

# ESSAY

## TOWARD A CONSTITUTIONAL REVIEW OF THE POISON PILL

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*We argue that the state-law rules governing poison pills are vulnerable to challenges based on preemption by the Williams Act. Such challenges, we show, could well have a major impact on the corporate-law landscape.*

*The Williams Act established a federal regime regulating unsolicited tender offers, but states subsequently developed a body of state antitakeover laws that impose additional impediments to such offers. In a series of well-known cases during the 1970s and 1980s, the federal courts, including the Supreme Court, held some of these state antitakeover laws preempted by the Williams Act. To date, however, federal courts and commentators have paid little attention to the possibility that the state-law rules authorizing the use of poison pills—the most powerful impediment to outside buyers of shares—also preempted.*

*Our study examines this subject and concludes that there is a substantial basis for questioning the continued validity of current state-law rules authorizing the use of poison pills. The Essay shows that these rules now impose tighter restrictions on unsolicited offers than those once imposed by state antitakeover regulations that the federal courts invalidated on preemption grounds. Preemption challenges to these poison-pill rules could well result in their invalidation by the federal courts.*

*Finally, we discuss how state lawmakers could revise poison-pill rules to make them more likely to survive a federal preemption challenge. This could be done, we show, by imposing substantial limits on the length of time during which a poison pill can be used to block tender offers. Whether preemption challenges lead to invalidation of*

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*existing poison-pill state rules or to their substantial modification, such challenges could well reshape the market for corporate control.*

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#### INTRODUCTION

Nearly all standard corporate-law casebooks include an account of the significant line of cases in which the federal courts reviewed the constitutionality<sup>1</sup> of state antitakeover statutes. These textbooks, however, go on to

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1. As we explain below, as a formal matter these courts considered whether the Williams Act preempts state antitakeover statutes—and, thus, whether such statutes are rendered void by operation of the Supremacy Clause. See U.S. Const. art. VI, cl. 2 (“This Constitution and the Laws of the United States . . . shall be the Supreme Law of the Land . . .”); see also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 78–87 (1987) (applying Supremacy Clause to state-law rules governing hostile takeovers); *Edgar v. MITE Corp.*, 457 U.S. 624, 630–39 (1982) (White, J.)

express the accepted view among researchers and practitioners that these cases are no longer practically relevant to contemporary corporate law, because a private-law innovation—the poison pill—now dominates the antitakeover influence of state statutes.<sup>2</sup> In this Essay, we argue that this widely shared view is mistaken.<sup>3</sup>

We show that the cases in which the federal courts have evaluated the constitutionality of state antitakeover statutes raise serious questions about the validity of the state-law rules authorizing the use of the poison pill. The Essay presents a systematic analysis of the possibility that these rules are preempted by the Williams Act and provides a framework for assessing preemption challenges to those rules. Litigation over the validity of these rules, we show, could have profound implications for the governance of American corporations.

The literature on the constitutionality of state antitakeover laws is quite substantial. Indeed, more than one hundred law review articles have considered whether and how the Williams Act might preempt various state statutes that govern corporate takeovers.<sup>4</sup> Just four years ago, the *Business Lawyer* dedicated a symposium issue to analysis of whether the Williams Act preempts Delaware's business-combination statute.<sup>5</sup> Yet this large literature has paid limited attention to the question whether the state-law rules with the most powerful antitakeover effect—the rules authorizing use of the poison pill—are preempted.

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(same). For ease of exposition, in this Essay we occasionally refer to the invalidation of state law by operation of the Supremacy Clause as rendering such laws “unconstitutional.”

2. See, e.g., William T. Allen, Reinier Kraakman & Guhan Subramanian, Commentaries and Cases on the Law of Business Organization 588–97 (3d ed. 2009) (noting, in the course of describing the emergence of state antitakeover statutes and cases addressing their constitutional validity, that “poison pills were [instead] the decisive legal development of the hostile takeover era”); Melvin Aron Eisenberg & James D. Cox, *Corporations and Other Business Organizations: Cases and Materials* 1343 (10th ed. 2011) (emphasizing, during discussion of these cases, emergence of the poison pill).

3. This Essay continues our recent work considering the interplay of federal constitutional law and state corporate-law rules. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 *Harv. L. Rev.* 83, 83–85 (2010) [hereinafter *Bebchuk & Jackson, Corporate Political Speech*] (arguing that recent developments in federal constitutional law highlight the need for changes in state-law rules governing corporations' political speech decisions); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 *Geo. L.J.* 923, 949–53 (2013) [hereinafter *Bebchuk & Jackson, Shining Light*] (arguing that the Securities and Exchange Commission should adopt rules requiring disclosure of corporate spending on politics).

4. For examples from this literature, see *infra* note 57 and accompanying text (discussing Westlaw search yielding 191 such articles published since 1982).

5. See Guhan Subramanian, Steven Herscovici & Brian Barbetta, *Is Delaware's Antitakeover Statute Unconstitutional? Evidence from 1988–2008*, 65 *Bus. Law.* 685, 686–88 (2010) [hereinafter *Subramanian, Herscovici & Barbetta, Is Delaware's Antitakeover Statute Unconstitutional?*] (examining whether Delaware's antitakeover law is vulnerable to federal preemption because it denies bidders “meaningful opportunity for success”). The symposium included several responses to this important article. See *infra* note 46.

In this Essay, we systematically analyze this question and conclude that there is substantial doubt as to whether current state-law poison-pill rules are valid. As we explain, these rules provide incumbents with an even more powerful antitakeover defense—and impose an even lengthier delay on tender offerors—than the state statutes that the federal courts have held to be invalid. The validity of state-law poison-pill rules thus should not be taken for granted, and we provide a framework for analyzing preemption challenges to these rules.

Using this framework, we discuss three alternative approaches that the federal courts may follow when faced with preemption challenges to the validity of state-law rules governing poison pills. This analysis shows that the courts are likely to conclude that existing state-law poison-pill rules are preempted. This Essay also examines what changes in existing state-law rules might make them more likely to survive constitutional scrutiny. We show that state corporate law that substantially limits the length of time during which a poison pill can be used to delay tender offers would be significantly more likely to withstand a preemption challenge than current state-law rules in this area.

The remainder of the Essay proceeds as follows. Part I reviews the Williams Act and the emergence of state antitakeover laws after the Act's passage.<sup>6</sup> This Part also discusses the large body of cases in which the courts have considered whether the Act preempts state antitakeover statutes. The Essay explains that, despite this long line of cases, the federal courts have paid limited attention to the possibility that poison-pill rules are preempted by the Williams Act.

