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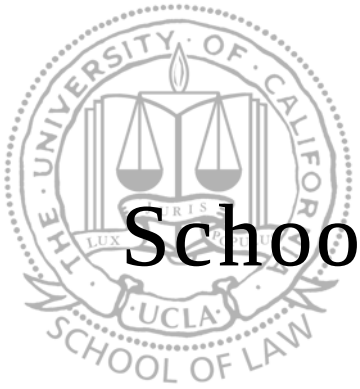
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Director Primacy in Corporate Takeovers: Preliminary Reflections

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***Abstract*:** Prepared for a Stanford Law Review symposium, this essay comments on an article by Harvard Professors Bebchuk, Coates, and Subramanian; namely, Lucian Ayre Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. __ (forthcoming). Bebchuk, Coates, and Subramanian's data demonstrate that (1) the incidence of staggered boards has increased substantially in the last two decades and (2) most, if not all, of this increase can be linked to the staggered board's utility as a takeover defense. In response, they offer a policy prescription "stated simply" as: "Courts should not allow managers to continue blocking a takeover bid after they lose one election conducted over an acquisition offer." It is this recommendation and the normative foundations on which it is premised, rather than the minutiae of their empirical analysis and theoretical models, which are the focus of this comment. Like much of modern academic commentary on corporate law, Bebchuk, Coates, and Subramanian's policy recommendation rests on the principle of shareholder primacy. In contrast, this comment argues that corporate law is better understood as a system of director primacy in which the board of directors is not a mere agent of the shareholders, but rather is a sort of Platonic guardian serving as the nexus of the various contracts making up the corporation. The comment concludes by proposing a director primacy-based standard for reviewing the tandem use of classified boards and poison pills as an alternative to Bebchuk, Coates, and Subramanian's proposed prophylactic bar on their use.

Keywords: corporations, corporate governance, takeovers, takeover defenses, board of directors

JEL Classification: G34, K22

Director Primacy in Corporate Takeovers: Preliminary Reflections

Stephen M. Bainbridge*

Who decides? This question lies at the heart of corporate takeover jurisprudence. Shall it be the shareholders who decide whether an acquisition shall occur or, as with virtually all other important policy questions, shall it be the board of directors?[1] In statutory acquisitions, such as mergers or asset sales, the answer is clear—the target corporation's board of directors decides. If the board rejects a proposed merger or asset sale, the shareholders are neither invited to, nor entitled to, pass on the merits of that decision.[2] Only if the target's board of directors approves the transaction are the shareholders invited to ratify that decision.[3] In nonstatutory acquisitions, such as tender offers, the answer is more complicated. A bidder makes a tender offer directly to the shareholders of the target corporation, thereby bypassing the board of directors.[4] When the hostile tender offer emerged in the 1970s as an important acquirer tool, however, lawyers and investment bankers working for target boards responded by developing defensive tactics designed to impede such offers.[5] Takeover defenses reasserted the target board's primacy, by extending the board's gatekeeping function to the nonstatutory acquisition setting. These developments have prompted a vast academic literature, most of which is quite hostile to granting the target board a significant gatekeeping function.[6]

In recent years, a particularly potent takeover defense has emerged via the combination of a poison pill and a classified board (a.k.a. a staggered board).[7] In their

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* Professor, UCLA School of Law. I thank Lynn Stout and Leo Strine for their comments.

[1] *See* Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 521 (1992) (suggesting that "the fundamental governance question presented by unsolicited offers" is whether "right to decide whether to accept or reject the offer reside with the shareholders or is it, like all other important policy questions, initially a decision for the board to make until it reveals itself to be disabled by self-interest").

[2] *See* Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PENN. L. REV. 315, 321-22 (1987) (explaining that corporate law vests the decision to reject a merger in the unilateral discretion of the target corporation's board of directors).

[3] *See, e.g.*, MODEL BUS. CORP. ACT ANN. § 11.04 (b) (1984) (providing that "*after* adopting the plan of merger . . . the board of directors must submit the plan to the shareholders for their approval"; emphasis supplied).

[4] *See* Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 844 (1993) (explaining that "takeovers . . ., in contrast to mergers, are achieved by tender offers to the shareholders, and thus bypass incumbent management's approval").

[5] *See generally* PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS 167-234 (3d ed. 2002) (tracing the development of takeover defenses).

[6] For a recent summary of the academic literature on takeovers, along with a bibliography, see George Bittlingmayer, *The Market for Corporate Control (Including Takeovers)*, in III ENCYCLOPEDIA OF LAW & ECONOMICS 725 (2000).

[7] The literature on poison pills is voluminous. *See, e.g.*, Martin M. Cohen, *"Poison Pills" as a Negotiating Tool: Seeking a Cease-Fire in the Corporate Takeover Wars*, 1987 COLUM. BUS. L. REV. 459; Peter V. Letsou, *Are Dead Hand (and No Hand) Poison Pills Really Dead?*, 68 U. CIN. L. REV.

new article on staggered boards, Bebchuk, Coates, and Subramanian opine that a poison pill and staggered board used in tandem have had a substantial impact "on the market for corporate control [that] has not been adequately recognized by courts, academics, or practitioners."[8] Strikingly, they find that during a recent five year period (1996-2000), combining an effective staggered board and a poison pill almost doubled the chances of a target corporation remaining independent.[9]

Bebchuk, Coates, and Subramanian's data demonstrate that (1) the incidence of staggered boards has increased substantially in the last two decades and (2) most, if not all, of this increase can be linked to the staggered board's utility as a takeover defense.[10] Standing alone, of course, their data is but a mere observation—albeit an empirically interesting one.[11] In the penultimate section of their article, however, Bebchuk, Coates, and Subramanian move from the positive to the normative. Specifically, they offer a policy prescription "stated simply" as: "Courts should not allow managers to continue blocking a takeover bid after they lose one election conducted over an acquisition offer."[12] It is this recommendation and the normative foundations on which it is premised, rather than the minutiae of their empirical analysis and theoretical models, which interest me and, accordingly, will be the focus of my remarks here.

1101 (2000); Guhan Subramanian, *A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill*, 23 Del. J. Corp. L. 375 (1998); Thomas R. Wilcox, Note, *Delaware's Attempt to Swallow a New Takeover Defense: The Poison Pill Preferred Stock*, 10 DEL. J. CORP. L. 569 (1985). The literature on classified boards is considerably smaller. *See, e.g.*, Richard H. Koppes et al., *Corporate Governance Out of Focus: The Debate over Classified Boards*, 54 BUS. LAW. 1023 (1999); Chamu Sundaramurthy et al., *Governance Antecedents of Board Entrenchment: The Case of Classified Board Provisions*, 22 J. MGMT. 783 (1996).

[8] Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 889 (2002). *But see, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 684 (2002) (noting that "combining a poison pill with a classified board shark repellent gives the board an especially powerful negotiating device"); Ronald J. Gilson, *Unocal Fifteen Years Later (And What We Can Do About It)*, 26 Del. J. Corp. L. 491, 504 (2001) (noting that "institutional investors [have] decided that, because of the interaction of staggered boards with poison pills, they would not vote for them"); Neil C. Rifkind, Note, *Should Uninformed Shareholders be a Threat Justifying Defensive Action by Target Directors in Delaware?: "Just Say No" After Moore v. Wallace*, 78 B.U.L. REV. 105, 111 (1998) (observing that "[w]hen poison pills and classified boards are used in tandem, the bidder either must mount two consecutive proxy contests to elect a majority of directors, or convince a court that the target directors' opposition to the offer constitutes a breach of the directors' fiduciary duties."); Robert B. Thompson, *Shareholders as Grown-Ups: Voting, Selling, and Limits on the Board's Power to "Just Say No,"* 67 U. CIN. L. REV. 999, 1017-18 (1999) (using legal treatment of poison pill and classified board provisions as a measure of jurisdictional commitment to shareholder primacy).

[9] Bebchuk et al., *supra* note 8, at 931.

[10] *Id.* at 895-900.

[11] This observation becomes especially interesting and valuable when coupled with the apparent disconnect between their findings and practitioner perceptions. *See id.* at 902 (summarizing survey data).

[12] *Id.* at 945.

In fairness, of course, developing a comprehensive normative justification for shareholder choice was not the task Bebchuk, Coates, and Subramanian set for themselves on this occasion. Instead, they addressed that task independently elsewhere.[13] Having said that, however, their article proposes a rather dramatic change in Delaware law, which is grounded on contestable normative principles. It is therefore appropriate to challenge those foundational premises.

