Ferrell, supra note 1, at 1177-94.

[58] See Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908 (1998); Kamar and Kahan, Price Discrimination in the Market for Corporate Law, Working Paper (2000); Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757, 841-52 (1995).

[59] Indeed, our view that state competition is imperfect has influenced our design of choice-enhancing intervention. See infra Part III.D.

1. *The View that Regulatory Competition Provides Desirable Incentives*

The more enthusiastic proponents of federal nonintervention contend that there is a great deal of convergence between state corporate law and shareholder wealth maximization.[60] The reasoning is essentially as follows. States will compete by seeking to make their corporate law attractive to shareholders. States successful in attracting incorporations would be those that offer rules that maximize shareholder wealth; not doing so would put oneself at a competitive disadvantage.

The same point has often been made by invoking the idea of the firm as a nexus of contracts. The decision of a corporation, contemplating an IPO, to select a particular state for its corporate law via its incorporation decision has been analogized to the selection of the terms of the contract the corporation and its future public shareholders will enter into. The assumption that freely arrived at contract terms are optimal, pro-state competition scholars argue, should apply in this context as well. Those who take a company public will wish to have the company incorporated in a state with corporate law that is attractive to shareholders. States will therefore have an incentive to provide a body of corporate law, including takeover law, which is desirable from shareholders' point of view.

Despite this reasoning, most of those who argue that state competition works well also believe that state takeover law restricts takeovers excessively. They reconcile these beliefs by characterizing state takeover law as a fluke, an aberration, an imperfection in the competitive process. Delaware, they note, has a less draconian antitakeover statute than other states, which they interpret as a sign that competitive pressures are at least somewhat working in favor of shareholders, albeit imperfectly.

[60] See generally Easterbrook & Fischel, supra note 32.

We are skeptical of this rationalization of what has happened. It is hard to regard the systematic adoption of takeover defenses as a fluke or an accident. Takeover defenses have been perhaps the most important issue in corporate law that the states have had to deal with in the last twenty-five years. It has been considered time and time again in state after state. And states across the board, including Delaware, have persistently imposed significant restrictions on takeovers. Accordingly, we favor the view, which we will now outline briefly, that states have powerful incentives to restrict takeovers excessively.[61]

2. *The View that Regulatory Competition Provides Incentives to Restrict Takeovers Excessively*

There is an alternative view of state competition, which one of us has put forward in an earlier work, according to which there are several important corporate law areas in which state competition is likely to produce undesirable regulatory choices by the states.[62] One of these areas, indeed one of the most likely, is the regulation of takeovers.[63] When it comes to takeover regulation, this theory of state competition indicates that shareholders' interests are likely to be compromised for the benefit of incumbent managers who might be on the receiving end of hostile tender offers. Excessive restrictions on takeovers are not a fluke or an accident, as some would argue, but the predictable outcome of the incentives created by the current system of regulatory competition. The following is a summary of why this is so.

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[61] See generally Bebchuk & Ferrell, supra note 1, at 1193-1999.

[62] See Bebchuk, supra note 1, at 1458-84.

[63] See Bebchuk & Ferrell, supra note 1, at 1172-1177.

(a) *Why States Pay Attention to Managers' Preferences*

The reason why a state, assuming that it is interested in maximizing the number of companies that are incorporated there,[64] will care a great deal about managerial preferences is fairly straightforward. Managers have significant control over reincorporation decisions. In order for a corporation to change its state of incorporation, a firm's managers need to decide to bring a reincorporation proposal to a shareholder vote.[65] If management fails to do so, reincorporation will simply not occur. Moreover, managers, through their control of the voting process, can have some influence on the outcome of a reincorporation vote.[66]

How managers exercise their power over the reincorporation process will affect how successful a state ultimately is in maximizing the number of corporations chartered there.[67] Indeed, the more successful a state is in this contest, the more important it becomes for the state to convince corporations already incorporated there to stay put.[68] The happier the managers of these corporations are with the state's corporate rules, even if their shareholders' interests are not

[64] The whole focus on the debate over the effects of federalism on the provision of desirable corporate rules is based on this assumption. See Mark J. Loewenstein, Delaware as Demon: Twenty-Five Years after Professor Cary's Polemic, 71 U. Colo. L. Rev. 497, 502-508 (2000). To the extent that all the states are indifferent to how successful they are in the market for corporate charters, the state corporate law process will not be subject, for better or worse, to competitive forces.

[65] Clark, supra note 7, at 414-17.

[66] See Bebchuk, supra note 1, at 1470-76; John C. Coffee, Jr., The Mandatory/Enabling Balance in Corporate Law: An Paper on the Judicial Role, 89 Colum. L. Rev. 1618, 1674-76 (1989); Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Colum. L. Rev. 1549, 1573-80 (1989).

[67] See, e.g., Mark Roe, Takeover Politics in The Deal Decade (Brookings Institute, 1993), 321, 350-352 (describing Delaware's concern over its future success in the reincorporation market as a reason for why Delaware erected antitakeover defenses).

[68] Delaware, easily the most successful state in attracting incorporations, will therefore have a very powerful interest in catering to the interests of incumbent management. The threat of reincorporation is a real one, even for Delaware, if corporations feel strongly enough about a legal issue. Cf. Cohen, Lipton Tells Clients that Delaware May Not be a Place to Incorporate, Wall St. J., Nov. 11, 1988, at B7, col. 2.

as attentively attended to, the more likely the state will be successful in maximizing the number of corporations chartered there.

Of course, the weight given managerial interests is not necessarily problematic. The desire to satisfy managerial interests is only of concern if there is a divergence of interest between managers and shareholders. When hostile takeovers are involved this divergence is likely to be acute.

(b) *Managers' Interests as Potential Targets*.

From a manager's perspective, the desired takeover regime might very well depend on whether one is the incumbent management of a corporation that is the target of a hostile tender offer or part of the management team of a bidder attempting to acquire a corporation against the wishes of its board. Both managers' interests as the head of a potential target and their interests as potential acquirers need to be considered.

Turning to the first issue, it is apparent that managers have an interest in having a legal regime that allows target management to use defensive tactics to defeat tender offers. Having veto power over whether one's company is acquired or not, cannot hurt and could even save one's job. Suppose a corporation's stock is depressed due to poor management thereby making the firm an inviting acquisition target. If such an acquisition occurs, it is unlikely that the target managers will retain their jobs along with whatever other private benefits of control that they enjoy from their status. This interest could very well, although by no means inevitably, outweigh any increase in managers' stock options and stock holdings due to a tender offer premium.[69]

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[69] For a general discussion of the incentive effects of stock holdings by corporate managers see Michael C. Jensen & Kevin Murphy, Performance and Top Management Incentives, 98 J. Pol. Econ. 225 (1990).

Moreover, even if target management is not opposed to being acquired, the power to block the acquisition might increase their ability to extract side payments from a potential acquirer.

Management of potential targets can assure themselves of protection against unwanted bids by making sure that their corporation is incorporated in a state with takeover law that impedes hostile takeovers. The selection of a state of incorporation will determine, if the corporation subsequently becomes the target of a hostile bid, the impediments that the hostile bidder will face in its quest for control. The state of incorporation of a firm, on the other hand, does not determine which takeover defenses are available and which bidder restrictions apply if the incorporating firm decides to acquire another corporation.