Part II discusses the legal landscape that the drafters of the Williams Act faced when they passed the Act in 1968. This landscape was fundamentally altered by the emergence of state-law poison-pill rules that allow incumbents to delay tender offers for lengthy periods of time. Indeed, we explain, those rules provide incumbents with an even more powerful antitakeover defense—and impose an even lengthier delay—than the state statute that the Supreme Court

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6. As one of us has shown in a series of articles, the evolution of state antitakeover law has been influenced by incumbents' interest in having more extensive protections from unsolicited tender offers than the Williams Act provided. Articles analyzing how states' antitakeover rules have been influenced by incumbents' preference for antitakeover protection include Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Takeover Law: The Race to Protect Managers from Takeovers*, 99 *Colum. L. Rev.* 1168, 1172–76 (1999); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 *Harv. L. Rev.* 1435, 1458–83 (1992); Lucian Arye Bebchuk & Allen Ferrell, *On Takeover Law and Regulatory Competition*, 57 *Bus. Law.* 1047, 1049–59 (2002). A formal model of this subject is developed in Oren Bar-Gill, Michal Barzuzza & Lucian Bebchuk, *The Market for Corporate Law*, 162 *J. Institutional & Theoretical Econ.* 134, 134–38 (2006). For empirical evidence that states providing strong antitakeover protections are more successful in attracting incorporations, see Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 *J.L. & Econ.* 383, 413–17 (2003). The empirical evidence on this subject is also reviewed and discussed in Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 *Calif. L. Rev.* 1775, 1806–20 (2002).

invalidated as preempted by the Williams Act. Thus, we argue, the constitutional validity of current state-law rules governing poison pills should not be taken for granted.

Some prior work on the validity of state antitakeover laws has noted that poison pills are private contractual arrangements, suggesting that pills are thereby distinguishable from the state antitakeover laws that have been held preempted by the Williams Act.<sup>7</sup> In Part II, we explain that this view overlooks the critical role that state-law rules play in enabling poison pills to delay tender offers for lengthy periods of time—a result in considerable tension with the Williams Act. Furthermore, some of the state antitakeover laws that were invalidated by the federal courts blocked only unsolicited offers that incumbent directors choose to oppose—just as current state-law poison-pill rules do. The federal courts considering preemption challenges to those state antitakeover laws have not suggested that the presence of a private choice by directors precludes a preemption challenge to the state laws making that private choice possible. To the contrary, we explain, these courts proceeded to consider whether the challenged state law was consistent with the Williams Act.<sup>8</sup>

Part III provides a comprehensive analysis of how courts can be expected to approach preemption challenges to state-law poison-pill rules. We examine in Part III the three approaches that federal courts have followed in the past in evaluating claims that the Williams Act preempts state antitakeover laws, and we analyze the expected consequences that would follow if each approach were applied to current state-law poison-pill rules. The first judicial approach we consider focuses on whether tender offerors are given a meaningful opportunity to succeed in obtaining control of the target and whether shareholders are given an opportunity to evaluate the merits of tender offers. We show that if this approach were applied to current state-law poison-pill rules, the courts would likely conclude that these rules are *per se* preempted.

Next, Part III considers judicial approaches from prior cases on Williams Act preemption that have focused on whether, in fact, the state law at issue enhances investor protection. We show that, if this approach is followed in an examination of the validity of current state-law poison-pill rules, courts will be required to hold evidentiary hearings to determine whether current state-law poison-pill rules do in fact enhance shareholder value. We explain that, given existing evidence that the agency-cost effects of managerial entrenchment might impose significant costs on investors, this approach might well also result in the invalidation of current state-law poison-pill rules.

Third, we consider an approach drawn from prior cases in which the federal courts have opined that the Williams Act preempts only state laws that

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7. See, e.g., Subramanian, Herscovici & Barbeta, *Is Delaware's Antitakeover Statute Unconstitutional?*, *supra* note 5, at 711 (noting that the poison pill is private-law innovation requiring affirmative action by the board of directors, and hence may be distinguishable from state antitakeover statutes that the federal courts have held unconstitutional). But see Larry E. Ribstein, *Preemption as Micromanagement*, 65 *Bus. Law.* 789, 792–96 (2010) (stating that attempts to distinguish the poison pill on this basis are, “at best, shaky”).

8. See *infra* text accompanying notes 83–94.

conflict directly with the procedures mandated by the Act. If a court facing a preemption challenge to the validity of state-law poison-pill rules were to follow this approach, it would likely hold that these rules are *per se* valid. While we discuss this possibility, we provide reasons to believe that this approach is unlikely to carry the day among federal courts, and most importantly the Supreme Court, if those courts are faced with preemption challenges to state-law poison-pill rules.<sup>9</sup>

Once state lawmakers recognize that current state-law poison-pill rules may be preempted, they may wish to take steps to avoid that result. Thus, in Part IV, we provide a framework for lawmakers considering changes to state law designed to avoid preemption. Because the federal courts have emphasized the length of the delay that state-law rules impose on unsolicited tender offers, this Essay explains, the risk of preemption may be considerably reduced by substantially limiting the period of time during which incumbents may use a poison pill to block tender offers they disfavor. While such revisions might ensure the survival of some state-law poison-pill rules, they would bring about a major change in the mergers-and-acquisitions landscape and the governance of public companies.

Before proceeding, we note that some might question our assertion that state-law poison-pill rules may well be preempted on the ground that litigation based on such a claim has not yet been aggressively pursued. But it is not uncommon for claims that were ultimately successful in the federal courts to be brought after a long period of time during which they were not raised—even when the stakes have been significant, and the potential litigants have had substantial resources. For example, for decades well-counseled corporations

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9. In response to the arguments advanced in this Essay, five senior partners of the law firm of Wachtell, Lipton, Rosen & Katz, including founding partner Martin Lipton, issued a twelve-page, single-spaced memorandum arguing that “there has never been any doubt, and never will be,” that state-law rules authorizing the poison pill are consistent with the Williams Act. Martin Lipton, A Response to Bebchuk and Jackson’s *Toward a Constitutional Review of the Poison Pill*, Harvard Law Sch. Forum on Corporate Governance & Fin. Regulation (Mar. 13, 2014, 4:30 PM), <http://blogs.law.harvard.edu/corpgov/2014/03/13/a-response-to-bebchuk-and-jacksons-toward-a-constitutional-review-of-the-poison-pill/> [hereinafter Wachtell Response] (on file with the *Columbia Law Review*). The Wachtell Response relies upon the cases noted above, which suggest that the Williams Act preempts only state-law rules that conflict directly with the procedures proscribed by the Act, and asserts that these cases reflect the “true state of the law.” *Id.* In a detailed reply to the Wachtell Response, we explain that this assertion is unwarranted. See Lucian Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill: A Reply to Wachtell Lipton*, Harvard Law Sch. Forum on Corporate Governance & Fin. Regulation (Mar. 17, 2014), <http://blogs.law.harvard.edu/corpgov/2014/03/17/toward-a-constitutional-review-of-the-poison-pill-a-reply-to-wachtell-lipton> [hereinafter Forum Reply] (on file with the *Columbia Law Review*).