Like most modern academic commentary on corporate law,[14] Bebchuk, Coates, and Subramanian's policy recommendation rests (mostly implicitly) on the principle of shareholder primacy. Although it takes various guises, shareholder primacy generally contends (1) that shareholders are the principals on whose behalf corporate governance is organized and (2) that shareholders do (and should) exercise ultimate control of the corporate enterprise.[15] It is the latter aspect of shareholder primacy on which I diverge from Bebchuk, Coates, and Subramanian.[16] Their recommended new prophylactic rule is explicitly intended to "revitalize the ballot box route" for takeovers,[17] which necessarily presumes the desirability of ultimate shareholder decisionmaking authority. In contrast, my recent scholarship has emphasized a competing understanding of corporate governance, which I refer to as "director primacy."[18] In the director primacy model, the board of directors is not a mere agent of the shareholders, but rather is a sort of Platonic guardian serving as the nexus of the various contracts making up the corporation.[19] As a positive theory of corporate governance, director primacy claims that fiat—centralized decisionmaking—is the essential attribute of efficient corporate governance.[20] As a normative theory of corporate governance, director primacy claims

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[13] *See, e.g.*, Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

[14] *See infra* text accompanying note 35.

[15] *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440-41 (2001) (describing the "standard shareholder-oriented" model); *see also id.* at 449 (making the standard shareholder primacy assumption that shareholder voting rights that are both exclusive and strong).

[16] I accept (and have elsewhere defended) the first half of shareholder primacy, which embraces what I prefer to call the shareholder wealth maximization norm. *See, e.g.*, Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm*, 50 WASH. & LEE L. REV. 1423 (1993); *see also* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 281 (1998). (observing: "The most frequent defender of the shareholder primacy norm in recent scholarship has been Stephen Bainbridge.").

[17] Bebchuk et al., *supra* note 8, at 951.

[18] *See, e.g.*, BAINBRIDGE, *supra* note 8, at 195-208 (developing the director primacy model).

[19] *See* PLATO, THE REPUBLIC 289-90 (Benjamin Jowett trans. 1991) (describing the education of philosopher-kings who rule "for the public good, not as though they were performing some heroic action, but simply as a matter of duty"). In Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988), former Delaware Chancellor William Allen opined: "The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters." *Id.* at 663. Director primacy squarely rejects this claim. Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. __, ___ (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=300860.

[20] BAINBRIDGE, *supra* note 8, at 199.

that resolving the resulting tension between authority and accountability is the central problem of corporate law.[21]

Unfortunately, time and space limitations preclude me from addressing all of the arguments advanced by Bebchuk, Coates, and Subramanian—all highly prolific—in their various articles, let alone the extensive literature by other scholars, in favor of the shareholder primacy approach to takeovers. Doing so is a task for another day and a future full-blown article. Instead, herein I use Bebchuk, Coates, and Subramanian's article as a jumping off point for sketching out the director primacy approach to takeover jurisprudence. In the course of doing so, however, I hope to show that Delaware courts should not adopt Bebchuk, Coates, and Subramanian's proposed policy prescription.

Part I of this essay briefly elaborates on Bebchuk, Coates, and Subramanian's policy recommendations and the normative foundation on which it rests. Part II summarizes my director primacy model. Part III suggests a director primacy-based standard for reviewing the tandem use of classified boards and poison pills as an alternative to Bebchuk, Coates, and Subramanian's proposed prophylactic bar on their use.

I. Bebchuk, Coates, and Subramanian's Policy Recommendation

Standing alone, neither a poison pill nor a staggered board is a particularly effective takeover defense. A standard poison pill typically contains a provision for redemption by the board of directors, which makes the pill vulnerable to a pre-offer proxy contest in which the hostile bidder seeks to elect to a new slate of directors committed to redeeming the pill.[22] A classified board shark repellent is almost wholly ineffective unless it is buttressed by provisions insulating the classification scheme from removal of directors without cause or packing of the board with new appointments supported by a hostile bidder.[23] Unless the incumbent directors have unusually strong backbones, moreover, they will often play along with a hostile bidder who succeeds in winning a proxy contest to elect one of the board classes.[24]

When a pill and a classified board shark repellent are deployed in tandem, however, they become a far more effective defense. The pill deters a hostile bidder from buying a

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[21] *Id*. As a positive description of corporate governance, director primacy bears some resemblance to Blair and Stout's team production model, especially in that both models assume that control over the corporation and its "assets is exercised by an internal hierarchy" at the apex of which a board of directors whose authority over the use of corporate assets is virtually absolute. . . ." Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 251 (1999). As a normative matter, however, director primacy and team production diverge in that the former includes and the latter rejects the shareholder wealth maximization norm. *See id*. at 304 (noting that "the mediating hierarchy model predicts that shareholders benefit from granting directors discretion to favor other constituencies").

[22] Bebchuk et al., *supra* note 8, at 905.

[23] BAINBRIDGE, *supra* 8, at 677.

[24] *Id*.

control block of stock prior to the pill being redeemed.[25] Instead, in the face of board resistance, the acquirer must conduct a proxy contest to elect a slate of directors committed to redeeming the pill.[26] When a classified board shark repellent is added to the equation, moreover, the bidder must go through two successive proxy contests in order to obtain a majority of the board.[27] Prevailing in two such successive contests, without owning a controlling block of stock, is extremely difficult and Bebchuk, Coates, and Subramanian therefore predict that the poison pill and staggered board tandem constitutes a significant deterrent to hostile takeovers.[28]

Bebchuk, Coates, and Subramanian's empirical research confirms their theoretical argument. When the staggered board/poison pill tandem is in place, the odds that the target will remain independent increase from 34% to 60%.[29] Strikingly, they also find that the theoretical option of conducting two consecutive proxy contests provides an ineffectual "safety valve": during the 1996-2000 period they studied, there was no "ballot box victory" by a bidder facing the staggered board/poison pill tandem.[30] Finally, they conclude that shareholders have suffered a significant economic injury—in terms of lost or reduced takeover premia—from the growing use of a staggered board/poison pill tandem.[31]

Bebchuk, Coates, and Subramanian advocate a prophylactic rule pursuant to which corporations would not be barred from using a staggered board/poison pill tandem. In order to "revitalize the ballot box" "safety valve," however, they argue that the incumbent directors and managers should not be allowed to "continue blocking a takeover bid after they lose one election conducted over an acquisition offer."[32] They leave much of the heavy lifting of implementing this rule to the courts. They do not, for example, explain how one tells the difference between an "election conducted over acquisition offer" from a standard proxy contest.[33] Similarly, they do not explain what

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[25] *See* Facet Enterprises, Inc. v. Prospect Group, Inc., 1988 WL 36140 at *3 (Del.Ch. 1988) (observing that the target's board of directors "knew that the existence of the 'poison pill,' unless redeemed, would deter any tender offer for all of [the target's] shares").

[26] Delaware Vice Chancellor Leo Strine explains:

> When poison pills became prevalent, would-be acquirors resorted to proxy contests as a method of obtaining indirectly that which they could no longer get through a tender offer. By taking out the target company's board through a proxy fight or a consent solicitation, the acquiror could obtain control of the board room, redeem the pill, and open the way for consummation of its tender offer.

In re Gaylord Container Corp. Shareholders Litig., 753 A.2d 462, 482 (Del. Ch. 2000) (footnote omitted).

[27] *See id.* (noting that a "staggered board provision . . . can delay an acquiror's ability to take over a board for several years").

[28] *See* Bebchuk et al., *supra* note 8, at 899 (discussing deterrent effect); *see also* BAINBRIDGE, *supra* note 8, at 684 (same).

[29] Bebchuk et al., *supra* note 8, at 931.

[30] *Id*. at 928.

[31] *See id*. at 934-40 (summarizing data).

[32] *Id.* at 945.

[33] Doing so would oblige courts to engage in a sorting task similar to that required by the competing *Unocal* and *Blasius* standards. The familiar *Unocal* standard, of course, applies when a target board of

happens if the incumbent board of directors is reelected but the margin by which they are elected was less than the number of votes cast by incumbent directors or managers or by an ESOP. And so on.[34]

II. Director Primacy

Today, most corporate law scholars embrace some variant of shareholder primacy.[35] In its various guises, shareholder primacy contends not only that shareholders are the principals on whose behalf corporate governance is organized, but also that shareholders do (and should) exercise ultimate control of the corporate enterprise.[36] Some form of shareholder primacy presumably provides the normative foundation on which Bebchuk, Coates, and Subramanian's policy recommendation rests. As noted, their proposal is expressly intended to "revitalize the ballot box" in corporate

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directors "addresses a pending takeover bid." Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985). If triggered, *Unocal* requires that the board's response satisfy a two-pronged standard of review: (1) that the target board had reasonable grounds for believing that a danger to corporate policy or effectiveness existed, an obligation they satisfy by showing good faith and reasonable investigation; and (2) that their response was reasonable in relationship to the threat posed by the hostile bid. *See id.* at 955 (describing standard). Under *Blasius* and its progeny, however, where the target board's defensive response disenfranchises target shareholders, the board must show a "compelling justification" for their action. *See, e.g*., Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1379 (Del.1995); Stroud v. Grace, 606 A.2d 75, 92 n. 3 (Del.1992); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del.Ch.1988). Three distinguished Delaware jurists (former Chancellor Allen and current Vice Chancellors Jacobs and Strine) observe that the *Unocal* and *Blasius* standards "are not easily separable." William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1314 (2001). Courts therefore have had some difficulty determining which standard to apply to specific cases. *Id.* at 1313-15.