(c) *Managers' Interests as Potential Acquirers*

Of course, managers might be on the other side of the transaction and have, correspondingly, different interests. As potential acquirers, they may desire a permissive takeover regime with few defensive tactics allowed by law. In other words, because managers might be on either side of a takeover, one might at first glance conclude that they will not favor a takeover law that is unduly restrictive.

This reasoning is misguided, however. Consider a manager who is considering whether to pursue reincorporating to state X. The manager's evaluation of state X's takeover law, and whether it serves management's interests, will focus on the scenario in which the company is a target rather than the situation where the company is a bidder. The reason is simple. The manager's reincorporation decision will definitely influence the takeover rules that will apply to his use of defensive tactics should the company become a target. But the corporation's reincorporation decision will have no effect on the power to defend against a takeover that will

be possessed by the managers of firms that might be subject to hostile takeover by that corporation.

3. *Evidence on How Delaware Compares with Other States*

Supporters of state competition often argue that Delaware corporate law, even if imperfect, is superior to the law of other states, either generally or in the area of takeover regulation in particular. More specifically, supporters of state competition have long pointed out that Delaware's antitakeover statute is not as protective of incumbent management as that of some other states.[70] Pennsylvania, for instance, has a far more draconian antitakeover statute than Delaware's business combination statute. Whereas Pennsylvania's "disgorgement" statute can by itself make hostile takeovers far less profitable and thus less likely to occur, Delaware's business combination statute, by itself, cannot significantly curtail takeovers.[71] This milder nature of Delaware's antitakeover statue is viewed by supporters of state competition as evidence that state competition, on the whole, is working.

We will begin our discussion of this line of reasoning by questioning whether Delaware takeover law is indeed significantly better than the takeover law of other states. Perhaps even more importantly, we will then explain why, even if Delaware law is superior in some respects to the corporate law of other states, this would not be sufficient to establish that state competition is functioning well in the takeover area.

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[70] Winter, supra note 2, at 289; Easterbrook & Fischel, supra note 2, at 222-23; Romano, supra note 2, at 858-59.

[71] See, e.g., Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions 58-73 (2d ed. Supp. 1995).

Although it is true that Delaware's antitakeover statute provides fewer protections to incumbent management than those provided by some other state statutes, it is far from clear that the overall protection given to Delaware firms from takeovers is significantly less than that provided by most other states. As we stressed earlier, the main source of protection from takeovers is the ability by incumbent management to use defensive tactics. In particular, the ability by incumbent management to use the poison pill defense is, by itself, a powerful defense against unwanted bids. Until a bidder gains control of the board, proceeding with a hostile bid in the face of a poison pill is prohibitively expensive. As a result, a hostile bidder will typically need to remove incumbent management in a proxy contest as a necessary condition to a takeover. This is the situation under current Delaware law just as it is under the law of other states. State antitakeover statutes generally do not impede a bidder who has gained control of the target's board since statutory antitakeover protections usually do not apply to acquisitions approved by the board. Thus, given current poison pill jurisprudence, Delaware's mild antitakeover statute does not appear to have much practical significance in the battle between a bidder and incumbent management for control of a company. The protections afforded incumbents under Delaware law, therefore, do not appear to differ weaker than those of most other states even though Delaware's antitakeover statute is not as extreme as in some states.

In a recent study that has already received substantial attention,[72] Robert Daines has attempted to measure the effect of Delaware law on shareholder value and on the incidence of takeover bids and acquisitions.[73] He finds that Delaware companies have a higher Tobin's Q, which is a standard measure of firm value. Furthermore, he finds that Delaware firms receive

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[72] See, e.g., Albert B. Crenshaw, Delaware Inc., Wash. Post, May 7, 2000, at H1; Wall St. J., Feb.28, 2000, at C21.

[73] See Robert Daines, Does Delaware Law Improve Firm Value?, Working Paper No.159 (NYU Center for Law and Business).

more bids and are more likely to be acquired. He infers from this finding that Delaware law increases shareholder value and that the beneficial effect of Delaware law is to a significant extent a result of Delaware's law being less restrictive of takeovers than that of some other states.

A problem with Daines' inference is in the causation chain. The fact that Delaware firms have a higher Q and receive more bids does not imply that this is a result of Delaware's law. It might be that Delaware firms are different from other firms in some respects and the difference in Tobin's Q might reflect these differences rather than increased value due to Delaware law.

To Daines' credit, he makes considerable effort in his study to control for various parameters. But there are still reasons to believe that the differences between Delaware and non-Delaware firms are due to some nonlegal dimensions. The fundamental problem is one of endogeneity. Whether companies are in Delaware or not cannot be taken as an exogenous variable. Rather, the state of incorporation is a function of the choices the company has made. There is therefore a potential selection effect. Whether or not a firm is in Delaware might result from some of the firm's characteristics, which might explain partly or fully the identified differences in firm value.

As way of illustration, consider the following possibility. Suppose that Delaware law is in no way better than that of other states, but that it is more familiar nationally and Delaware incorporation is thus likely to be favored by law firms centered in national financial centers such as New York City. And further suppose that companies who choose for their counsel such firms rather than local firms are more likely to have managers that are sophisticated, or ambitious, or visionary, or have some other ability or quality that operates to increase shareholder value. Accordingly, companies with such managers might be more likely to have a high Tobin's Q and to be an attractive acquisition target. In this case, Delaware companies will have higher share

value and a higher takeover likelihood, despite Delaware's law being equivalent to that of other states, due to the differences between Delaware and non-Delaware in management.[74]

We have suggested that there are reasons to doubt that Delaware takeover law is considerably better than that of other states. Be that as it may, the most important point to emphasize for our purposes is that such a conclusion would not imply in any event that regulatory competition between the states works well. If anything, Daines' findings are more consistent with the kind of reform of regulatory competition we advocate than with federal nonintervention.

It is important to keep in mind that there is a difference between the relative performance of the victor in a competitive process and the performance of the process as a whole. Whether state competition overall creates pressure to adopt good or bad regulation, we would expect Delaware, the victorious state, to offer shareholders a somewhat better deal. If shareholders are willing to vote for reincorporations to Delaware, then the effect of a move to Delaware is likely to be positive or at least not significantly negative. Even if Delaware law were substantively the same as the law of other states, Delaware would offer the advantage of its specialized and experienced judiciary.

None of this means that competitive pressures have moved the states as a whole in a positive direction. It might be that regulatory competition has pushed the states in a negative

[74] Daines recognizes the potential problem of selection effects, and he tries to address it by conducting also a test focusing on firms that were incorporated long ago. One might think that an incorporation choice made a long time ago should not be correlated with anything about the company and its management at the present. But this is not necessarily the case. One cannot rule out the possibility that the identified differences in corporate value are due not to legal factors but to managerial factors. Firms who have stayed in their original state of incorporation, whenever that incorporation occurred, are firms that have been and are making the implicit decision not to reincorporate to another state. Thus, if one looks at firms that have stayed in their home state for a significant period of time, these are firms which might be more likely to have not obtained, post-incorporation, the kind of managers that tend to hire national counsel and move to Delaware. Thus, even focusing on companies whose last incorporation decision was made long ago, the relatively low value of non-Delaware firms might still reflect the type of managers and business plans that these corporations have right now rather than any differences in the quality of their governing law.

direction with the victorious state, Delaware, being still slightly better than the others. Putting it in terms of a grade analogy, suppose that arrangements are graded in terms of how good they are for shareholders. The mere fact that Delaware produces arrangements with a somewhat higher grade does not imply that state competition has not, at least with respect to takeover law, pushed states in the direction of say a Gentlemen's C, with Delaware leading the pack with a B-.