As the Forum Reply explains, the Wachtell Response does not provide an accurate description of the state of the law in this area. The Wachtell Response gives little weight to, and occasionally fails even to acknowledge, the federal-court decisions noted above and described in further detail in this Essay, see *infra* Part III.A–B, that have concluded that the Williams Act’s preemptive scope is far broader than the Wachtell Response suggests. In the Forum Reply and in this Essay, we show that the approaches taken by these courts would likely lead judges to conclude that current state-law poison-pill rules are preempted.

defended claims under the Alien Tort Statute (ATS) based on events occurring outside the United States without arguing that the statute did not confer jurisdiction over such claims.<sup>10</sup> Yet the Supreme Court recently declared that the ATS does not provide jurisdiction over such claims—an argument that had not been raised by either the corporations or the courts during the many years in which cases in this area had been litigated.<sup>11</sup> Similarly, companies have been defending ATS suits for many years without arguing that the statute does not reach the conduct of private corporations.<sup>12</sup> Yet the Second Circuit, home to many such suits, recently held that corporations cannot be held liable under the statute at all.<sup>13</sup> Thus, the fact that a preemption challenge to state-law poison-pill rules has not yet been fully litigated should not lead one to presume that such a challenge would be unlikely to succeed. Indeed, as we explain below, there is a substantial basis for concluding that such a challenge would have a substantial likelihood of being accepted by the courts.<sup>14</sup>

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10. See, e.g., *Sinaltrainal v. Coca-Cola Co.*, 256 F. Supp. 2d 1345, 1353–54 (S.D. Fla. 2003) (describing claims against Coca-Cola based solely on events in Colombia and explaining that, although Coca-Cola succeeded in having the claims dismissed, the company did not argue that the statute did not confer jurisdiction over claims based on those events); *Iwanowa v. Ford Motor Co.*, 67 F. Supp. 2d 424, 432–34 (D.N.J. 1999) (same, with respect to claims against Ford based on events in Germany during World War II).

11. See *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659, 1668–69 (2013) (stating that ATS presumptively does not apply extraterritorially); see also Alan O. Sykes, *Corporate Liability for Extraterritorial Torts Under the Alien Tort Statute and Beyond: An Economic Analysis*, 100 *Geo. L.J.* 2161, 2178 (2012) (“Most ATS actions to date have involved conduct within foreign nations . . . [M]ost lower courts [and litigants] have simply assumed that such conduct is covered by the statute.”).

12. See, e.g., *Doe v. Unocal Corp.*, 963 F. Supp. 880, 883 (C.D. Cal. 1997) (allowing suit to proceed against corporation without expressly addressing whether corporations, as opposed to natural persons, could be held liable under ATS). See generally Julian G. Ku, *The Curious Case of Corporate Liability Under the Alien Tort Statute: A Flawed System of Judicial Lawmaking*, 51 *Va. J. Int’l L.* 353, 354–55 (2011) (“For over two decades, U.S. courts have held that private corporations . . . can be subject to lawsuits under the [ATS]. This approach . . . was so widely accepted that courts barely acknowledged the issue when deciding on cases involving corporate defendants.” (footnote omitted)).

13. See *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111, 149 (2d Cir. 2010) (“Corporate liability, however, is simply not ‘accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms’ recognized as providing a basis for suit under the law prescribed by the ATS—that is, customary international law.” (quoting *Sosa v. Alvarez-Machain*, 542 U.S. 692, 725 (2004))), *aff’d* on other grounds, 133 S. Ct. 1659. But see *Sarei v. Rio Tinto, PLC*, 671 F.3d 736, 748 (9th Cir. 2011) (holding that corporations can be held liable under ATS), *vacated*, 133 S. Ct. 1995 (2013) (mem.); *Flomo v. Firestone Natural Rubber Co.*, 643 F.3d 1013, 1021 (7th Cir. 2011) (same); *Doe v. Exxon Mobil Corp.*, 654 F.3d 11, 56 (D.C. Cir. 2011) (same); *Romero v. Drummond Co.*, 552 F.3d 1303, 1315 (11th Cir. 2008) (same).

14. In a recent article, Professor Guhan Subramanian quotes this paragraph of this Essay and expresses agreement with our argument that the validity of state-law poison-pill rules should not be inferred from the lack of challenges over a long period of time. See Guhan Subramanian, *Delaware’s Choice: A Brief Reply to Commentators*, 39 *Del. J. Corp. L.* 85, 89 (2014) (referring to our example as “powerful” and agreeing with our observation that “an unconstitutional [state law] can survive for decades without constitutional challenge”).

While the literature on the constitutionality of state antitakeover law is rather extensive, this work, like previous case law, has paid insufficient attention to whether the Williams Act also preempts state-law poison-pill rules. In this Essay, we provide a framework for future consideration of this issue. In our view, constitutional litigation over the subject may well have a transformative effect on the modern law of mergers and acquisitions and the corporate-governance landscape.

In particular, state-law poison-pill rules currently give incumbents a powerful means of blocking unsolicited offers to acquire the firm. As a result, the market for corporate control is significantly weaker than it would be if courts concluded that the Williams Act limits the scope of those rules. Of course, corporate-law commentators have widely varying views about whether a more robust market for corporate control would be beneficial for investors. Some have argued that lowering antitakeover barriers and strengthening the market for control would benefit investors by reducing agency costs and managerial slack, providing incumbents with powerful *ex ante* incentives to maximize the value of the firm.<sup>15</sup> Others worry that a stronger market for control might lead incumbent managers to pursue short-term profits at the expense of more productive long-term investments.<sup>16</sup> Notwithstanding the divergence of views concerning whether state-law poison-pill rules are beneficial or detrimental for investors, all should agree that constitutional litigation that invalidates those rules, or imposes substantial limits on the poison-pill rules that states may have, would have a profound effect on corporate law.

In particular, such litigation would have a meaningful effect on the operation of the market for corporate control and the incidence of mergers and acquisitions. It would, in turn, also influence how the prospect of an unsolicited offer affects the ongoing management decisions of incumbent directors and managers. In this Essay, we provide a framework for assessing constitutional

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15. For articles arguing that strong antitakeover impediments are undesirable, see, for example, Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 *U. Chi. L. Rev.* 973, 993 (2002) [hereinafter *Bebchuk, The Case Against Board Veto*], and 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, 1173–74 (1981); see also Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 *Stan. L. Rev.* 887, 950–51 (2002) [hereinafter *Bebchuk, Coates & Subramanian, Powerful Antitakeover Force*]. For empirical studies providing evidence that takeover defenses are associated with lower firm value, see, for example, Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 *Rev. Fin. Stud.* 783, 823 (2009), and Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 *Q.J. Econ.* 107, 107 (2003), which find that stronger shareholder rights are associated with higher firm value.

16. For articles taking this view, see Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 *Bus. Law.* 101, 104 (1979) [hereinafter *Lipton, Takeover Bids*], and Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 *U. Chi. L. Rev.* 187, 188 (1991). For an analysis of, and response to, the argument that market pressures are detrimental to long-term value creation, see Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 *Colum. L. Rev.* 1637 (2013).



challenges to current state-law poison-pill rules and explain why courts may well conclude that those rules are invalid.