[34] It also may be noteworthy that Bebchuk, Coates, and Subramanian propose adding yet another standard of review to Delaware law, which stands in sharp contrast to the arguments recently advanced by the same Delaware jurists in favor of substantially reducing the number of standards of review in Delaware corporate law. Allen et al., *supra* note 33, at 1317-21.

[35] *See* Douglas M. Branson, *The Very Uncertain Prospect of "Global Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, (2001) (asserting that "United States academic elites, including the global convergence advocates, seem to hold as universal a view of ... profit maximization as each firm and the nation's goal"); Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2128 (2001) (noting "the ascendance of the shareholder primacy norm"); *see, e.g.*, Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 330-31 (2001) (citing prior work in which he "extolled the American system because [of] its openness to external monitoring through a stock market-centered capital market"); Jeffrey N. Gordon, *Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany*, 5 COLUM. J. EUR. L. 219, 219 (1999) (asking whether "corporate governance will ultimately converge" on the "Anglo-American model whose features are shaped by the shareholder primacy norm"); Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) (opining: "Shareholder wealth maximization is usually accepted as the appropriate goal in American business circles."); *see generally* Bainbridge, *supra* note 16, at __ (describing various forms of shareholder primacy).

[36] *See supra* note 15 and accompanying text.

takeovers.[37] At least implicitly, this proposal reflects Bebchuk's preference for what he calls "undistorted shareholder choice"—i.e., a mechanism requiring "winning a shareholder vote as a formal or practical condition for a takeover."[38] Although not all shareholder primacy theorists accept Bebchuk's theory of undistorted shareholder choice,[39] there is little doubt that his theory is based on the shareholder primacy model's emphasis on ultimate shareholder control.[40] Consequently, Bebchuk, Coates, and Subramanian's policy recommendation rises and falls with the validity of shareholder primacy.

A. *De Jure* Director Primacy

What is the corporation? In the eyes of the law, the corporation is a legal fiction, possessing some attributes that are contractual in nature and others that are entity-like.[41] In economic terms, however, the corporation is a unique vehicle by which large groups of individuals, each offering a different factor of production, privately order their relationships so as to collectively produce marketable goods or services.[42] To facilitate this process of private ordering, the state's corporation code offers a basic set of default rules that the parties are generally free to accept, reject, or modify as they see fit.[43] In the familiar terminology of the prevailing nexus of contracts model, the firm thus is referred to as a nexus of contracts.[44]

The firm is more accurately described, however, as *having* a nexus of contracts.[45] This claim is premised on Kenneth Arrow's work on organizational decisionmaking, which identified two basic decisionmaking mechanisms: "consensus" and "authority."[46]

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[37] *See supra* text accompanying note 17.

[38] Bebchuk, *supra* note 13, at 976.

[39] *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 185-87 (1991).

[40] In fact, Bebchuk's article lacks an explicit normative rationale for treating "undistorted shareholder choice" as an end of corporate governance rather than as a means towards an end. In the absence of such a rationale, there is no justification for his implicit rhetorical device of treating "undistorted shareholder choice" as the null hypothesis against which counter-arguments must bear the burden of proof. *See generally* Lynn A. Stout, *Bad and Not-so-Bad Aguments for Shareholder Primacy*, 73 SO. CAL. L. REV. __ (forthcoming) (rejecting *a priori* justifications for shareholder primacy). Presumably some variant of shareholder primacy will be invoked as justification for doing so, but we shall see that shareholder primacy is a flawed model of corporate governance. *See infra* Part II.A.

[41] *See* William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1071 (2002) (noting "the 'property' and the 'entity' models that have dominated American corporation law scholarship and jurisprudence for the last one hundred years").

[42] *See generally* G. Mitu Gulati et al., *Connected Contracts*, 47 UCLA L. REV. 887, 894-95 (2000) (arguing that the firm consists of a set of contracts among factors of production).

[43] *See* BAINBRIDGE, *supra* note 8, at 29-31 (discussing role of default rules in corporate law)

[44] *Id.* at 200-01.

[45] BAINBRIDGE, *supra* note 8, at 201-203.

[46] KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 68-70 (1974). Professor Michael Dooley deserves credit for the seminal applications of Arrow's work to corporate governance, but none of the

Consensus is utilized where each member of the organization has identical information and interests, which facilitates collective decisionmaking. In contrast, authority-based decisionmaking structures arise where team members have different interests and amounts of information. Because collective decisionmaking is impracticable in such settings, authority-based structures are characterized by the existence of a central agency to which all relevant information is transmitted and which is empowered to make decisions binding on the whole.[47] Not surprisingly, the modern public corporation precisely fits Arrow's model of an authority-based decisionmaking structure.[48] No single corporate constituency has the information or the incentives necessary to make sound decisions on either operational or policy questions.[49] Overcoming the collective action problems that prevent constituency involvement would be difficult and costly.[50] Rather, as Arrow explained, under condition of disparate access to information and conflicting interests, it is "cheaper and more efficient to transmit all the pieces of information to a central place" and to have the central office "make the collective choice and transmit it rather than retransmit all the information on which the decision is based."[51]

Where is that nexus located? Both law and business practice give us the same answer. As Berle and Means famously demonstrated, U.S. public corporations are characterized by a separation of ownership and control.[52] The firm's so-called owners, the shareholders, exercise virtually no control over either day to day operations or long-term policy.[53] Instead, control is vested in the hands of the board of directors and their subordinate professional managers, who typically own only a small portion of the firm's shares.[54] Hence, the board of directors and the senior management team function as Arrow's central office.[55]

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blame for my subsequent uses (or misuses) thereof. *See, e.g.,* Dooley, *supra* note 1, at 467-71 (discussing Arrow's work).

[47] ARROW, *supra* note 46, at 68-69.

[48] Dooley, *supra* note 1, at 467-68.

[49] *See* Stephen M. Bainbridge, *Privately Ordered Participatory Management: An Organizational Failures Analysis*, 23 DEL. J. CORP. L. 979, 1057-60 (1998) (discussing the conflicting interests and access to information of corporate constituents).

[50] *Id.* at 1056.

[51] ARROW, *supra* note 46, at 68-69.

[52] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 66 (1932). Separation of ownership and control is a useful shorthand, but it is nevertheless a misnomer. Shareholders do not own the corporation. The corporation in fact is not a thing capable of being owned. Instead, per the most widely accepted theory of the corporation, the nexus of contracts model, the firm is a legal fiction representing a complex set of contractual relationships. Because shareholders are simply one of the inputs bound together by this web of voluntary agreements, ownership is not a meaningful concept under this model. Bainbridge, *supra* note 16, at 1426-28; Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 301-02 (1980); Stout, *supra* note 38, at ___.

[53] BERLE & MEANS, *supra* note 52, at 82.

[54] *Id.* To be sure, it is often said that, in the real world, boards are captured by senior management. According to this view, senior "managers dominate their boards by using their de facto power to select and compensate directors and by exploiting personal ties with them." Barry Baysinger & Robert E.

The board of directors' primacy is strongly reinforced by U.S. corporate law. Under all corporation statutes, the vast majority of corporate decisions are assigned to the board of directors or their subordinates acting alone.[56] As the Delaware code puts it, the corporation's business and affairs "shall be managed by or under the direction of a board of directors."[57] The vast majority of corporate decisions accordingly are made by the board of directors alone (or by managers acting under delegated authority).[58] The statutory decisionmaking model thus is one in which the board acts and shareholders, at most, react. Put simply, control is vested in the board—not the shareholders.[59] Shareholders have virtually no power to initiate corporate action; indeed, they are entitled to approve or disapprove only a very few board actions.[60] The direct restrictions

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Hoskisson, *The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy*, 15 ACAD. MGMT. REV. 72, 72-73 (1990). As I have argued elsewhere, the board capture phenomenon seems less valid today, however, than it once was. BAINBRIDGE, *supra* note 8, at 205-06. In any event, if there is overt conflict between the board and top management, the formal model of statutory authority is intended to ensure that the board's authority prevails as a matter of law, if not always in practice. *Id.* at 206.