The important question, then, is not to assess the impact of the limited differences between the takeover law of Delaware and other states, but rather to assess the body of state takeover law that the system has produced taken as a whole. Whether the differences among the states are slight or significant, the various approaches adopted by states are much closer to each other than any of them are to a regime like that established by the British City Code. States are all quite protective of incumbent managers. All states allow for poison pills. No state provides searching judicial scrutiny to the decisions by incumbents to maintain pills for substantial periods of time in the face of an attractive bid. No state has prevented incumbents from using pills in conjunction with classified boards that were adopted long before shareholders could have anticipated how the staggered board would be used, in combination with the availability of poison pills, to form formidable takeover defenses. These critical points of commonality collectively place all the states, from the worst to the best, far to one side of the spectrum, thereby constituting an approach that is very different from both the regime favored by many commentators, and from that actually implemented by the British City Code.

Thus, praise for Delaware for being somewhat more hospitable to takeovers than other states should not stop there. Supposing that such praise is merited, one should then focus on the fact that Delaware is clearly far from the end point in terms of how far one can go in terms of facilitating takeovers. If a more permissive regime, even just somewhat more permissive, has the beneficial effect on bid incidence and shareholder value suggested by Daines' study, then there is at least a serious possibility that going further in the direction of less antitakeover protections

afforded incumbents would provide shareholders with even greater benefits. More generally, those who praise Delaware for being more hospitable to takeovers than other states should be especially open to the possibility that shareholders of many corporations would value having access to a regime that would be more permissive towards takeovers than that provided by the law of any state.

4. *State Law is Unlikely to Move to a More Permissive Takeover Regime*

Our view of state competition in takeover law, as outlined above, suggests that state competition provides strong incentives for states to restrict takeovers excessively. The development of state takeover law in the last quarter of a century, we have argued, is quite consistent with this theory.

It is worth emphasizing, however, that one need not accept this view of how state competition leads to a systematic antitakeover bias in state law in order to support choice-enhancing federal intervention. Whether the development of state takeover law is a product of an aberration or systematic forces at work, one would have to conclude that state law is unlikely to produce in the foreseeable future a regime that would be significantly more hospitable to takeovers. The persistent and uniform tendency of states to provide considerable protection to incumbents gives little reason to expect that things are likely to change anytime soon. Thus, in the absence of some form of federal intervention, a regime permissive of takeovers would likely be unavailable to shareholders, regardless of their views on the subject.

III. Choice-Enhancing Federal Intervention in Takeover Law

Even if hope springs eternal, then, it is doubtful that state takeover law can be expected to provide shareholders with the option of a more takeover-friendly regime in the foreseeable future. Doubt springs both from the incentives states have to restrict takeovers to protect incumbent management and the long history of states, through a number of devices, consistently and persistently attempting to restrict hostile takeovers. All indications are that, if there is no federal intervention in the area of takeover regulation, it is quite unlikely that shareholders will be able to have, even if they so desire, a regime that is more hospitable to takeovers.

A. *The Reluctance to Adopt Mandatory Federal Takeover Law*

One obvious reaction, especially by someone who believes that states have systematic incentives to restrict takeovers excessively, is to consider the adoption of a mandatory federal takeover law. Indeed, an analysis of the shortcomings of state competition in the takeover area has led one of us to support in an earlier work such a mandatory federal takeover law.[75] More recently, Samuel Thompson has proposed a federal uniform standard governing the actions of a board of directors when the corporation is a target in a hostile tender offer.[76] But many commentators are reluctant to endorse replacing states' responsibility in this area with that of the federal government. There are several commonly voiced concerns over federal regulation that might explain this hesitancy.

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[75] Bebchuk, supra note 1, at 1499-1510.

[76] See Samuel Thompson, Change of Control Board: Federal Preemption of the Law Governing a Target's Directors, Working Paper (1999).

1. *Federal Mandatory Law Might Make Matters Worse*

An immediate and understandable reaction to any suggestion of mandatory federal rules is to ask: Who is to say that such rules might not be even worse than those provided by state law? To start with, the federal government might adopt bad rules because of poor policy choices. Indeed, how would we even know for sure if the federal regime is better or worse than what it is replacing? Perhaps, despite all the arguments to the contrary, the current mix of antitakeover regulations imposed by the states is superior to the British City Code or any other conceivable scheme that provides for fewer protections to incumbent managers. And if the adopted mandatory federal takeover law is inferior to what the states have chosen to provide, there will be nothing corporations will be able to do. There will be no way out.

Moreover, even if the substantive arrangements imposed by federal regulation are superior to existing state takeover law, it is possible that through lobbying by corporate managers and other interest groups, or through poor policy choices, the federal regime will gradually become more protective of managers than is optimal.[77] The mandated federal substantive arrangements might eventually become as bad as or even worse than current state takeover regulation. And, again, if this happens, there will be no escape.

2. *Federal Mandatory Law Would Have Difficulty Adjusting to Changing Needs*

There is a separate additional concern. If Ralph Winter and other commentators are right about the benefits of federal nonintervention, would imposing a mandatory, uniform set of federal takeover regulations not sacrifice these healthy competitive pressures that ensure state takeover law is responsive to changing conditions? Even if the optimal takeover regime were

[77] Professor Romano relies heavily on this possibility in arguing for federal nonintervention in her work. See, e.g., Roberta Romano, The Genius of American Corporate Law (1993).

initially crafted and implemented at the federal level, there is no guarantee that that this would be the right set of arrangements for all time for all companies.

If a state decides to adopt harmful corporate regulation, the state faces a migration of its chartered firms to other states through reincorporation as well as garnering fewer initial incorporations. At the extreme, if a state adopted regulations that significantly reduced shareholder value of corporations incorporated there, it will have effectively ensured that no corporations will elect to be subject to its laws. The federal government would not face similar pressures to adjust its takeover law or face a flight of firms from its jurisdiction. There would be far less room for innovation and experimentation if there were a single regulatory monopoly. The current regulatory flexibility in the face of constantly changing economic and business conditions, it is feared, would be permanently lost.

B. *The Elements of Choice-Enhancing Intervention*

There is another choice that is possible, which has not been considered. There is a form of federal intervention, choice-enhancing intervention, that would not involve mandating any substantive takeover arrangements yet would address many of the shortcomings of state competition. Federal choice-enhancing intervention, we will argue, is clearly superior to federal nonintervention and should be acceptable to those reluctant to adopt mandatory federal takeover law. Below we outline the elements of such intervention: an optional federal takeover law, an accompanying system of implementation and adjudication, and a mandatory process rule governing opting into and out of the federal takeover law. We recognize that someone might accept this general approach while not accepting the particular takeover arrangements we would include in the optional federal takeover regime. Our aim is not to fully specify all the details of

choice-enhancing intervention. Rather, we wish to outline the basic features that such an approach would have in order to place this general approach on the table for discussion.

1. *Optional Federal Takeover Law*

(a) Substantive Arrangements

As we have discussed, what is missing from the current menu of state takeover regimes, despite the possibility that shareholders of many companies might desire such a choice, is one that is more hospitable to takeovers. To improve the menu offered to shareholders, therefore, the optional federal takeover law should be such a regime. Readers attracted to the idea of ensuring that a regime more hospitable to takeovers is available to shareholders will likely have somewhat different views on the regime's particulars. Below we discuss briefly the takeover regime that we prefer. We wish to emphasize upfront, however, that a reader might very well accept our general thesis that choice-enhancing intervention is an improvement over the current situation but differ on the particulars of the optional federal takeover law.