### I. CONSTITUTIONAL REVIEW OF STATE ANTITAKEOVER LAW

In this Part, we introduce the law governing constitutional review of state antitakeover rules. We explain why the federal courts found it necessary to scrutinize whether the laws adopted by the states to regulate takeovers were preempted by the Williams Act and discuss the evolution of state antitakeover laws and judicial scrutiny of those laws. The Essay then highlights that the federal courts have thus far not conducted a systematic constitutional review of these state-law poison-pill rules—by far the most important antitakeover rules in contemporary corporate law.

As explained below, federal courts considering challenges to state antitakeover rules examine whether such rules are preempted by the Williams Act. Preemption challenges arise in many contexts, and indeed they may occur whenever a state adopts a law in an area where Congress has also enacted legislation. In general, federal law will preempt state law where the federal law at issue expressly preempts state law; where federal law occupies an entire field, leaving no room for further state lawmaking; or where state law stands as an obstacle to the achievement of the objectives or purposes of a federal law.<sup>17</sup> Federal courts face such challenges frequently; in particular, preemption challenges based on the possibility that state law stands as an obstacle to the achievement of the purposes and objectives of federal law are now common at the Supreme Court.<sup>18</sup> The courts' analysis whether the Williams Act preempts

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17. In general, “express” preemption applies where a federal statute includes a clause explicitly withdrawing particular powers from the states; “field” preemption applies where a federal law so completely occupies a particular field that the states may no longer regulate in that area; and “conflict” preemption applies where federal law preempts state law because the two “actually conflict[.]” *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990). According to the Supreme Court, “such a conflict exists if either (1) compliance with both the state and federal law is ‘a physical impossibility’ or (2) state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” Caleb Nelson, *Preemption*, 86 Va. L. Rev. 225, 228 (2000) (quoting *Boggs v. Boggs*, 520 U.S. 833, 844 (1997)).

Because the Williams Act does not include an express preemption clause and cannot be said to occupy its field, the federal courts' analysis of the relationship between the Williams Act and state antitakeover law has focused exclusively on conflict preemption. See, e.g., *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 79 (1987) (“Because it is entirely possible for entities to comply with both the Williams Act and [a particular state antitakeover law], the[se] state statute[s] can be pre-empted only if [they] frustrate[] the purposes of the federal law.”).

18. In the recently completed October 2013 Term alone, the Supreme Court decided six preemption cases, most of which examined whether state law frustrated the purposes and objectives of, and thus was preempted by, federal law. See *Mut. Pharm. Co. v. Bartlett*, 133 S. Ct. 2466, 2470 (2013) (federal drug laws preempt state design-defect claims against pharmaceutical companies); *Arizona v. Inter Tribal Council of Ariz., Inc.*, 133 S. Ct. 2247, 2257 (2013) (federal voting law preempts state-law requirement that voters provide evidence of citizenship); *Am. Trucking Ass'n v. City of L.A.*, 133 S. Ct. 2096, 2099 (2013) (federal law preempts city's concession agreement related to parking); *Hillman v. Maretta*, 133 S. Ct. 1943, 1947 (2013) (federal law preempts certain state laws related to beneficiaries of insurance plans); *Dan's City*

state antitakeover law has focused exclusively on whether the state law at issue is an obstacle to the achievement of the purposes of federal law, and in particular on the possibility that the state law is an obstacle to the accomplishment of Congress's objectives when enacting the Williams Act. Thus, throughout this Essay, our discussion of the validity of state-law poison-pill rules focuses on whether those rules are an obstacle to the objectives Congress sought to achieve in the Williams Act.

In Part I.A, we describe the Williams Act and the concerns that motivated Congress to enact it. Part I.B describes the federal courts' approach to reviewing the relationship between the Williams Act and state antitakeover statutes. Part I.C explains that the courts' analysis to date has not directly addressed the constitutionality of state-law poison-pill rules—rules that play a key role in the modern corporate-governance landscape.

#### A. *The Williams Act and the States*

Until 1968, cash tender offers in the United States were unregulated. Motivated by the specter of coercive tender offers,<sup>19</sup> in that year Congress passed the Williams Act, mandating federal regulation that would require tender offerors to give investors sufficient time and information to decide whether to tender their shares.<sup>20</sup>

The Williams Act, and the rules that the Securities and Exchange Commission has promulgated under the Act's authority, extensively regulate the terms of tender offers. They mandate, for example, that tender offers remain open for at least twenty business days, and that tender offerors open their offers to all shareholders and pay all who tender the "best" price.<sup>21</sup>

The Williams Act went through extensive revisions prior to its enactment as Congress debated how to establish the appropriate balance among the players in a tender offer—outside investors, shareholders, and management.<sup>22</sup> Senator Williams himself acknowledged that his initial proposal might disfavor outside investors, and he withdrew the bill after discussions with SEC staff highlighted that problem.<sup>23</sup> The Senator then introduced a second bill, noting

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Used Cars, Inc. v. Pelkey, 133 S. Ct. 1769, 1775 (2013) (federal law does not preempt state-law claims related to storage and disposal of towed automobile); *Wos v. E.M.A.*, 133 S. Ct. 1391, 1398 (2013) (federal law preempts state law governing reimbursement from beneficiary's tort damage proceeds).

19. While before 1968 coercive cash tender offers had been relatively uncommon, they became "daily fare for the readers of the financial page" in the late 1960s. Note, *Cash Tender Offers*, 83 Harv. L. Rev. 377, 377 (1969).

20. 15 U.S.C. §§ 78m(d)–(e), 78n(d)–(f) (2012).

21. See *id.* § 78n(d)(4)–(7); see also 17 C.F.R. §§ 240.14d-10, 240.14e-1 (2014).

22. See, e.g., S. Rep. No. 90-550, at 3 (1967) ("It was strongly urged during the hearings [on the proposed Williams Act] that takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management.").

23. 111 Cong. Rec. 28,258 (1965) (statement of Sen. Williams) (acknowledging initial proposal would "obviously work to the disadvantage of any corporate takeover specialists"). For a detailed analysis of the legislative history of the Williams Act, see Andrew E. Nagel, Andrew N.

that he had “taken extreme care with this legislation to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders,” and that “[e]very effort ha[d] been made to avoid tipping the balance . . . in favor of management or in favor of the offeror.”<sup>24</sup> When a congressional hearing revealed that even his second proposal raised concerns that the statute shifted this balance too far in favor of insiders,<sup>25</sup> Senator Williams introduced a third proposal, which eventually became the Williams Act.<sup>26</sup> The Senator explained that his revisions were designed to “provide the offeror and management equal opportunity to present their case” to shareholders in the event of a tender offer.<sup>27</sup>

In the decades since the Williams Act became law, many states have developed legal arrangements designed to supplement the rules established by the Act. These supplemental state-law rules generally limited the ability of outside investors to take control of public companies—and therefore provided incumbents with additional protection from such investors. These developments raised the question whether, and to what extent, such state-law rules disrupted the “careful balance” between outside investors and management that Congress struck in the Williams Act—and, thus, were preempted by the Act. As the next section explains, that question has been the focus of several decisions by the federal courts, including the Supreme Court.