[55] *See* Bainbridge, *supra* note 49, at 1009 (discussing the role of the central office in modern corporations); *see also* Stout, *supra* note 38, at __ (arguing that "shareholders display a revealed preference for rules that promote director primacy").

[56] All state corporate codes provide for a system of nearly absolute delegation of power to the board of directors, which in turn is authorized to further delegate power to subordinate firm agents. *See* MODEL BUS. CORP. ACT ANN. § 8.01 at 8-10—8-11 (1995) (reviewing statutes).

[57] DEL. CODE. ANN. tit. 8, § 141(a) (2001).

[58] Of course, operational decisions normally are delegated by the board to subordinate employees. The board, however, retains the power to hire and fire firm employees and to define the limits of their authority. Moreover, certain extraordinary acts may not be delegated, but are instead reserved for the board's exclusive determination. *See, e.g.*, Lee v. Jenkins Bros., 268 F.2d 377 (2d Cir. 1959); Lucy v. Hero Int'l Corp., 281 N.E.2d 266 (Mass. 1972).

[59] The board of directors as an institution of corporate governance, of course, does not follow inexorably from the necessity for fiat. After all, an individual chief executive could serve as the hypothesized central coordinator. Yet, corporate law vests ultimate control in the board. Why? I have elsewhere suggested two answers to that question: (1) under certain conditions, groups make better decisions than individuals and (2) group decisionmaking is an important constraint on agency costs. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002).

[60] Formal shareholder control rights in fact are so weak that they scarcely qualify as part of corporate governance. Under the Delaware code, for example, shareholder voting rights are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolution. See Michael P. Dooley, Fundamentals of Corporation Law 174-77 (1995) (summarizing state corporate law on shareholder voting entitlements). As a formal matter, only the election of directors and amending the bylaws do not require board approval before shareholder action is possible. Del. Code Ann., tit. 8, §§ 109, 211 (2000). In practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board. *See* Bayless Manning, *Book Review*, 67 YALE L.J. 1477, 1485-89 (1958) (describing incumbent control of the proxy voting machinery); *see generally* Michael P. Dooley, *Controlling Giant Corporations: The Question of Legitimacy*, *in* CORPORATE GOVERNANCE: PAST & FUTURE 28, 38 (Henry Manne ed., 1982) (observing that the "limited governance role assigned to shareholders is intentional and is, in fact, the genius of the corporate form").

on shareholder power supplied by U.S. corporate law are supplemented by a host of other economic and legal forces that prevent U.S. investors from exercising significant influence over corporate decisionmaking.[61]

I refer to this understanding of corporate law and governance as the "director primacy" model. In it, the corporation is a vehicle by which the board of directors hires various factors of production.[62] Consequently, directors are not mere agents of the shareholders. To the contrary, "the directors in the performance of their duty possess [the corporation's property], and act in every way as if they owned it."[63] It thus makes no sense to speak—as Bebchuk does[64]—of the directors' powers as being delegated from the shareholders. Instead, as an old New York decision put it, the board's powers are "original and undelegated."[65] The directors thus are Platonic guardians of a *sui generis* entity in which shareholders are but one of many contracting inputs.[66]

B. *De Facto* Shareholder Primacy?

Some proponents of shareholder primacy concede that shareholders lack formal control of the corporation, but argue that they still exercise ultimate *de facto* control. According to John Coates, for example, the market for corporate control ensures a residual form of shareholder control, transforming "the limited *de jure* shareholder voice into a powerful *de facto* form of shareholder control."[67] Granted, the market for corporate control depends on the existence of shareholder voting rights. Moreover, the market for corporate control doubtless is an important accountability mechanism.[68] Market-based accountability and control—by which I mean the right to exercise decisionmaking fiat—are distinct concepts, however. Directors are held accountable to shareholders through a variety of market forces, such as the capital and reputational markets, but one cannot fairly say that those markets confer control rights on the shareholders. How then can one say that the market for corporate control does so? The

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[61] *See generally* Stephen M. Bainbridge, *Constraints on Shareholder Activism in the United States and Slovenia* (May 17, 2000), *at* http://papers.ssrn.com/author=16596 (summarizing constraints).

[62] I develop this thesis in more detail in Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, __ IOWA L. REV. ___ (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=299743. In a recent article, Bebchuk identified arguments against shareholder choice grounded in the perspectives of four constituencies: all target shareholders; long-term target shareholders; total shareholder wealth; and nonshareholder constituencies. Bebchuk, *supra* note 13, at 989-90. In doing so, he thus overlooks the perspective that director primacy emphasizes; namely, that of the board itself.

[63] Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918).

[64] *See* Bebchuk, *supra* note 13, at 995 (treating the directors' authority as being a matter of shareholder "delegation to boards").

[65] Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918).

[66] *See supra* note 19 and accompanying text.

[67] John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable are U.S. Public Corporations?*, 24 J. CORP. L. 837, 850 (1999).

[68] *See generally* Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

right to fire is not the right to exercise fiat—it is only the right to discipline. In any event, as Bebchuk, Coates, and Subramanian's data confirm, takeover defenses—especially the combination of a poison pill and a staggered board—have gone a long way towards restoring director primacy vis-à-vis the shareholders.[69]

Other scholars argue that institutional investor activism gives teeth to shareholder control.[70] Acknowledging that rational apathy precludes small individual shareholders from playing an active role in corporate governance, even if the various legal impediments to shareholder activism were removed, these scholars focus on institutional investors, such as pension and mutual funds. Because institutional investors own large blocks, and have an incentive to develop specialized expertise in making and monitoring investments, they could play a far more active role in corporate governance than dispersed shareholders. Institutional investors holding large blocks thus potentially have greater power to hold management accountable. Their access to firm information, coupled with their concentrated voting power, might enable them to more actively monitor the firm's performance and to make changes in the board's composition when performance lagged.

There is relatively little evidence that institutional investor activism has mattered, however.[71] Due to a resurgence of direct individual investment in the stock market, motivated at least in part by the day trading phenomenon and the technology stock bubble, the trend towards institutional domination stagnated in recent years.[72] Even the most active institutional investors spend only trifling amounts on corporate governance activism.[73] Institutions devote little effort to monitoring management; to the contrary, they typically disclaim the ability or desire to decide company-specific policy questions.[74] They rarely conduct proxy solicitations or put forward shareholder

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[69] *See supra* notes 29-31 and accompanying text (summarizing effect of staggered board/poison pill tandem on hostile takeovers).

[70] *See, e.g.*, MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990).

[71] *Cf.* Branson, *supra* note 35, at 322 (arguing that elite corporate law scholarship tends to be faddish and specifically criticizing those "scholars [who] wrote about, and subsequently oversold, institutional investor activism").

[72] Between 1970 and 1990, the percentage the percentage of total U.S. equities held by institutions increased from 28.2% to 41.4%. NEW YORK STOCK EXCHANGE, FACT BOOK 61 (2001). Between 1990 and 2000, however, the percentage increased from 41.4% to only 45.8%. *Id.* As of the third quarter of 2001, the percentage of total U.S. equities held by institutions was 46.7%. *Id. See also* THE CONFERENCE BOARD, INSTITUTIONAL INVESTMENT REPORT—FINANCIAL ASSETS AND EQUITY HOLDINGS (November 2000) (observing that institutional investor stock ownership has stagnated for a long time at just under 50% of the market).

[73] *See* Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459, 460 (1998) (noting that even "activist institutions spend less than half a basis point of assets … on their governance efforts").

[74] *Cf.* ROE, *supra* note 70, at 235 (arguing that: "The model institutional overseer would not micromanage the firm from day to day, but be ready to make changes during crisis and hold the managers accountable during the interim.")

proposals.[75] Not surprisingly, empirical studies of U.S. institutional investor activism have found "no strong evidence of a correlation between firm performance and percentage of shares owned by institutions."[76]

To be sure, Bebchuk, Coates, and Subramanian recite evidence of institutional investor opposition to management-sponsored proposals to stagger the board of directors.[77] I am not persuaded by these findings, however. First, as they also report, activist shareholders have made little headway in efforts to "de-stagger" the board.[78] Second, by their own account, almost 60% of public corporations now have staggered boards.[79] They present no data on the remaining 40%. Perhaps public corporations lacking a staggered board do not need one as a takeover defense, because they have other strong takeover defenses in place (such as the existence of a friendly controlling shareholder or dual class stock). Consequently, contrary to Bebchuk, Coates, and Subramanian's claim that shareholder opposition has killed management-sponsored staggered board proposals, the declining number of proposals may be attributable to other factors. Finally, and most importantly, Bebchuk, Coates, and Subramanian also find that, among firms going public, the incidence of staggered boards has increased dramatically (from 34% in 1990 to over 70% in 2001).[80] If what investors do matters more than what they say,[81] IPO investors are voting for staggered boards with their wallets.