Our preferred regime would provide what one of us has described as "undistorted shareholder choice,"[78] i.e. enabling shareholders to act in the same way as a sole owner of an asset would.[79] This requires two elements: prohibiting defensive tactics by incumbents and adopting arrangements that ensure that shareholder choice will not be distorted by a pressure to tender. A real-world tested regime that comes close to this ideal is the British City Code

[78] Bebchuk, Toward Undistorted Choice, supra note 21, at 1696.

[79] See Bebchuk, The Sole Owner Standard for Takeover Policy, supra note 21, at 197-98.

To enable shareholders to pass judgment on a bid, it is necessary to stop target management from preventing the bid from ever being considered by shareholders in the first place. Given the managerial interests at stake, management might impede bids that shareholders favor to serve the managers' own interests.[80] The City Code accomplishes this by a sweeping prohibition on the use by incumbent management of defensive tactics unless there is shareholder approval. The Code states that after a bona fide offer has been communicated to the board of a target corporation, or after a target board has reason to believe that such an offer will be communicated, the target board is prohibited from taking "any action" without shareholder approval which "could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits."[81] Wisely, the Panel on Takeovers and Mergers has concluded that this prohibition is flexible and a prohibited action need not be identified within the Code as a defensive tactic beforehand.[82] To have concluded otherwise would have been potentially fatal given the creativity of lawyers, and the enormous incentives that exist to find and exploit loopholes. The poison pill, for example, was adopted on a large-scale basis by corporations across the United States within a few years of its invention. It was an astonishing and unexpected development. The federal regulatory regime should have a similarly broad prohibition on the use of any defensive tactics, whether existing or yet to be invented.

The second crucial element is a set of arrangements which ensure that shareholders' decisions on whether to accept a takeover bid are not distorted by a pressure to tender.

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[80] See Bebchuk, The Case for Facilitating Competing Tender Offers, 95 Harv. L. Rev. 1028 (1982); Bebchuk, Toward Undistorted Choice, supra note 24, at 1704-05; Ronald Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, 819-20 (1981); Easterbrook & Fischel, The Proper Role, supra note 4, at 1161-62.

[81] 1 P.F.C. Begg, supra 56, at A.7.4.

[82] See Consolidated Gold Fields PLC (Takeover Panel, May 9, 1989, at 14).

Shareholders could be pressured to tender their shares to a bid that they wish would fail because of their fear of ending up with low-value minority shares in the event that the bidder gains control. To eliminate this pressure to tender, one could make bidder acquisition of control contingent on the bid being approved by a shareholder vote on the bid, a vote that would be separate from the decision whether to tender shares, or by some other vote-like mechanism.[83] The City Code does not ignore the threat that the pressure to tender problem poises to shareholder welfare. The Code addresses this problem by providing for a second opportunity for shareholders to tender their shares.[84] While this is not a perfect solution to the problem,[85] it is a step in the right direction.

With these two basic features as part of our proposed federal regulatory regime, shareholders' interests, we believe, would be well served. Of course, one could propose a different set of arrangements that might also represent a possible improvement over current state takeover regulation. The most important thing is that the federal regulatory regime, on the whole, provide less protection to incumbents from hostile bids than existing state takeover law. If such a regime were to be offered, shareholders of U.S. corporations would have their set of choices expanded in a meaningful, and perhaps quite beneficial, way.

(b) *Adjudication and Enforcement*

It would be important, of course, for parties to be able to have any claims arising under the federal takeover law quickly and professionally adjudicated. An effective system of

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[83] See Lucian Ayre Bebchuk, The Pressure to Tender: An Analysis and a Proposed Remedy, 12 Del. J. Corp. L. 911, 931-35 (1987); Bebchuk, Toward Undistorted Choice, supra note 24, at 1747-48.

[84] Begg, supra note 56, at A7.14-A7.15 (Rules 9.1.-9.5)

[85] See Bebchuk, The Pressure to Tender, supra note 83, at 944-46; Bebchuk, Toward Undistorted Choice, supra note 21, at 1797-98.

implementing the federal takeover regime's requirements for those corporations that have opted into the federal regime is an obvious necessity. Delaware's experienced and respected judiciary working with a well-developed jurisprudence, after all, is one of its attractions that commentators often stress.[86] The Delaware Chancery Court, for instance, is renowned for its expertise in corporate law matters.[87]

One way of accomplishing would be to allow litigants to bring their federal takeover claims, along with any other corporate law issues that might arise, to state courts. If a litigant wished to take advantage of the expertise of the Delaware Chancery Court, even if the corporation is governed by federal takeover law, then it could still do so. On the other hand, litigants could also bring their federal claims, along with related state corporate law claims, to federal court if they so choose.

Another approach would be to create a special federal body responsible for the implementation of the federal optional takeover regime. The federal government could create a specialized federal forum that would focus on federal takeover matters thereby ensuring that over time it would acquire valuable experience and expertise in this area much like the Delaware Chancery Court. This federal forum charged with adjudication and implementation of the federal optional takeover law could be structured in several different ways. One could imagine a specialized court with jurisdiction over federal takeover law matters, much like the Federal Tax Court on federal tax matters.[88] Or advantage could be taken of the adjudicatory and enforcement

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[86] See Kamar, supra note 58, at 1925-27; Bernard Black, Is Corporate Law Trivial?: A Political and Economic Analysis, 84 Nw. U.L.Rev. 542, 590 (1990); Jill Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters, 68 U. of Cin. L. Rev. 1061 (2000); Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J.L. Econ. & Org. 225, 274-78 (1985).

[87] See William H. Rehnquist, The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice, 48 Bus. Law. 351, 354 (1992).

[88] Cf. Rochelle Cooper Dreyfuss, The Federal Circuit: A Case Study in Specialized Courts, 64 N.Y.U. L. Rev. (1989) (discussing the Court of Appeals for the Federal Circuit's patent specialization).

powers of the Securities and Exchange Commission. The panel on takeovers and mergers in Great Britain, for instance, does some investigatory work and gives pre-rulings which parties sometimes find useful.

We believe that having some form of federal implementation of the federal takeover regime by an entity, whether it be a court or an agency, with special expertise and ability in the takeover area would be a preferable route over concurrent state and federal court jurisdiction. This would have the benefit of ensuring that corporations that are not incorporated in Delaware have access to an effective system of adjudication without having to reincorporate. As with other particulars of the optional federal takeover regime, this is something on which supporters of choice-enhancing intervention might reasonably differ.

Other important details relating to adjudication and implementation would also need to be addressed. For example, when a company opts into the federal takeover regime, the question will inevitably arise of whether a particular disputed issue is governed by federal takeover law or state law. But these problems are far from insurmountable. There is a lot of experience dealing with these types of issues. Such issues routinely arise, for example, in state corporate law matters on which the federal securities laws might be relevant.[89]

2. *Mandatory Process Rule for Opting In and Out*

If the rules governing how an existing firm opts into the optional federal regime are the same as those governing the procedure by which a firm may reincorporate from one state to another, our proposal would be of limited help in enhancing shareholder choice. The standard

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[89] For example, a standard issue dealt with by courts is whether managerial conduct that breaches state fiduciary obligations also gives rise to Rule 10b-5 liability. See Sante Fe Indus. v. Green, 430 U.S. 462 (1977).

procedure under state corporate law for a reincorporation or for other fundamental corporate changes is for managers to initiate the change and then seek shareholder approval. The problem is that, all else being equal, managers are unlikely to initiate a change to a more permissive takeover regime. This is precisely the reason why states will not necessarily choose the takeover law that would be best for shareholders even if they are interested in maximizing the number of corporations chartered there.[90]

Accordingly, choice-enhancing intervention includes a mandatory vote procedure by which shareholders can choose to have their corporation governed by the federal takeover rules rather than that of their corporation's state of incorporation. Similarly, federal law would prescribe a similar vote procedure by which shareholders can choose to opt out of the federal takeover regime and return to state takeover regulation. Unlike most proxy solicitations or shareholder resolutions addressing the use of poison pills, these shareholder votes would be binding on the corporation and would have the effect of bringing the corporation into or out of the federal takeover regime.