#### B. Federal Scrutiny of State Antitakeover Law

Following the passage of the Williams Act, the states have adopted a wide range of rules that supplement the Act’s regulation of takeovers. Accordingly, over time the federal courts have developed a series of doctrinal tests to evaluate whether the Williams Act preempts these state-law rules. As we explain below, however, the courts have not yet resolved the validity of the most important state-law rules in the modern corporate-governance landscape: those authorizing the use of the poison pill.

1. *First-Generation Takeover Laws and Edgar v. MITE Corp.* — Immediately after Congress adopted the Williams Act, some thirty-seven states

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Vollmer & Paul R.Q. Wolfson, Wilmer Cutler Pickering Hale & Dorr LLP, *The Williams Act: A Truly “Modern” Assessment* 1–4 (2011), available at <http://blogs.law.harvard.edu/corpgov/files/2011/10/The-Williams-Act-A-Truly-Modern-Assessment.pdf> (on file with the *Columbia Law Review*).

24. 113 Cong. Rec. 854 (1967) (statement of Sen. Williams).

25. See Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Sec. of the S. Comm. on Banking and Currency, 90th Cong. 133–35 (1967) (statement of Stanley Kaplan, Professor, University of Chicago Law School).

26. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. § 78).

27. 113 Cong. Rec. 24,664 (1967) (statement of Sen. Williams).

enacted what are now known as “first-generation” takeover statutes.<sup>28</sup> These laws typically imposed additional burdens upon takeover bidders—for example, by requiring that a proposed tender offer be submitted to state officials for approval.<sup>29</sup>

The Supreme Court first examined the possibility that the Williams Act preempted such statutes in *Edgar v. MITE Corp.*<sup>30</sup> In *MITE* the Court considered a preemption challenge to the Illinois Business Take-Over Act, which allowed the Illinois Secretary of State to hold a hearing about any hostile tender offer, and authorized the Secretary to pass on the fairness of the offer—and enjoin a substantively unfair offer.<sup>31</sup> Justice White, writing for a plurality, concluded that the Illinois law was preempted by the Williams Act.<sup>32</sup>

Noting that the proper preemption inquiry was whether the state law “frustrate[d] the objectives of the Williams Act,” Justice White concluded that the Illinois statute impermissibly interfered with Congress’s objectives in two ways. First, the provisions of the statute authorizing the Secretary of State to call a hearing “frustrate[d] the congressional purpose by introducing extended delay into the tender offer process”; according to Justice White, “In enacting the Williams Act, Congress itself recognized that delay can seriously impede a tender offer and sought to avoid it.”<sup>33</sup>

Second, Justice White noted that the Williams Act implemented Congress’s policy to protect investors “while maintaining the balance between management and the bidder.” To do so, Congress required the bidder to “furnish the investor and the target company with adequate information but there was no inten[tion] to do . . . more than give incumbent management an opportunity to express and explain its position.”<sup>34</sup> However, Justice White explained that “[o]nce that opportunity was extended, Congress anticipated that the investor, if he so chose, and the takeover bidder should be free to move

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28. See, e.g., Neil Fabricant, *Hostile Tender Offers: Can the States Shut Them Down?*, 22 *J. Corp. L.* 27, 35–46 (1996) (comparing first-generation takeover statutes in Delaware and New York).

29. For a description of the statutes adopted by the states that enacted first-generation antitakeover statutes, see Michael W. Schwartz, Edward D. Herlihy & David A. Katz, Wachtell, Lipton, Rosen & Katz, *Selected Developments in Takeover Tactics and Defense*, in 1 *New Dimensions in Securities Litigation: Planning and Strategies* 323, 376–77 (Am. Law Inst.–Am. Bar Ass’n Comm. on Continuing Prof’l Educ. ed., 1992) (describing such statutes adopted in more than thirty-five states).

30. 457 U.S. 624 (1982). The Court’s opinion in *MITE* expanded upon its analysis of the purpose of the Williams Act in *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 22–24 (1977), in which the Court considered whether an implied cause of action arises under the Williams Act’s provisions addressing fraud in the tender-offer context.

31. *MITE*, 457 U.S. at 634–40 (discussing Illinois Business Take-Over Act).

32. *Id.* at 639–40.

33. *Id.* at 637–38 (quoting *Great W. United Corp. v. Kidwell*, 577 F.2d 1256, 1277 (5th Cir. 1978) (internal quotation marks omitted), rev’d on other grounds, *Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979)) (citing S. Rep. No. 90-550, at 4 (1967)).

34. *Id.* at 634 (quoting *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975)) (internal quotation marks omitted).

forward within the time frame provided by Congress.”<sup>35</sup> “[T]he Williams Act and its legislative history . . . indicate that Congress intended investors to be free to make their own decisions,” Justice White wrote, and the Illinois statute thus took “an approach quite in conflict with that adopted by Congress.”<sup>36</sup>

2. *Second-Generation Takeover Laws and CTS v. Dynamics Corp. of America.* — Following the Supreme Court’s decision in *MITE*, several states repealed their first-generation takeover laws, and within four years, twenty-one states had adopted so-called “second-generation” takeover statutes. These statutes typically deterred acquisitions by requiring a shareholder vote to approve the purchase of shares by any investor crossing specified ownership thresholds—and excluding shares owned by the acquiror for purposes of this vote.<sup>37</sup>

The Supreme Court considered whether the Williams Act preempted such statutes in *CTS v. Dynamics Corp. of America*.<sup>38</sup> The Court concluded that an Indiana statute that limited acquirors’ voting rights unless disinterested shareholders approved the transaction at a meeting to be held within fifty days of the offer was not preempted for two reasons.<sup>39</sup> First, the Court noted that, although the statute might impose some delay on tender offerors, a fifty-day delay was not so unreasonable as to warrant preemption. Unlike the statute in *MITE*,<sup>40</sup> which held the “potential for infinite delay,” the Court held that the potential fifty-day delay imposed by the Indiana law was reasonable.<sup>41</sup> Second,

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35. *Id.*

36. *Id.* at 639–40 (quoting *MITE Corp. v. Dixon*, 633 F.2d 486, 494 (7th Cir. 1980), *aff’d* sub nom. *Edgar v. MITE Corp.*, 457 U.S. 624). In the course of its critique of this Essay, the Wachtell Response claims that, in *MITE*, Justice White “[m]isread[.] . . . the Williams Act,” and that the Justice’s “stunning[.]” analysis is “insupportable.” Wachtell Response, *supra* note 9. As explained below, this criticism of our discussion of Justice White’s analysis is wholly unwarranted.