In sum, shareholders are almost wholly lacking in either direct or indirect mechanisms of control.[82] Likewise, there is little evidence of effective shareholder demand for such control. Instead, both *de facto* and *de jure* control is vested in the board of directors.

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[75] Black, *supra* note 73, at 460.

[76] *Id*. at 462.

[77] Bebchuk et al., *supra* note 8, at 900. They observe a substantial decline, over the last decade, in the number of public corporations in which there are proposed amendments to articles of incorporation to create a staggered board (from 88 proposals in 1986 to 10 in 2000). *Id.* They also point out that only four of the 10 proposals in 2000 involved companies in which incumbent managers did not own a controlling block of stock and that, among those four, only one of the proposals passed. *Id*. Finally, they observe an increase in both the frequency of precatory shareholder proposals to de-stagger boards and the votes cast for such proposals. *Id.*

[78] *Id.*

[79] *Id.* at 895. Another published estimate puts the figure even higher, at more than 70% of U.S. public corporations. Robin Sidel, *Staggered Terms for Board Members are Said to Erode Shareholder Value, not Enhance it*, WALL ST. J., Apr. 1, 2002, at C2.

[80] Bebchuk et al., *supra* note 8, at 889.

[81] *See infra* text accompanying note 122.

[82] *See* Dooley, *supra* note 1, at 525 (noting that "many prominent features of corporation law seem designed for the express purpose of making it difficult for shareholders to hold the board and its managers legally responsible, except in the most provocative circumstances").

C. The Tension between Authority and Accountability in the Director Primacy Model

If director primacy is valid, its critics might ask, why do we not observe an unrestricted right for target directors to veto unsolicited takeover bids? Why do we observe various director accountability devices, such as the shareholders' right to elect directors, to sue derivatively, or to approve certain fundamental transactions? Fair questions all, but limits on the board's authority are not evidence of shareholder primacy. Instead, they are mechanisms by which shareholders enforce certain bargained-for rights.

In its purest form, authority-based decisionmaking calls for all decisions to be made by a single, central decisionmaking body—i.e., the board of directors. If authority were corporate law's sole value, shareholders thus would have no voice in corporate decisionmaking. Authority is not corporate law's only value, however, because we need some mechanism for enforcing those rights for which shareholders and other constituencies have contracted. Recall that director primacy views the corporation as a vehicle by which directors bargain with factors of production. All corporate constituencies thus end up with certain bargained-for contractual rights, including the shareholders.[83] Chief among the shareholders' contractual rights is one requiring the directors to use shareholder wealth maximization as their principal decisionmaking norm.[84] Like many intra-corporate contracts, however, the shareholder wealth maximization norm does not lend itself to judicial enforcement except in especially provocative situations.[85] Instead, it is enforced indirectly through a complex and varied set of extrajudicial accountability mechanisms.

From this perspective, shareholder voting rights are not part of the firm's decisionmaking system, but simply one of many accountability tools.[86] Bebchuk's preference for "undistorted shareholder choice" thus could be justified under the director primacy model only if such choice were a desirable way of ensuring director accountability for shareholder wealth maximization.[87] But it is not.

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[83] I take up the question of whether shareholders would contract for a regime of undistorted shareholder choice *infra* Part II.E.

[84] *See* BAINBRIDGE, *supra* note 8, at 419-29 (explaining why shareholder wealth maximization would emerge from hypothetical bargaining between directors and shareholders even in the director primacy model).

[85] *See id.* at 422 (noting that "the business judgment rule (appropriately) insulates director from liability" in this context).

[86] As such, one cannot extrapolate ultimate shareholder control from the mere existence of shareholder voting rights. Accordingly, Bebchuk, Coates, and Subramanian's data on shareholder voting patters cannot *a priori* establish the normative legitimacy of undistorted shareholder choice.

[87] Bebchuk elsewhere argues that shareholder choice is necessary so as to preserve the hostile takeover as a constraint on agency costs. Bebchuk, *supra* note 13, at 993-94. The argument that there are "systemic agency cost effects of management resistance" is a staple of the shareholder primacy-oriented academic literature. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 39, at 171-74 (invoking systemic agency costs effects to justify their management passivity rule). I have rejected the systemic accountability argument elsewhere. BAINBRIDGE, *supra* note 8, at 715-18.

Since Berle and Means opined, more than 6 decades ago, that the "separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge,"[88] corporate law academics of the law and economics stripe have been preoccupied with what they now call agency costs.[89] A narrow focus on agency costs, however, easily can distort one's understanding. Corporate directors operate within a pervasive web of accountability mechanisms that substitute for monitoring by residual claimants. A variety of market forces provides important constraints. The capital and product markets, the internal and external employment markets, and the market for corporate control all constrain shirking by firm agents.

An even more important consideration, however, is that agency costs are the inevitable consequence of vesting discretion in someone other than the residual claimant. We could substantially reduce, if not eliminate, agency costs by eliminating discretion; that we do not do so suggests that discretion has substantial virtues. A complete theory of the firm thus requires one to balance the virtues of discretion against the need to require that discretion be used responsibly.[90] We cannot ignore either discretion or accountability, because both promote values essential to the survival of business organizations. Unfortunately, however, they also are antithetical—at some point, one cannot have more of one without also having less of the other. This is so because the power to hold to account is ultimately the power to decide. As Kenneth Arrow explained:

> [Accountability mechanisms] must be capable of correcting errors but should not be such as to destroy the genuine values of authority. Clearly, a sufficiently strict and continuous organ of [accountability] can easily amount to a denial of authority. If every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem.[91]

In other words, we cannot hold directors accountable without undermining their discretionary authority. Establishing the proper mix of discretion and accountability thus emerges as the central corporate governance question. Having said that, however, in light of the significant virtues of discretion, one should not lightly interfere with the board's decisionmaking authority in the name of accountability. Preservation of director discretion should always be the null hypothesis.[92]

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[88] BERLE & MEANS, *supra* note 52, at 7.

[89] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. ECON. 305 (1976) (setting out agency cost economics).

[90] *Cf.* Dooley, *supra* note 1, at 471 (arguing that the business judgment rule reflects a tension between "conflicting values" he refers to as "authority" and "responsibility").

[91] ARROW, *supra* note 46, at 78.

[92] Hence, my response to Bebchuk, Coates, and Subramanian's argument that shareholders are injured by the tandem of a staggered board and poison pill can be stated simply as: so what? Professor Dooley observed:

My central argument against shareholder choice now should be apparent. Investor involvement in corporate decisionmaking threatens to disrupt the very mechanism that makes the public corporation practicable; namely, the centralization of essentially nonreviewable decisionmaking authority in the board of directors. The chief economic virtue of the public corporation is not that it permits the aggregation of large capital pools, as some have suggested,[93] but rather that it provides a hierarchical decisionmaking structure well-suited to the problem of operating a large business enterprise with numerous employees, managers, shareholders, creditors, and other inputs. In such a firm, someone must be in charge: "Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success."[94] While some argue that shareholder activism "differs, at least in form, from completely *shifting* authority from managers to" institutions,[95] it is in fact a difference in form only. Shareholder activism necessarily contemplates that shareholders will review management decisions, step in when management performance falters, and exercise voting control to effect a change in policy or personnel. As Arrow's analysis suggests, giving investors this power of review differs little from giving them the power to make management decisions in the first place.

Bebchuk, Coates, and Subramanian doubtless would argue that they propose only a very limited form of shareholder involvement. In fact, however, within its limited sphere of operation, their proposal squarely rejects the value of authority. Consider that, their proposal aside, nobody expects a board to be passive in the face of a proxy contest.[96] To the contrary, the incumbent board's role is very active indeed. Why? Because the incumbent board members remain in office, and therefore remain legally obligated to conduct the business, unless and until replaced.[97] Passivity in the face of a proxy contest—even under the limited circumstances in which Bebchuk, Coates, and Subramanian's recommended rule operates—would be inconsistent with the directors' on-going obligations to the corporation and its shareholders.

> Preservation of the board's authority will necessarily sacrifice some degree of [accountability]. Ill-advised, as well as value-enhancing, takeover defenses will be permitted. Instances of managerial misbehavior of both the careless and corrupt variety will go undetected and unpunished. It cannot be otherwise.

Dooley, *supra* note 1, at 524-25. Why can it not be otherwise? Because, as Arrow observed, the power to review is the power to decide. See supra text accompanying note 91. At some point, authority and accountability cannot be reconciled. One cannot have more of one without having less of the other. Once we transfer the power to review board decisions to shareholders, we thus have planted the seeds of the destruction of the system of centralized decisionmaking on which efficient corporate governance rests. *See infra* notes 93-95 and accompanying text.

[93] *See* ROE, *supra* note 70, at 3-4 (summarizing this argument).