If shareholders wished to opt out of the process rule itself there is no reason why they should not be allowed do so through a charter amendment. The process rule would only be mandatory in the sense that regardless of state law, shareholders would have the option, if they did not forego it in their charter, to have their corporation opt in or out of the federal takeover regime. The goal of choice-enhancing intervention is to increase, not limit, shareholder choice. States, on the other hand, would not be allowed to opt out of the process rule through their corporate law because states have not been willing to give shareholders meaningful choice on whether they actually want certain takeover arrangements. Only shareholders can tie shareholders' hands on whether the process rule will be available or not.

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[90] See supra Part II.B.2.

There are important details, as with the optional federal takeover regime, that would need to be worked out. For instance, there would need to be some threshold of initial support that would be required for initiating such a vote so as to avoid unnecessary hassle and expense. For example, it could be required that a proposal be brought by shareholders collectively holding five percent or more of the outstanding shares in order for there to be a shareholder vote on whether to opt into (or opt out of) federal takeover regulation.

Finally, we leave open the question of whether a vote by shareholders to change the takeover regime would take effect immediately or only after a period of time has elapsed (assuming this issue was not addressed in the corporate charter). The optimal arrangement might involve some element of pre-commitment on the part of shareholders not to adopt a change in the governing legal standard in midstream under certain circumstances. Perhaps potential bidders are more likely to make a tender offer when a corporation, which is currently governed by a legal regime that prohibits the use of all defensive tactics, is unable to suddenly switch to a regime where poison pills are allowed or bids are kept open longer. Ex post shareholders might find this switch in their interests, given the increased bargaining power a poison pill might give them, or the likelihood of a larger offer if the bid is kept open, but harmful ex ante given the lower probability of a bid in the first place.[91] If one is concerned about this problem, then one would allow shareholders to switch takeovers regimes not with respect to bids already on the table but only with respect to future bids by stipulating that a switch of regime would take effect only after a certain period following the shareholder vote.

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[91] For some of the competing considerations involved in making such an analysis, see Bebchuk, Facilitating Competing Tender Offers, supra note 80 at 1034-1038 (arguing for the desirability of auctions); Frank H. Easterbrook & Daniel R. Fischel, Auctions and Sunk Costs in Tender Offers, 35 Stan. L. Rev 1 (1982)(same); Ronald J. Gilson, Seeking Competitive Bids versus Pure Passivity in Tender Offer Defense, 35 Stan. L. Rev. 51 , 66 (1982) (same). But cf. Alan Schwartz, Search Theory and the Tender Offer Auction, 2 J.L. Econ. & Org. 229 (1986) (arguing against laws that facilitate auctions in response to tender offers).

C. *The Superiority of Choice-Enhancing Intervention to Federal Nonintervention*

We now turn to explain why choice-enhancing intervention would be unambiguously superior to – and would thus dominate – federal nonintervention. Given the impact the traditional objections to federal regulation have had on the policy debate, we start by explaining in subsections 1 and 2 that choice-enhancing intervention would not raise any of these concerns. We then explain in subsection 3 that, rather than replace shareholder choice, choice-enhancing intervention would operate to expand it in a meaningful way. Thus, choice-enhancing federal intervention would improve the performance of regulatory competition without the baggage of federal mandatory rules.

1. *Choice-Enhancing Intervention Cannot Make Things Worse*

Recall the concern that federal takeover regulations might be worse than the state arrangements they came to address. However, for straightforward reasons, choice-enhancing intervention does not present the danger of imposing on shareholders arrangements even worse than those that state law currently mandates. Since shareholders could decline to exercise their right to opt into the alternative federal takeover regime, the selection at the federal level of inferior takeover arrangements would not pose the same problems that a mandatory federal takeover regime would. If the federal government selects the wrong set of takeover arrangements, whatever the reason, it will not attract corporations. No harm done. The federal takeover regime, just as is currently the case with states according to the pro-state competition point of view, would also be subject to the test of the market.

2. *Choice-Enhancing Intervention Would Enable Dynamic Adjustment*

The often voiced concern that over time, as new needs and issues arise, preventing state competition due to federal preemption would lead to unacceptable costs is equally inapplicable. Because shareholders will be able to opt out of federal law if they had decided to opt in at some earlier point, there will be a built-in check that would help prevent shareholders from being harmed from federal law if its quality deteriorated over time due to a failure to adjust. Federal regulators would receive feedback on how good a job they are doing.

If federal regulators make changes to the federal takeover regime that are harmful to shareholders, or fail to adjust in light of changes in the world, they will see a migration of corporations out of their jurisdiction. This migration would both be good in itself, as shareholders would not be subject to harmful regulation, as well as providing, perhaps, beneficial pressure for needed changes. Of course, since other states, as well as the federal government, would continue to offer and compete in the provision of takeover law, there would be the same opportunity as currently exists for innovation and experimentation in corporate law.

3. *Choice-Enhancing Intervention Would Expand rather than Retard Choice*

The benefit that state competition provides, according to many of its proponents, is shareholder choice. It is therefore important to highlight the fact that, in contrast to a mandatory federal law, choice-enhancing intervention would expand rather than retard shareholder choice.

In a sense, choice-enhancing intervention would be adding one more competitor to the competition and thereby be automatically expanding choice. In addition to the fifty states, there would also be the option of choosing federal law for a corporation's takeover regulation. Thus,

the addition of another competitor should be welcomed by supporters of state competition.[92] The more the merrier.

But the benefit is much greater, the expansion of choice far greater, than merely adding another option on top of the fifty already available. It is the identity of the choice that is so meaningful. If we added one more state to the Union, we would have technically one more choice, but the menu would be unlikely to expand in a meaningful way. The additional state would be subject to the same incentives as other states and would likely offer a body of law with substantial antitakeover protections as do all the states currently. The additional player that we propose, however, would be a different type of player with different incentives from the typical state for reasons we will discuss shortly.

Moreover, we propose that this player provide a body of law with far less antitakeover protections than those incumbent managers typically enjoy under state law. While state competition now offers fifty takeover regimes, they are all, as we have seen, clustered in one area of the spectrum in the extent of the protection provided to incumbents. Thus, adding a substantially different regime to the mix would expand choice in a meaningful way. At the minimum, therefore, the availability of the outlined federal regime would at least provide shareholders with an option not currently provided by any state. Along with other critics of state takeover law, we believe that a regime more hospitable to takeovers is the one that shareholders would often want. The desirability of choice-enhancing intervention, however, does not depend on hinge on whether one agrees with this assessment. It is sufficient for there to be at least the real possibility that a number of shareholders would desire fewer takeover protection than currently exist.