Our analysis does not assume that Justice White’s approach—although expressed in a plurality opinion of the Supreme Court—represents the current state of the law. We do note, however, that in *CTS v. Dynamics Corp. of America*, 481 U.S. 69 (1987)—the Supreme Court’s most recent opinion in this area—the Court applied Justice White’s framework to assess the Williams Act’s preemptive scope. See *infra* text accompanying notes 40–42. The Wachtell Response contends that the Court employed Justice White’s approach merely “for the sake of argument.” Wachtell Response, *supra* note 9. Supreme Court opinions, however, generally do not apply in their analysis, even for the sake of argument, an approach that is “insupportable.” *Id.* Furthermore, as explained below, the Justices in *CTS* could have adopted the narrow view of the Williams Act urged in the Wachtell Response. Indeed Justice Antonin Scalia described a similar view in a separate opinion in *CTS*, see 481 U.S. at 94 (Scalia, J., concurring in part and concurring in the judgment), but no other Justice joined that opinion. See *infra* text accompanying notes 123–124.

37. For an insightful discussion of the emergence of second-generation statutes, see Stephen A. Bainbridge, *Mergers and Acquisitions* 329 (3d ed. 2012).

38. 481 U.S. 69 (1987).

39. *Id.* at 86–87.

40. The *CTS* Court expressly chose not to overrule *MITE*, and noted only that Justice White’s opinion had not commanded a majority. *Id.* at 81–82 & n.6.

41. *Id.* at 85. The Court acknowledged more generally that, by regulating tender offers at all, the Indiana statute “makes them more expensive and thus deters them somewhat,” but it held the

the Court noted that, unlike the statute in *MITE*, which empowered state officials to decide whether a tender offer could go forward, the Indiana law “allow[ed] *shareholders* to evaluate the fairness of the offer collectively,” a result that supplemented, rather than undermined, the investor protections Congress mandated in the Williams Act.<sup>42</sup>

3. *Third-Generation Takeover Laws and Post-CTS Cases.* — In the wake of *CTS*, several states established new state-law arrangements further regulating tender offers. One type of law, the “business-combination” statute, prohibits a corporation from engaging in a business combination within a set time period after a shareholder acquires a particular level of share ownership.<sup>43</sup> Some states have also adopted statutes expressly authorizing directors to adopt antitakeover arrangements like the poison pill and limiting state courts’ ability to review such arrangements.<sup>44</sup> And in Delaware—the State whose law governs more than half of the publicly traded companies in the United States—the state

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law consistent with the Williams Act because “this type of reasonable regulation does not alter the balance between management and offeror in any significant way.” *Id.* at 82 n.7. That was true in *CTS* because the “principal result of the [Indiana law] is to grant shareholders the power to deliberate collectively about the merits of tender offers. This result is fully in accord with the purposes of the Williams Act.” *Id.*

42. *Id.* at 84 (emphasis in original). The Court also pointed out that, if the Williams Act were construed to preempt “any state statute that may limit or delay the free exercise of power after a successful tender offer,” “the Williams Act would preempt a variety of state corporate laws,” including those permitting staggered election of directors. *Id.* at 85. Lower courts interpreting *CTS* have suggested that one implication of this language is that state antitakeover laws that block tender offerors from taking control of a company for a lengthy period after acquiring a majority of its shares are not preempted because the *CTS* Court seemed to approve state laws permitting staggered board elections, which similarly block hostile acquirors from taking control of the board for long periods of time. See, e.g., *RP Acquisition Corp. v. Staley Cont’l, Inc.*, 686 F. Supp. 476, 486 (D. Del. 1988) (noting that, because Supreme Court “advised” in *CTS* “that a two year delay [caused by a staggered board] before an acquirer obtains ‘untrammled authority’ endures Supremacy Clause–Williams Act scrutiny,” Delaware’s business-combination statute, imposing three-year delay before tender offeror can take control of the board, must also survive constitutional review). It might be argued that *CTS*’s implicit approval of staggered board arrangements suggests that state-law poison-pill rules are also unlikely to be preempted. As we explain below, however, because state-law poison-pill rules can be used to block tender offerors from acquiring shares of the company’s stock—rather than blocking offerors who have already acquired the company’s stock from acquiring control—state laws authorizing staggered board elections do not block acquisitions of stock disfavored by incumbent directors, as poison-pill rules do. See *infra* note 104. Thus, this argument should not be expected to persuade the courts that state-law poison-pill rules are not preempted. See *infra* note 104.

43. See, e.g., Del. Code Ann. tit. 8, § 203 (2012) (prohibiting a corporation from engaging in a business combination with any interested stockholder for three years following such time the stockholder became an interested stockholder unless certain conditions are met). Other states have adopted “constituency” statutes, which allow, or in some cases require, boards of directors to consider the interests of constituencies other than shareholders in determining how to respond to a hostile takeover offer. See, e.g., Ohio Rev. Code Ann. § 1701.59(E) (West 1988) (allowing boards of directors to consider nonshareholder interests).

44. See Michal Barzuza, *The State of State Antitakeover Law*, 95 Va. L. Rev. 1973, 1995–97 (2009) (describing such statutes); see also, e.g., Va. Code Ann. § 13.1-727.1 (2014) (limiting state-court review of poison pills).

law governing defensive tactics like the poison pill has been developed through judicial decisions.<sup>45</sup>

The federal courts have considered whether third-generation takeover laws are preempted by the Williams Act in several recent cases challenging business-combination statutes. These cases suggest that the courts will take one of three approaches when evaluating whether the Williams Act preempts state takeover rules. All of these courts agree that where there is a direct conflict between the Williams Act and a state's takeover law, the state law will be held invalid. The courts are divided, however, with respect to whether there are meaningful constraints on state takeover law beyond those that directly conflict with the Williams Act.

The Supreme Court last spoke on Williams Act preemption in 1987, when the Court decided *CTS*. Since then, at least ten federal courts, including the Seventh Circuit, Fourth Circuit, and First Circuit, as well as district judges in Delaware, Maryland, Wisconsin, and Georgia, have examined the preemption of third-generation takeover laws. As explained below, these courts have produced widely divergent views on this subject. The decisions, however, can be usefully divided into three different approaches to the preemptive scope of the Williams Act.

a. *Preemption Due to Conflict with Congressional Purpose.* — One group of federal courts has held that the Williams Act preempts state laws that interfere with Congress's purpose in promulgating the Act. Some have emphasized that, to be consistent with that purpose, the statute must give tender offerors a "meaningful opportunity for success."<sup>46</sup> Others have contended that

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45. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1348 (Del. 1985) (considering the validity of the poison pill); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (putting forward standards for reviewing board responses to takeover proposals).