[94] ARROW, *supra* note 46, at 69.

[95] ROE, *supra* note 70, at 184 (emphasis in original).

[96] Dooley, *supra* note 1, at 516.

[97] *Id.*

On close examination, moreover, Bebchuk, Coates, and Subramanian's proposal may have wider implications. Bebchuk elsewhere argues "undistorted shareholder choice" in the takeover arena "strengthens and reinforces" the legitimacy of the board's exercise of discretionary authority in other spheres of decisionmaking.[98] In my view, however, shareholder choice more likely would weaken and undermine the board's authority in a variety of areas. Consider, for example, the board's authority to negotiate mergers. If the bidder can easily by pass the board by making a tender offer, hard bargaining by the target board becomes counter-productive. It will simply lead to the bidder making a low-ball tender offer to the shareholders, which they probably will accept due to the collective action problems that preclude meaningful shareholder resistance.[99] Restricting the board's authority to resist tender offers thus indirectly restricts its authority with respect to negotiated acquisitions.[100]

To take another example, a potential target can make itself less vulnerable to takeover by eliminating marginal operations or increasing the dividend paid to shareholders and thus enhancing the value of the outstanding shares.[101] A corporate restructuring thus often is a preemptive response to the threat of takeovers.[102] Bebchuk, Coates, and Subramanian's proposal presumably would prohibit such restructurings after the board has lost one election. But while such transactions may aid incumbents in securing their positions, it is hard to imagine valid objections to incumbents doing so through transactions that benefit shareholders.[103] Why then should it matter if the restructuring occurs after the board has lost an election? The shareholder choice argument not only says that it does matter, but taken to its logical extreme would require shareholder approval of all corporate restructurings.

A related but slightly different concern is the multiplicative effect that shareholder choice may have on the firm as a whole. Because "the efficiency of organization is affected by the degree to which individuals assent to orders, denying the authority of an organization communication is a threat to the interests of all individuals who derive a net

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[98] Bebchuk, *supra* note 13, at 996. Bebchuk's argument, however, depends on the claim that "the possibility of a takeover provides a safety valve and source of discipline." *Id*. Instead of providing an independent argument against a board veto, this part of Bebchuk's analysis thus merely collapses into his systemic accountability argument.

[99] In fairness, of course, Bebchuk's "undistorted shareholder choice" model is predicated on developing mechanisms for overcoming such collective action problems. Bebchuk, *supra* note 13, at 981.

[100] Many acquisitions are initiated by target managers seeking out potential acquirers. Rules restricting the board's ability to veto low-ball offers will discourage these takeovers, thus harming shareholders. No sensible seller would seek out potential buyers unless it is able to resist low ball offers. Unless the directors can plausibly threaten to preclude the bid from going forward, however, their defensive tactics have no teeth and thus provide no leverage.

[101] Dooley, *supra* note 1, at 516-17.

[102] MICHAEL USEEM, EXECUTIVE DEFENSE: SHAREHOLDER POWER & CORPORATE REORGANIZATION 26-27 (1993).

[103] Dooley, *supra* note 1, at 517 (1992); *cf*. Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 276 (Del.Ch.1989) (upholding an employee stock ownership plan despite its antitakeover effects, because the plan was "likely to add value to the company and all its stockholders").

advantage from their connection with the organization . . . ."[104] Put another way, by calling into question the legitimacy of the central decisionmaking body's authority in this critical decisionmaking arena, "undistorted shareholder choice" may reduce the incentive for subordinates to assent to that body's decisions in other contexts, as well, and thereby undermine the efficient functioning of the entire firm.

D. Alternative Constraints on Director Accountability

Bebchuk, Coates, and Subramanian contend that undistorted shareholder choice is necessary because, *inter alia*, the presence of independent directors on the board does not effectively constrain conflicts of interest in the takeover setting.[105] Granted, the evidence on the corporate governance utility of director independence is, at best, mixed.[106] Accordingly, it is appropriate to be skeptical of regulatory proposals intended to mandate that all corporations have a majority of independent directors.[107] At the same time, however, in the context of conflicted interest transactions, independent directors have an important role to play.

A common failing of the academic literature on takeovers is the tendency to conflate the roles of corporate officers and directors. The legal literature speaks of "management resistance" and "management defensive tactics," rarely recognizing any separate institutional role for the board.[108] Most commentators simply assume that independent directors are in thrall to senior managers and will ignore shareholder interests if necessary to preserve their patrons' jobs.[109]

In contrast, the Delaware courts take the board's distinct role quite seriously, especially with respect to its independent members. As a doctrinal matter, the board carries its burden of proof more easily if independent directors make the key decisions.[110] As a practical matter, the court's assessment of the outside directors' role often is outcome-determinative.[111]

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[104] Chester I. Barnard, The Functions of the Executive 169 (2d ed. 1962).

[105] *See* Bebchuk et al., *supra* note 8, at 909 (rejecting both independent directors and stock options).

[106] BAINBRIDGE, *supra* note 8, at 223-30.

[107] *See* Stephen M. Bainbridge, *A Critique of the NYSE's Director Independence Listing Standards*, *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=317121 (criticizing one-size-fits all NYSE listing standards on director independence).

[108] *See, e.g.*, Bebchuk et al., *supra* note 8, at 890 (opining that "managers of targets with staggered boards can—and most of the time do—maintain the target's independence").

[109] *E.g.*, Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 255, 256 (7th Cir. 1986), *rev'd on other grounds*, 481 U.S. 69 (1987); Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 266 n.12 (2d Cir. 1981); Panter v. Marshall Field & Co., 646 F.2d 271, 300 (7th Cir.) (Cudahy, J., dissenting), *cert. denied*, 454 U.S. 1092 (1981).

[110] Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[111] Dooley, *supra* note 1, at 518-19; *see also* William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055, 2060 (1990).

Why have the Delaware courts insisted on drawing such sharp distinctions between the board's role and that of management? Because while the conflict of interest unsolicited tender offers pose for the target company's managers is inescapable, the independent director's conflict of interest is merely a potential problem. For the independent directors, the conflicts posed by unsolicited tender offers are no different from those posed by freeze-out mergers, management buyouts, interested director transactions, or a host of similar situations. Corporate law does not prohibit these transactions simply because they potentially involve conflicts of interest. Instead, it regulates them in ways designed to constrain self-interested behavior. It is not self-evident that hostile takeovers deserve different treatment.

Consider, for example, the analogous case of management-sponsored leveraged buyouts. Like unsolicited tender offers, these transactions inherently involve a strong risk of management self-dealing. While management is acting as the sellers' agents and, in that capacity, is obliged to get the best price it can for the shareholders, it is also acting as a purchaser and, in that capacity, has a strong self-interest to pay the lowest possible price. Like unsolicited tender offers, management buyouts also create conflicts of interest for the independent directors. Just as an independent director may resist an unsolicited tender offer to avoid being fired by the hostile bidder, he may go along with a management buyout in order to avoid being fired by the incumbent managers. Alternatively, if an independent director is inclined to resist a hostile takeover because of his friendship with the insiders, why should he not go along with a management-sponsored buyout for the same reason? Strikingly, however, the empirical evidence indicates that shareholder premiums are essentially identical in management-sponsored leveraged buyouts and arms-length leveraged buyouts.[112] This evidence suggests that the potentially conflicted interests of independent directors are not affecting their ability to constrain successfully management misconduct. Accordingly, while judicial review of management buyouts tends to be rather intensive, courts have not prohibited such transactions, but have addressed the problem of conflicted interests by encouraging an active role for the firm's independent directors in approving a management buyout proposal.[113] Why should the same not be true of the board's response to unsolicited tender offers?

In sum, the conflict of interest present when the board responds to an unsolicited tender offers differs only in degree, not kind, from any other corporate conflict.[114] Although skepticism about their motives is thus appropriate, their conflict of interest does not necessarily equate to blameworthiness.[115] Rather, it is simply a state of affairs

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[112] Jeffrey Davis & Kenneth Lehn, *Information Asymmetries, Rule 13e-3, and Premiums in Going-Private Transactions*, 70 WASH. U.L.Q. 587, 595-96 (1992).

[113] *See, e.g.*, In re RJR Nabisco, Inc. Shareholders Litigation, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194 (Del. Ch. 1989); Freedman v. Restaurant Assoc. Indus., Inc., [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502 (Del. Ch. 1987).

[114] Dooley, *supra* note 1, at 517.