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[92] Cf. Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale. L.J. 2359 (1998) (proposing a system where the states and the federal government are competing providers of securities law).

D. *The Need for Federal Intervention*

Even if having the option of a takeover-friendly regime does no harm and might in fact benefit shareholders, why does the federal government need to do it? If having a regime with less takeover protection increases shareholder value in many companies, would not a state, say Montana, find it in its interest to offer such a regime? And does not the fact that no state has done so indicate that there is no shareholder interest in having such a regime? We now turn to answering these questions and thereby highlighting why federal intervention is essential in providing this option.

1. *The Need for Intervention to Allow Opting Out by Shareholders*

One reason why federal intervention is necessary is to provide a mandatory process rule that enables shareholders to opt out of state law. Suppose that an innovative state, again say Montana, were to consider offering a regime with fewer takeover protections. Even if such a regime would be beneficial to shareholders, Montana would have to recognize that its adoption would not result in Montana being attractive to the very large number of publicly traded companies already in existence. Even if one thinks about a point ten years down the road, the lion's share of the publicly traded companies that will exist then are ones that are currently in existence and already incorporated. Delaware has been so successful by attracting not only newly formed companies but also by convincing companies incorporated elsewhere to reincorporate there.[93]

[93] See, e.g., Demetrios G. Kaouris, Is Delaware Still a Haven for Incorporation?, 20 Del. J. Corp. L. 965, 1012 (1995) (reporting that 89% of his sample of companies that reincorporated between 1982 and 1994 moved to Delaware).

Suppose then that Montana imposed its new pro-shareholder takeover friendly regime on currently existing companies already incorporated there. While such a regime could be of interest to the shareholders of existing companies, Montana would quickly realize that it would be unable to attract companies that belong to the large stock of existing companies currently incorporated in other states. Those out-of-state companies are subject to the rules of their state, not Montana's, as to how they may reincorporate. Given that reincorporations have to be done by merger, and that all states require that boards initiate mergers, incumbents will have a veto power over any possible reincorporations. Thus, offering a regime that weakens the takeover protections given to incumbents would not enable a state to attract these out-of-state corporations due to this veto power.[94]

Choice-enhancing federal intervention would solve this problem. In addition to offering an optional takeover regime into which companies could opt in, a central component of choice-enhancing intervention is the provision of a federal mandatory process rule which would give shareholders the power to force their corporations to opt into this regime even against incumbent management's objections. This critical element is one that is not in the power of states to supply. A state could offer a particular takeover regime to companies incorporated in it but it has no power to enable the shareholders of companies incorporated in other states to opt into the regime it establishes.

2. *The Need for Intervention to Allow Opting Out with Respect to Takeover Law*

The mandatory process rule would be needed not only to enable shareholders to control the opting out decision but also to allow opting out with respect only to takeover law. Under

[94] Montana will also face an additional problem even if it was unconcerned with reincorporations, which is the ability of Delaware to match any popular innovation they come up with. See infra Part III.D.3.

current principles of federalism, a corporation cannot make itself subject to the rules of one state with respect to a subset of corporate legal rules. Therefore, a state cannot offer companies a takeover regime which companies could opt into without entirely leaving their state of incorporation as far as the rest of corporate law is concerned. As we argued earlier, takeover law is an area where state competition is especially likely to produce poor results. Suppose that Delaware law and Delaware's system of adjudication are beneficial for shareholders but its takeover regime is not. Another state could not offer a Delaware company an alternative regime just with respect to takeover law to address this shortcoming. In the current system, a company cannot get part of the state's law; it's a take it or leave it deal.

Under choice-enhancing intervention, federal law would address this shortcoming. Federal law could require that, under certain circumstances, a corporation would be subject to a federal body of takeover law while still remaining subject to the corporate law of its state of incorporation with respect to everything else. Establishing such a possibility for the companies incorporated in all states is something that an innovating Montana could not do but that is in the power of the federal government to do. And by doing so, such federal intervention would contribute to expanding shareholder choice.

3. *The Value of Federal Provision of an Optional Takeover Regime*

Thus far we have explained why a mandatory federal process rule is necessary. Someone persuaded by these arguments might support such a rule but wish to stop there. Wouldn't it be enough just to have a federal mandatory rule that allows shareholders to opt into or out of the takeover regime of states other than the company's state of incorporation? With such a process rule in place, so the argument might go, states might have an incentive to develop and offer whatever takeover regimes shareholders might find attractive. If a reader does take this view, we

feel that he or she has already accepted much of our thesis about the need for a federal role to improve regulatory competition. The "process" element that we have put forward, which only the federal government is in a position to do, is crucial for improving the state competition process. The addition of a mandatory federal process rule would by itself be a significant improvement over federal nonintervention.

In our view, however, federal intervention should also include the provision of a federal takeover regime into which shareholders would be able to opt (in and out). Our concern is that states might still not have adequate incentives, despite the existence of a mandatory process rule, to develop and offer a different novel takeover regime even if such a regime would be in the interests of shareholders.

The basis for our concern has to do with sunk costs and imperfect competition. A state will naturally want to recoup any investments it has made in the course of offering such a regime. Consider the decision of Montana whether to make a major commitment to developing a better takeover regime with the attendant judicial and legal infrastructure that would be a necessary prerequisite. Montana might reason that if they develop such a regime and make the necessary investments, then Delaware might just match them. Companies would then remain with Delaware, which after all has the built-in advantage of experience and familiarity. Montana would just serve as the stalking horse to get Delaware to do what is good for shareholders but would not gain itself.[95]

The concern we have attributed to Montana is a realistic one. Delaware has been very apt in keeping ahead of, or at least matching, legal innovations other states have put forward that

[95] Cf. Jean Tirole, The Theory of Industrial Organization 308-311 (1998).

companies have found to be attractive.[96] Delaware has maintained its dominant position for a very long time in spite of a substantial amount of innovation. As some corporate law scholars have emphasized, this is a market where just coming up with an innovation does not enable one to capture a big market share due to a dominant player's ability to imitate.[97]

The federal government presumably has different incentives. The federal government would be more likely to look to the aggregate interests of U.S. shareholders and companies and would not feel the same need to make a return on investment in developing an alternative takeover regime. It might still be a worthwhile project even if in the end Delaware matches them. That is, for the federal government to keep the states in check, it might be worthwhile to challenge Delaware and other states even if this challenge would itself garner little profit. If the federal government does not step up to the plate, it is unlikely anyone would. Political economy considerations surrounding choice-enhancing intervention will be discussed in some more detail shortly.

E. *An Alternative Version of Choice-Enhancing Intervention: A Federal Requirement that States Allow Shareholders to Opt Out of Antitakeover Arrangements*

Our strategy is not based on imposing a regime more hospitable to takeovers on shareholders but rather on making such a regime more accessible to shareholders should they wish to avail themselves of it. One possible way of accomplishing this is through the provision of an optional federal takeover law along with a mandatory federal process rule to enable shareholders to opt into and out of this body of takeover law. But there are alternative ways of

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[96] See Romano, supra note 86, at 240. William Carney has found that Delaware, although not the first mover on most corporate law changes, is a quick follower of successful innovations. William J. Carney, The Production of Corporate Law, 71 S. Cal. L. Rev. 715, 741-42 (1998).

[97] See Melvin Aron Eisenberg, The Structure of Corporation Law, 89 Colum. L. Rev. 1461, 1511-12 (1989); Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757, 842-47 (1995).

implementing choice-enhancing intervention which would also create meaningful shareholder choice.