46. See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988) ("[E]ven statutes with substantial deterrent effects on tender offers do not circumvent Williams Act goals, so long as hostile offers which are beneficial to target shareholders have a meaningful opportunity for success."); see also *West Point-Pepperell, Inc. v. Farley Inc.*, 711 F. Supp. 1096, 1102 (N.D. Ga. 1989); *City Capital Assocs. v. Interco, Inc.*, 696 F. Supp. 1551, 1555 (D. Del. 1988); *RP Acquisition Corp.*, 686 F. Supp. at 482–84. In a recent symposium in the *Business Lawyer* assessing whether Delaware's business-combination statute, tit. 8, § 203, is preempted by the Williams Act, the principal article and three of the five commentaries each assumed that this approach continues to govern analysis of Williams Act preemption claims. See Subramanian, Herscovici & Barbetta, *Is Delaware's Antitakeover Statute Unconstitutional?*, supra note 5, at 705; see also Greg A. Jarrell, *A Trip down Memory Lane: Reflections on Section 203 and Subramanian, Herscovici, and Barbetta*, 65 *Bus. Law.* 779, 780 (2010) (noting that, at the time the Delaware legislature was considering section 203, lawmakers were attempting to "avoid [having the statutes be] ruled unconstitutional," and the "trick was to make sure that the law somehow afforded a hostile bidder some meaningful chance to succeed"); Eileen T. Nugent, *A Timely Look at DGCL Section 203*, 65 *Bus. Law.* 753, 757 n.22 (2010) ("Indeed, the definition of 'meaningful opportunity for success' is itself key to any [constitutional] analysis."); A. Gilchrist Sparks, III & Helen Bowers, *After Twenty-Two Years, Section 203 of the Delaware General Corporation Law Continues to Give Hostile Bidders a Meaningful Opportunity for Success*, 65 *Bus. Law.* 761, 762 (2010) (describing test as the "relevant legal standard"); cf. Guhan Subramanian, Steven Herscovici & Brian Barbetta, *Is Delaware's Antitakeover Statute Unconstitutional? Further Analysis and a Reply to Symposium Participants*, 65 *Bus. Law.* 799, 806 (2010) [hereinafter

state laws that interfere with investors' freedom to determine whether to accept a tender offer are preempted.<sup>47</sup> All of the decisions in this group, however, conclude that state laws in tension with Congress's broader purposes are preempted by the Williams Act.

This Essay discusses these decisions, and their implications for the validity of state-law poison-pill rules, in Part II.A below. As explained there, courts taking this approach can be expected to conclude that current state-law poison-pill rules are preempted by the Williams Act.

b. *Preemption Due to Adverse Effects on Investor Interests.* — Another set of decisions suggests that the Williams Act preempts only those state laws that are in fact detrimental for shareholders—that is, laws that can be shown to reduce shareholder value.<sup>48</sup> Under this view, the Williams Act sets a floor for the level of protection shareholders must receive in connection with tender offers; states are free to provide protection to investors above that level. State laws that reduce investor value, however, are preempted by the Act.

The Essay discusses this approach and its likely effect on the validity of state-law poison-pill rules in Part II.B below. As explained there, courts taking this approach will have to determine whether state laws that empower directors to use the poison pill to delay tender offers for long periods of time enhance shareholder value.

c. *Preemption Only Due to Conflict with Statutorily Mandated Procedures.* — Finally, some courts evaluating whether business-combination statutes are preempted by the Williams Act have concluded that the Act preempts only those laws that directly conflict with the procedures set forth in the Act.<sup>49</sup> So long as the participants in a tender offer can comply with the

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Subramanian, Herscovici & Barbeta, Further Analysis and a Reply] (concluding that courts are likely to adopt “meaningful opportunity for success” test in response to a Williams Act preemption challenge of section 203, but noting that this choice is not “mandated by existing law”). But see Stephen P. Lamb & Jeffrey M. Gorris, A Practical Response to a Hypothetical Analysis of Section 203's Constitutionality, 65 Bus. Law. 771, 772–74 (2010) (noting later cases have cast “doubt” on whether “meaningful opportunity for success” test is appropriate analysis for Williams Act preemption); Ribstein, *supra* note 7, at 792 (arguing “meaningful opportunity for success” test does not provide clear guidance to practitioners or lawmakers about how to avoid preemption of antitakeover statutes).

47. See, e.g., *Hyde Park Partners v. Connolly*, 839 F.2d 837, 853 (1st Cir. 1988) (Coffin, J., for unanimous panel including then-Judge Breyer) (noting state laws that let “management decide for investors instead of letting investors decide for themselves” are likely to be preempted); *RTE Corp. v. Mark IV Indus., Inc.*, No. 88-C-378, 1988 WL 75453, at \*3 (E.D. Wis. May 6) (noting state laws that “vest[] existing management with the power to block a tender offer . . . frustrate[] the purpose of the Williams Act”), vacated as moot, 1988 WL 75453 (June 22, 1988).

48. See, e.g., *Veere, Inc. v. Firestone Tire & Rubber Co.*, 685 F. Supp. 1027, 1030 (N.D. Ohio 1988) (“[T]he purpose of the Williams Act [was not a] guarantee of a level playing field for offeror and management in the take-over game . . . but as protection for the investor while management and offeror are on the field.”).

49. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 503 (7th Cir. 1989) (noting that the Williams Act and other federal securities rules “frequently regulate process while state corporate law regulates substance”); see also *WLR Foods v. Tyson Foods*, 65 F.3d 1172, 1179 (4th Cir. 1995) (“While the Williams Act governs the process of tender offers, it



requirements of both the Williams Act and state law, these courts have held, the state laws are not preempted. Under this view, states may authorize antitakeover devices that completely block outside offers if states choose to do so.

We discuss these decisions and their likely implications for the validity of state-law poison-pill rules in Part II.C below. As we explain there, courts taking this approach are likely to hold that the Williams Act does not preempt these rules. But, as we also explain below, courts considering a preemption challenge to state-law poison-pill rules are unlikely to adopt this approach.

### C. *The Unresolved Validity of State-Law Poison-Pill Rules*

Commentators generally agree that the rules governing the poison pill are among the most important issues in contemporary corporate law.<sup>50</sup> And, as we explain in the next Part, these rules are clearly the most important aspect of modern mergers and acquisitions. Despite these rules' importance, however, the courts have not clearly resolved whether the Williams Act preempts them. And, surprisingly, the unresolved constitutional status of these rules has received little attention from commentators.

Most importantly, although a significant number of judicial opinions have considered the constitutionality of various types of state antitakeover impediments, the federal courts have paid limited attention to the possibility that the Williams Act preempts state-law poison-pill rules. To begin, neither of the Supreme Court cases in this area, *MITE* and *CTS*, expressly considered this possibility with respect to poison-pill rules.