[115] *Cf.* Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments Pertaining to Directors' Conflicting Interest Transactions*, 44 BUS. LAW. 1307, 1309 (1989)

inherently created by the necessity of conferring authority in the board of directors to act on behalf of the shareholders. To be sure, that state of affairs could be avoided by declining to confer such authority on the board in this context. Yet, if the legal system deprives the board of authority here, it will be hard-pressed to decline to do so with respect to other conflict transactions. As has been the case with other situations of potential conflict, we therefore would expect the courts to develop standards of review for takeover defenses designed to detect, punish, and deter self-interested behavior. Because the risk may be greater in this context, stricter than normal policing mechanisms may be required, but this does not mean that we must set aside authority values by divesting the board of decisionmaking authority.

E. Would Shareholders Contract for Undistorted Shareholder Choice?

The director primacy model is contractarian in nature. As noted, it conceives of the corporation as a vehicle by which directors contract for factors of production. Consequently, a shareholder's ability to dispose of his stock—whether on the open market or in response to a tender offer—is not defined by notions of private property, but rather by the terms of the corporate contract, which in turn are provided by the firm's organic documents and the state of incorporation's corporate statute and common law.[116] The terms of the corporate contract, as presently written, require directors to maximize shareholder wealth.[117] That obligation, however, is neither unbounded nor does it ensure shareholders any right of undistorted choice. As Delaware's Vice Chancellor Walsh observed, "shareholders do not possess a contractual right to receive takeover bids. The shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics."[118]

(stating that: "Contrary to much popular usage, having a 'conflict of interest' is not something one is 'guilty of'; it is simply a state of affairs.").

[116] *See supra* note 52 (explaining that ownership is not a meaningful concept in contractarian models).

[117] *See* Bainbridge, *supra* note 16, at __ (reconciling director primacy and the shareholder wealth maximization norm).

[118] Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del.Ch.), *aff'd*, 500 A.2d 1346 (Del.1985) (affirmed post-*Unocal*). *Accord* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 272 (Del.Ch.1989) (observing that "stockholders have no contractual right to receive tender offers or other takeover proposals"). I am using the term "corporate contract" here in the economic sense rather than the legal sense of the term. On the distinction between the legal and economic concepts of contract, see BAINBRIDGE, *supra* note 8, at 27-28. The "corporate contract" thus consists not of a single written document, but rather a host of explicit and implicit understandings embodied in statute, judicial decisions, and the corporation's organic documents. *Cf. id.* at 29-31 (discussing the role and selection of default rules in corporate law). Those understandings certainly include a right of alienation, as reflected in the statutory restrictions on contractual prohibitions of alienation. *See, e.g.*, DEL. CODE. ANN. tit. 8, § 202 (2001). Those understandings, however, do not include the right to sell into a tender offer. In all change of control transactions, except tender offers and stock purchases, the board of directors has always acted as a gatekeeper. *See supra* notes 2-3 and accompanying text. When *Unocal* was decided, the use of an unsolicited tender offer as a mechanism for bypassing the board's gatekeeping function was still

Contractarian proponents of shareholder choice will respond that the law has chosen the wrong set of default rules. Put another way, they will argue that shareholders would bargain for a regime of undistorted shareholder choice. In my view, however, such an argument fails on two counts. First, as developed in the preceding sections, there are good reasons for shareholders to prefer—and thus contract for—director primacy even in the take over setting. Second, Bebchuk, Coates, and Subramanian's own data suggests that shareholders, when given the opportunity to do so, in fact do not contract for undistorted shareholder choice. Most public corporations have staggered boards.[119] Corporations having a staggered board make most IPOs.[120] Despite precatory shareholder requests that boards be "de-staggered," incumbent directors and managers are declining to do so.[121] Easterbrook and Fischel observe:

> Although agency costs are high, many managerial teams are scrupulously dedicated to investors' interests. . . . By increasing the value of the firm, they would do themselves a favor (most managers' compensation is linked t the stock market, and they own stock too). Nonexistence of securities said to be beneficial to investors is telling.[122]

I find the trends identified by Bebchuk, Coates, and Subramanian with respect to the staggered board/poison pill tandem to be equally telling.[123]

III. What Should Delaware Do?

Bebchuk, Coates, and Subramanian acknowledge that their proposal represents a departure from the purported trend in Delaware law towards "solidifying and expanding

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relatively new. *See* BAINBRIDGE, *supra* note 8, at 652 (noting that the tender offer emerged as an important takeover device in the 1960s). Almost from the outset of the tender offer's rise to prominence, moreover, efforts were made to restore the board's gatekeeping function through the use of takeover defenses and state takeover legislation. *See supra* text accompanying note 5. In light of this history, it is difficult to believe that shareholders' bargained-for rights have ever included the right to sell their shares into a tender offer without interference by the board of directors.

[119] *See supra* note 79 and accompanying text.

[120] *See supra* note 80 and accompanying text.

[121] *See supra* note 78 and accompanying text.

[122] EASTERBROOK & FISCHEL, *supra* note 39, at 205.

[123] Bebchuk, Coates, and Subramanian argue that shareholders could not have consented to the adoption of effective staggered boards, because when most such classification schemes were adopted shareholders were unaware of their effectiveness. Bebchuk et al., *supra* note 8, at 941. Yet, if shareholders are that myopic, why do we want to give them the final say? In any case, Bebchuk, Coates, and Subramanian's own data confirm that most recent IPOs are made by corporations having a staggered board when they go public. *See supra* text accompanying note 80. They glide over that problem by claiming that shareholder approval "was not necessary" in the IPO context. Bebchuk et al., *supra* note 8, at 941. This is technically true in the sense that there was no vote of public shareholders, but it ignores the fact that investors were willing to buy stock in the IPO despite the presence of a staggered board. In doing so, the shareholders effectively manifested their consent to the classification scheme through the working of the pricing mechanism. *Cf.* EASTERBROOK & FISCHEL, *supra* note 39, at 18 (stating that: "The mechanism by which stocks are valued ensures that the price reflects the terms of governance and operation . . . .").

the 'Just Say No' defense."[124] They contend, however, that their proposal is consistent with the general thrust of *Unocal* and its progeny.[125] This is true, however, only if one accepts their premise that *Unocal* and its progeny require the preservation of a viable mechanism by which shareholders can elect incumbent directors out of office. Certainly, some Delaware jurists opine, "the shareholders' right to elect the corporation's governing body is a fundamental, cardinal foundation of Delaware corporation law."[126] Despite the rhetorical allegiance of Delaware case law to the free exercise of the shareholder franchise, however, Delaware law in fact treats constraints on shareholder choice as a means to an end rather than as an end in and of itself.[127]

I freely concede that Delaware has not explicitly embraced director primacy.[128] Yet, Delaware law reflects many of the concerns that the director primacy model predicts should loom large in any analysis of director decisionmaking. In the first instance, Bebchuk, Coates, and Subramanian fail to acknowledge that their proposal marks a departure from the Delaware courts' long-standing practice of preferring standards to rules. This preference was established at the very outset of Delaware's modern takeover jurisprudence, when the *Unocal* court rejected Frank Easterbrook and Dan Fischel's proposed prophylactic prohibition of any target board resistance to unsolicited bids.[129] In the years since, despite repeated criticism from academics,[130] the Delaware supreme court has consistently reaffirmed the *Unocal* analysis.[131] With one lamentable exception, Delaware courts thus have remained faithful to their preference for the *Unocal* standard of review over the many prophylactic rules advocated by academics.[132]

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[124] Bebchuk et al., *supra* note 8, at 951.

[125] *Id*. at 946-48.

[126] Allen et al., *supra* note 33, at 1311.

[127] *See generally* BAINBRIDGE, *supra* note 8, at 718-38 (reviewing Delaware takeover case law). Delaware chancellors Allen, Jacobs, and Strine recently observed that Delaware courts have beat a steady retreat from the exacting *Blasius* standard of review applicable when target board action disenfranchises shareholders, by folding it "into *Unocal*, effectively making the former a subset of the latter." Allen et al., *supra* note 33, at 1316.

[128] *See* Allen et al., *supra* note 41, at 1078 (arguing that Delaware law has elements of both director and shareholder primacy).

[129] *Compare* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 n.10 (Del. 1985) (observing that Easterbrook and Fischel's argument for passivity "clearly is not the law of Delaware") *with* 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) (arguing for a prophylactic rule requiring target directors and managers to be passive in the face of an unsolicited bid).

[130] *See, e.g.*, Gilson, *supra* note 8, at 512 (stating that he is "quite negative in my assessment of the fifteen-year *Unocal* experiment"); Johnson & Siegel, *supra* note 2, at 330 (arguing that *Unocal* is a "toothless standard" that is "fairly inconsequential"); Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 Tex. L. Rev. 261, 284 (2001) (arguing that *Unocal* is "incapable of policing management entrenchment").

[131] *See, e.g.*, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1154 n.18 (Del. 1989) (rejecting purported views of Professors Johnson and Siegel).