In particular, one alternative version would be to have a federal law that requires states that provide antitakeover arrangements to do so in a way that enables shareholders to opt out of those arrangements. Given existing state takeover regulation, and the centrality of the poison pill, a promising starting point might be a federal law requiring states to allow shareholders of companies, whose charter is silent on the question, to adopt binding by-laws that prohibit the future use of poison pills (or place restrictions on their use). By limiting this to companies whose charter does not otherwise prohibit such by-laws, such a federal law would not impose a permissive takeover regime on shareholders who do not want it.

This form of choice-enhancing federal intervention is worth considering. However, it is not without some shortcomings. First, antitakeover measures evolve and change over time. The poison pill is a dramatic example of this fact. It would therefore not be enough to have a rule that allows for opting out with respect to only certain particular antitakeover arrangements, as the rule allowing shareholders to adopt by-laws limiting pills would do. Another possibility then would be a broadly worded federal statute allowing opting out of antitakeover arrangements and perhaps letting the SEC define from time to time what antitakeover arrangements this encompasses. Such a federal statute would be a significant step in the direction of the British City Code regime and its position on defensive tactics.

Another potential shortcoming of such an approach is that the ability to opt out of particular antitakeover arrangements does not mean that shareholders will thereby be ensured of a coherent comprehensive takeover-friendly regime. There are other important aspects to a takeover regime that might be important to shareholders. This is the advantage of the version of choice-enhancing intervention that we have discussed – that of providing a body of federal takeover law complete with a system of adjudication and enforcement. For this reason, we

believe the version of choice-enhancing intervention we have focused on is preferable, but nevertheless requiring states to allow opting out of antitakeover arrangements is also a plausible candidate for implementing choice-enhancing intervention.

E. *Note on the Political Economy of Federal and State Regulation*

A number of commentators have contended that the federal government would be unlikely to offer a takeover regime that is hospitable to takeovers.[98] This has formed, after all, the basis for one of the standard objections to having mandatory federal rules. The federal government, as they point out, has its own political dynamic and is influenced by various interest groups. Managers, so the argument goes, perhaps aligned with labor interests, might have enough political power to influence any national legislation concerning takeover law to the ultimate detriment of shareholders. Therefore, it is important to comment on whether political economy concerns provide a reason to oppose choice-enhancing intervention.

One question is whether federal legislators would be willing to adopt choice-enhancing intervention. Although we will argue shortly that this might be politically feasible, the main focus of this paper is to identify choice-enhancing intervention as a potentially attractive option for reformers that has not been recognized to date. While it is worthwhile asking whether any changes that have been identified as beneficial would be politically possible, it is, of course, also necessary to figure out first which changes would in fact be an improvement over the current situation. This is the central issue we focus on.

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[98] Roberta Romano in particular has stressed this point. See, e.g., Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale. L.J. 2359, 2386-87 (1998); Roberta Romano, The Future of Hostile Takeovers: Legislation and Public Opinion, 57 U. Cin. L. Rev. 457 (1988).

Another question that might be raised is whether, assuming that federal law adopts a choice-enhancing intervention, the optional federal takeover law that would be provided would be one hospitable to takeovers. As explained below, there are reasons to think that this could happen. To be sure, we cannot rule out the possibility that managers, right away or over time, would be able to push the optional federal takeover law in a direction favorable to them. With choice-enhancing intervention, however, its very design would guarantee that such a development would not harm shareholders. If the federal regime over time includes ever more prohibitions on takeovers than shareholders at some point will elect not to opt into (or, if they have done so previously, to opt out of) the federal optional regime.

Let us turn to explain why, in our view, the chances that federal officials would provide arrangements that are hospitable to takeovers are higher than the probability that state officials would unilaterally do so. At both the state and federal level, lobbying and pressure by interest groups is always possible. But one important force pushes state law to restrict takeovers which is not present at the federal level. This force is the incentives created by regulatory competition between the states.

Recall the analysis of how the very desire to influence the reincorporation decisions of managers induces states to provide takeover law favorable to managerial interests. This implies that, even if managers were to invest no resources in lobbying for favorable state takeover law, state takeover law would likely be attuned to their interests. The pressures placed on states by having to compete with each other operates in addition to whatever lobbying by interest groups occurs. And this pressure, it bears repeating, tends to be in the direction of restricting takeovers.

With choice-enhancing intervention, this pressure, which has been pushing states to restrict takeovers, would disappear. To be sure, lobbying by managerial interests might still be strong, but such lobbying can occur at the state as well as the federal level. It is also possible that such lobbying could be countered at the national level by lobbying by financial interests and

the financial services industry. While there is little reason to be optimistic that state takeover law would suddenly become more hospitable to takeovers, the selection of such rules by federal officials designing an optional federal takeover law is a plausible scenario.

Past experience supports this position. The history of takeover regulation is consistent with the view that state lawmakers are more eager to impose restrictions on takeovers than their federal counterparts. Throughout the past thirty years, states have been far ahead of federal law in rescuing incumbents from unwanted bidders. Federal law, pursuant to the Williams Act amendments to the 1934 Exchange Act, has merely attempted to create an auction between bidders when a corporation is up for sale in contrast to state takeover law, which has repeatedly attempted to block unwanted bidders. The SEC advisory committee on takeovers in 1983 came up with recommendations that were much more restrictive of managers' ability to use defensive tactics than what state law has subsequently permitted.[99] Following the *Unocal* decision in 1985 the SEC promulgated the all-holders rule that prevented the future use of the potent defensive tactic that Unocal was able to mount against an unwanted bidder through a discriminatory self-tender.[100] Several years later, in 1987, corporate management failed in their attempt to pass federal takeover legislation.[101] Interests other than those of incumbent managers have been represented at the federal level in contrast to what has often happened at the state level. This may be due, in part, to the incentives of states to cater to managerial preferences independent of interest group politics, a bias that federal lawmakers seeking to maximize the number of opt-ins to an optional federal takeover regime would not share.

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[99] See SEC Advisory Committee on Tender Offers, Report of Recommendations (1983), reprinted in [Extra Ed. No. 1028] Fed. Sec. L. Rep. (CCH) (July 15, 1983).

[100] See Rule 14d-10, 17 C.F.R. s 240.14d-10 (1995).

[101] Stephen Bainbridge, The Politics of Corporate Governance, 18 Harv. J. of Law & Public Policy 671, 705-709 (1995).

G. *Note on Mandatory Rules*

So far, in the debate over the desirability of a federal role in takeover regulation, the debate has been limited to comparing the choice between federal nonintervention and mandatory federal takeover regulation. This paper has outlined a third alternative. This third alternative of choice-enhancing regulation, we have argued, is clearly superior to federal nonintervention, and therefore nonintervention should be put off the table. The policy choice should be between choice-enhancing intervention and mandatory federal regulation. Which one of these two approaches is superior is another question.

We will briefly discuss the comparative merits of these two approaches. Mandatory rules would obviously involve costs not shared by choice-enhancing intervention. The reason why choice-enhancing regulation does not dominate mandatory takeovers rules is that it would solve only some and not all the problems created by state competition in takeover law. The unresolved problems, however, could conceivably be solved by federal mandatory rules.

The problem with state takeover law that we have so far focused on is one that arises from managerial opportunism. Because states might cater to managers' interests, and because managers could prefer laws that restrict takeovers more than shareholders would ideally want, states might excessively impede hostile bids. Choice-enhancing regulation serves the valuable role of enabling shareholders to decide for themselves which takeover regime serves their interests.