[132] The notable exception is the Delaware supreme court's decision in Quickturn Design Sys., Inc. v. Mentor Graphics Corp., 721 A.2d 1281 (Del. 1998), in which the court invalidated a so-called no hand

One is therefore skeptical, merits aside, that the Delaware courts are likely to accept Bebchuk, Coates, and Subramanian's recommendation.

Delaware's preference for standards over rules is consistent, moreover, with the basic thrust of director primacy—i.e., that the null hypothesis should always and everywhere be insulation of director discretionary authority from review by courts and/or shareholders. In particular, despite *Unocal*'s famous observation that target board resistance to an unsolicited takeover bid is tainted by an "omnipresent specter that a board may be acting primarily in its own interests,"[133] the Delaware courts have consistently demonstrated a sensitivity to the risk that aggressive application of *Unocal* and its progeny could undermine the authority of the board of directors.[134] Chancellor Allen, for example, observed that unless *Unocal* was carefully applied "courts—in exercising some element of substantive judgment—will too readily seek to assert the primacy of their own view on a question upon which reasonable, completely disinterested minds might differ."[135] Chief Justice Veasey's *QVC* opinion likewise emphasized that a court should not second-guess a board decision that falls within the range of reasonableness, "even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination."[136] Other examples could be cited.[137] Just as the director primacy model predicts, Delaware takeover jurisprudence has three key features: (1) an awareness that target board resistance to unsolicited takeover bids presents a conflict of interest raising significant accountability concerns; (2) an awareness that the power to review is the power to decide, such that aggressive judicial review could undermine the board of directors' decisionmaking authority; and (3) an effort to balance the competing demands of authority and accountability.[138]

Delaware has struck its balance between authority and accountability via a reasonableness standard, applied on a case-by-case basis,[139] in which the board's motive

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poison pill on grounds that the board lacked statutory authority to adopt such a pill. *Id.* at 1283. For a critique of *Quickturn*, which argues that the Delaware supreme court should have stuck to using standards of review rather than prophylactic rules, see Stephen M. Bainbridge, *Dead Hand and No Hand Pills: Precommitment Strategies in Corporate Law* (forthcoming).

[133] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del.1985).

[134] This is not to deny, of course, that the standard of review must be a more exacting one than mere business judgment rule-based review. *See* BAINBRIDGE, *supra* note 8, at 697 (opining that Delaware's former primary purpose test for reviewing takeover defenses "added little to the highly deferential treatment of board decisions mandated by the traditional business judgment rule and therefore proved an ineffective response to the conflict of interest present when target boards and management respond to a takeover bid").

[135] City Capital Assoc. Ltd. Partnership v. Interco Inc., 551 A.2d 787, 796 (Del.Ch.1988).

[136] Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del.1994).

[137] *See* BAINBRIDGE, *supra* note 8, at 718-19 (quoting former Delaware supreme court Justice Moore and former Chancellor Allen, among others).

[138] *See id.* at 736-37 (discussing the Delaware standard).

[139] *See, e.g.*, Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del.1994) (holding that: "The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on

is what weighs most heavily.[140] As former Delaware Chancellor Allen explained in the closely related context of management buyout transactions: "The court's own implicit evaluation of the integrity of the . . . [board's decisionmaking] process marks that process as deserving respect or condemns it to be ignored."[141] Assuming that the board would appoint a special committee of independent directors to consider the proposed transaction, Allen went on to explain:

> When a special [board of directors] committee's process is perceived as reflecting a good faith, informed attempt to approximate aggressive, arms length bargaining, it will be accorded substantial importance by the court. When, on the other hand, it appears as artifice, ruse or charade, or when the board unduly limits the committee or when the committee fails to correctly perceive its mission—then one can expect that its decision will be accorded no respect.[142]

Delaware's reasonableness test is well suited to preventing the board from acting on improper motives. Notice that the reasonableness test parallels the definition of fairness used in the former Revised Model Business Corporation Act provisions governing interested director transactions, namely, whether the transaction in question falls "within the range that might have been entered into at arms length by disinterested persons."[143] Both standards seem designed to ferret out board actions motivated by conflicted interests by contrasting the decision at hand to some objective standard. The implicit assumption is that a reasonable decision is not tainted by conflicted interest or, at least, that improper motives are irrelevant so long as the resulting decision falls within a range of reasonable outcomes. The standard of review is more intrusive than most, reflecting the unusually pronounced accountability concerns present in this context, but preserves the board's authority by making clear that, so long as the board's conduct falls within the bounds of reasonableness, Delaware courts will not second guess the board's decisions.[144] In contrast, Bebchuk, Coates, and Subramanian's prophylactic rule leaves no room for a motive-based analysis.

From the director primacy perspective, Delaware's case-by-case standard of review is preferable to the sort of prophylactic rule proposed by Bebchuk, Coates, and Subramanian. To be sure, any exercise of the power to review infringes on the board's power to decide. Where a serious conflict of interest raises substantial accountability concerns, some such infringement is necessary. In order to strike the appropriate balance between authority and accountability, however, Arrow explains that:

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which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing."),

[140] *See* BAINBRIDGE, *supra* note 8, at 721-25 (discussing the emphasis on analysis of the target board's motives in the Delaware case law); *see also* Dooley, *supra* note 1, at 517-24 (same).

[141] Allen, *supra* note 111, at 2060.

[142] *Id*.

[143] MODEL BUS. CORP. ACT ANN. § 8.31 cmt. 4 (1984).

[144] *See, e.g.*, Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1388 (Del.1995) (holding that so long as "the board of directors' defensive response is not draconian (preclusive or coercive) and is within a 'range of reasonableness,' a court must not substitute its judgment for the board's").

> To maintain the value of authority, it would appear that [accountability] must be intermittent. This could be periodic; it could take the form of what is termed "management by exception," in which authority and its decisions are reviewed only when performance is sufficiently degraded from expectations. . . .[145]

Intermittent accountability accomplished through "management by exception" is precisely what the Delaware standard has achieved. In contrast, like most other academic proposals, Bebchuk, Coates, and Subramanian's recommended rule creates an entirely new and radically different system of corporate governance, stripping the board of some or all of its normal decisionmaking authority by a flat prohibition of continued resistance after one election is lost.

IV. Conclusion

Bebchuk, Coates, and Subramanian's article confirms the increasingly widely accepted proposition that the tandem of a staggered board and a poison pill makes for a very potent takeover defense. In view of the very substantial accountability concerns raised by such a potent weapon and the serious conflict of interest inherent in its use, I concur with their claim that some "safety valve" mechanism is necessary to police the use of such a tandem. Yet, one can concede the need for a "safety valve," without having to concede Bebchuk, Coates, and Subramanian's claim that the shareholder "ballot box" is the appropriate safety valve. Hence, I have argued here that courts should continue to apply Delaware's current *Unocal*-based standard of review rather than adopting Bebchuk, Coates, and Subramanian's proposed prophylactic rule.

My preference for current Delaware law rests on more than just a preference for standards vis-à-vis rules. Bebchuk, Coates, and Subramanian's policy recommendation rests (albeit, in this paper, most implicitly) on their normative preference for an "undistorted choice by shareholders."[146] In turn, the norm of shareholder choice necessarily rests on the shareholder primacy model of corporate governance. In contrast, I have argued here that shareholder primacy is both normatively and positively inferior to the director primacy model. Shareholder primacy is not the law, nor should it be the law. Director primacy is the law, just as it ought to be. For these reasons, undistorted shareholder choice should not be the null hypothesis—preservation of the board's discretionary authority should be.

We stared with a very basic question: Who decides? My answer is: The board decides.[147] Delaware's post-*Unocal* standard of review is consistent with that basic

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[145] ARROW, *supra* note 46, at 78.

[146] *See* Bebchuk, *supra* note 13, at 976 (arguing that "once a mechanism that ensures an undistorted choice by shareholders is in place, the board should not be able to veto an acquisition beyond the period necessary for preparing alternatives for shareholder consideration").

[147] To modify the terminology of Bebchuk's recent article, I would self-categorize as a proponent of "board veto" subject to a judicial reasonableness-based inquiry. *See* Bebchuk, *supra* note 13, at 988 (describing what he "label[s] the 'board veto' view). I concede that there may not be much difference, in practice, in the results obtained under the two standards. It is hard to imagine situations in which it would be reasonable for a board to continuing resisting an unsolicited offer after the hostile bidder has won an initial proxy contest. So long as there might be some such situations, however, a case by case analysis

proposition. Bebchuk, Coates, and Subramanian's proposed prophylactic prohibition is not.

will be preferable to a flat prohibition (setting aside administrative costs). In any case, and more importantly, ideas have consequences. The reasonableness standard, by its very nature, acknowledges the legitimacy of board authority in a way that the prophylactic rules does not.