But this is also a potential cost. Shareholders might prefer a takeover regime that restricts takeovers more than is socially optimal. This is because takeovers have an external effect on outside buyers.[102] In assessing the desirability of a regime that would govern a hostile takeover

[102] See Sanford J. Grossman & Oliver D. Hart, Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation, 11 Bell J. Econ. 42, 42-43 (1980); Lucian Bebchuk & Marcel Kahan, A Framework for

for their company, shareholders would not take into account the gain to the hostile bidder from a successful bid. As a result, while the regime that shareholders prefer might be more hospitable to takeovers than existing state takeover law, it might nevertheless be less hospitable than the one that is socially optimal. And because the externality problem noted above results from the divergence between the interest of target shareholders and social welfare, an intervention seeking to provide shareholders the regime they prefer would not necessarily result in socially optimal takeover regulation.

If one attaches sufficient weight to this externality problem, then one might consider adopting a regime that facilitates takeovers even more than shareholders would wish by mandatory federal law. Whether this should be done would depend on an assessment of the magnitude of the externality with the costs of mandatory intervention discussed earlier. Addressing these issues, and thus whether one would want to go beyond choice-enhancing intervention, is outside the scope of this paper, the aim of which has been to introduce choice-enhancing intervention as an important option and show that its introduction should remove federal nonintervention as an attractive option.

H. *Toward a General Reconsideration of Regulatory Competition in Corporate and Securities Law*

The new approach that we put forward in this paper has implications for the general subject of regulatory competition in corporate and securities law. It suggests the possibility of a new approach to this subject that has long occupied the attention of students of corporate and securities law. We develop our general approach to regulatory competition in corporate and

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Analyzing Legal Policy Toward Proxy Contests, 78 Cal. L.Rev. 1071 (1990); Lucian Bebchuk & Luigi Zingales, Corporate Ownership Structures: Private versus Social Optimality in Concentrated Ownership (R. Morck, ed.) (2000).

securities law in another work,[103] but we want here to sketch the direction in which the analysis of this paper points and which we pursue elsewhere.

For the last quarter of a century there have been two camps in the debate over regulatory competition in corporate law. One camp is supportive of federal nonintervention. Proponents of this view contend that competition between the states is sufficient to create a "race to the top." Whoever offers a product, in this case takeover law, that is closest to the social optimal has a competitive edge. Proponents of this view have recently advocated expansion of federal nonintervention to securities regulation which has long been subject to mandatory federal rules.[104]

The opposing camp has been critical of state competition. William Cary was one of the first to express the concern that regulatory competition might in fact lead states to prefer managers over shareholders. While Cary did not consider the market constraints on managers, one of us subsequently showed how, notwithstanding market forces, Cary's concerns might be valid with respect to certain major corporate law subjects.[105]

The problem for critics of state competition has been what, if anything, should be done. Until now, it appeared as if the only alternative to federal nonintervention was federally mandated substantive arrangements. Cary, for instance, advocated "federal standards of corporate responsibility."[106] Another suggestion has been that mandatory federal rules might be

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[103] See Lucian Ayre Bebchuk & Allen Ferrell, Toward a New Model of Federalism in Corporate and Securities Law (work in progress).

[104] See Stephen J. Choi & Andrew T. Guzman, Portable Reciprocity: Rethinking the International Reach of Securities Regulation, 71 S. Cal. L. Rev. 903, 914-924 (1998); Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale L.J. 2359, 2383-88 (1998).

[105] See Bebchuk, supra note 1, at 1458-84.

[106] William Cary, Federalism and Corporate Law: Reflections upon Delaware," 83 Yale. L.J. 663, 701 (1974)

desirable with respect to some issues.[107] However, because mandatory rules have their own costs recognition of the shortcomings of state competition did not by itself establish the case for such intervention. Critics of federal nonintervention seemed to face the choice of either having mandatory federal substantive arrangements with their associated costs or staying with state law with all of its apparent deficiencies.

As the debate has been thus far framed, then, there were only two choices: either federal nonintervention or mandatory federal substantive arrangements. This paper, however, has identified a third way – a new approach that involves federal intervention but not federal imposition of mandatory substantive arrangements. The aim of this approach is not to replace regulatory competition and shareholder choice. Rather, it seeks to improve regulatory competition by enhancing shareholder choice through enlarging the set of choices available to shareholders and by facilitating shareholders' ability to make such choices. In this paper we have put forward such an intervention with respect to the specific but important area of takeover law. We believe, however, that this form of intervention can be an important option to consider for corporate and securities law in general. And we develop elsewhere how such choice-enhancing intervention with respect to corporate law in general would operate. As is the case for choice-enhancing intervention in the area of takeover law, choice-enhancing intervention for corporate and securities law would include two elements, which we briefly describe below.

One element would be a mandatory federal process rule that would set the "switching rules" among competitors in the regulatory competition landscape. Specifically, the federal process rule would establish a process by which companies would switch from one state to another and, in particular, would make it possible for shareholders to initiate and approve such switches even without managers' initiation. As things currently stand, state law governs how companies can switch to a competitor through the reincorporation process. And the law states

[107] Bebchuk, supra note 1, at 1498-1507.

have chosen to adopt is one which makes it impossible for shareholders to switch without managerial initiation, which ensures that managers' interests are given substantial weight in how states craft their corporate law. This leads to inefficient incentives on the part of states, one possible example being takeover law. Under choice-enhancing intervention, however, federal law would establish a process by which shareholders can, even without managers' consent, opt-out of that state's takeover regime. This will leave regulatory competition in place but much improved. Such a change will increase the pressure on states to have arrangements that shareholders actually want or suffer the consequences.

The other element of the choice-enhancing intervention would be the possibility of federal incorporation. The federal government would establish a regime into which companies could incorporate. This regime would be optional, and would only apply to those companies wishing to incorporate there. Because a federal regime would have more resources and stronger incentives to try to improve upon the leading state competitor at any point in time, the availability of the federal regime could further operate to augment shareholder choice and to improve the performance of regulatory competition.

IV. Conclusion

This paper has reconsidered the long-standing policy debate over state competition in corporate law and takeover law in particular. We have offered a critique of state takeover law, suggesting that it is quite possible if not probable that shareholders would prefer a regime more hospitable to takeovers than the one produced by state law. Given these potential problems with state takeover law, we have placed on the table for discussion a new form of federal intervention that does not rely on mandating substantive takeover arrangements. This choice-enhancing intervention, we have argued, is clearly superior to federal nonintervention.

One contribution of our work is in suggesting a new approach to the long-standing debate on federalism in American corporate law. We have shown that the choice is not only between no federal intervention and mandatory federal substantive rules. There is another possibility, federal choice-enhancing intervention, that would not impose mandatory substantive arrangements but rather operate to expand the set of choices shareholders have. While we have focused in this paper on takeover law, we believe that the choice-enhancing approach can be used more broadly and can provide the basis for a new approach to federalism in corporate law.

A second contribution of our paper is to the debate surrounding the regulation of takeovers. We have shown that a regime that facilitates takeovers can be made accessible to shareholders that desire it without imposing it on shareholders that do not wish it. Thus, our proposal would enable shareholders to capture the potential benefits of such a permissive regime, which many commentators support, without mandating it. Making such a regime available to shareholders, we believe, will result in a healthier and more vigorous takeover market to the benefit of investors.