Moreover, the subsequent federal-court decisions that expressed a willingness to impose limits on the scope of state antitakeover law did not expressly apply their analysis to state-law poison-pill rules.<sup>51</sup> In one case, a federal trial court briefly indicated in dictum that such rules "may be preempted by the Williams Act."<sup>52</sup> But aside from this exception, the courts that have held that the Williams Act imposes meaningful limits on the devices that states can

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leaves to the states the power to regulate substantive matters of corporate governance."); *Realty Acquisition Corp. v. Prop. Trust of Am.*, No. JH-89-2503, 1989 WL 214477, at \*5 (D. Md. Oct. 27, 1989) (citing *Amanda Acquisition*, 877 F.2d at 496).

50. See, e.g., *Allen, Kraakman & Subramanian*, supra note 2, at 593 (stating that the poison pill "dominates" state takeover statutes because the pill makes it practically impossible to acquire a stake sufficient to trigger such statutes).

51. See, e.g., *Hyde Park*, 839 F.2d at 853 (holding state-law rules letting "management decide for investors instead of letting investors decide for themselves" preempted, but not expressly considering state-law poison-pill rules); *RTE Corp.*, 1988 WL 75453, at \*3 (holding that state laws "vesting existing management with the power to block a tender offer" are preempted, but not explicitly discussing state-law poison-pill rules).

52. See *Southdown, Inc. v. Moore McCormack Res., Inc.*, 686 F. Supp. 595, 604-05 (S.D. Tex. 1988) ("In reviewing the authorities on the use of the exclusionary-rights pill, it has occurred to the court that its only justification of buying time may be preempted by the Williams Act.").

authorize to interfere with tender offers have not addressed whether the Act preempts state-law poison-pill rules.<sup>53</sup>

The federal courts that have taken the view that the Williams Act imposes no substantive limits on the scope of state-law antitakeover devices have also paid little attention to whether the Act preempts state-law poison-pill rules. It is worth noting that some discussion of this subject appears in two of the federal-court opinions taking this view of the Williams Act's preemptive scope. While these opinions focused on other state-law antitakeover rules, they did observe that their approach would lead to the conclusion that state-law poison-pill rules are not constitutionally problematic.<sup>54</sup> As we explain below, we acknowledge that, should the federal courts adopt this approach to the Williams Act's preemptive reach, state-law poison-pill rules would be held *per se* valid.<sup>55</sup> However, as explained in detail in Part III.C below, the narrow approach to the Williams Act's preemptive scope put forward in these cases is unlikely to prevail in future cases or, ultimately, in the Supreme Court.<sup>56</sup> Importantly, there is a body of cases that takes a substantially more expansive view of the preemptive reach of the Act. These cases have not explicitly addressed the poison pill—except for the brief dictum described above—but, as we explain below, their reasoning implies that state-law poison-pills are in significant tension with the Williams Act.

Like the federal courts, scholars have paid limited attention to whether the Williams Act preempts state-law poison-pill rules, despite extensive literature on the constitutionality of state antitakeover law more generally. Indeed, since 1982, when the Supreme Court first considered the constitutionality of such laws, academics and practitioners have published more than one hundred

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53. We also note that, in response to a request from the Securities and Exchange Commission for comment on the development of poison pills, several commentators stated that poison pills are in tension with the intent of the Williams Act. Concept Release on Takeovers and Contests for Corporate Control, Exchange Act Release No. 34-23486, 36 SEC Docket 230, 236 (July 31, 1986) (“The Commission requests comment as to the appropriateness of federal intervention into the area of poison pills . . . .”); Div. of Corp. Fin., SEC, Summary of Comments Relating to Takeovers and Contests for Corporate Control, Release No. 34-23486, File No. S7-18-86, at 61 (1987) (on file with the *Columbia Law Review*) (“Thirteen commentators raised the concern that poison pills undermine, circumvent or violate either the intent of the Williams Act specifically or federal law in general.”).

54. See *WLR Foods*, 65 F.3d at 1181 (upholding Virginia statute authorizing corporations to issue rights pursuant to poison-pill arrangements); *Amanda Acquisition*, 877 F.2d at 504 (suggesting, without holding, that the “state law [that] enforces poison pills” could not “be thought preempted by the Williams Act”). We also note that the Delaware Supreme Court addressed the possibility that the Williams Act preempts state-law poison-pill rules in the well-known case of *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985). In that case, the Delaware Supreme Court held that such rules are not preempted. See *id.* at 1353. The views of state courts, however, are not binding on any federal court with respect to questions of federal law.

55. See *infra* Part III.C.

56. See *infra* text accompanying notes 123–135 (noting that this view is difficult to reconcile with the text of Williams Act, the Supreme Court's recent cases on the Supremacy Clause, and the fact that the Court could have adopted, but declined to adopt, such a view in *CTS*).

articles analyzing the case law on the constitutionality of state antitakeover statutes.<sup>57</sup> This scholarship, however, has focused largely on antitakeover statutes, paying limited attention to the validity of state-law poison-pill rules.<sup>58</sup>

Following this literature, nearly every corporate-law casebook includes a substantial section describing constitutional litigation over state antitakeover statutes—but indicates that such statutes are irrelevant in light of the overwhelming influence of the poison pill on the state-law landscape. One leading casebook, for example, describes the major cases in this area before concluding that the pill, rather than state antitakeover statutes, functionally dominates the takeover landscape.<sup>59</sup> To the contrary, this Essay shows that these cases have not been rendered unimportant by the poison pill. Instead, an understanding of these cases is necessary to assess whether the state-law rules governing the pill *itself* are vulnerable to constitutional challenge.

As we show in the next Part, the state-law rules that authorize the poison pill have indeed transformed the tender-offer landscape. Then, in Part III, we turn to a comprehensive investigation of the validity of these state-law poison-pill rules.

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57. A search of Westlaw's database of law reviews, texts, and bar journals for articles with the phrase "preemption" and "takeover" in the same sentence published since 1982 identified 191 such articles. Prominent examples of such articles include Jeffrey N. Gordon, "Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett, 19 *Cardozo L. Rev.* 511, 512–14 (1997); Roberta S. Karmel, Is It Time for a Federal Corporation Law?, 57 *Brook. L. Rev.* 55, 77–78 (1991); Arthur R. Pinto, The Constitution and the Market for Corporate Control: State Takeover Statutes After *CTS Corp.*, 29 *Wm. & Mary L. Rev.* 699, 703–77 (1988); Ribstein, *supra* note 7, at 792; and E. Norman Veasey, Jesse A. Finkelstein & Robert J. Shaughnessy, The Delaware Takeover Law: Some Issues, Strategies and Comparisons, 43 *Bus. Law.* 865, 877–78 (1988). Other prominent articles addressing this subject include William W. Bratton & Joseph A. McCahery, The Equilibrium Content of Corporate Federalism, 41 *Wake Forest L. Rev.* 619, 657–58 (2006); David W. Leebron, Games Corporations Play: A Theory of Tender Offers, 61 *N.Y.U. L. Rev.* 153, 219–21 (1986); and Jonathan R. Macey, Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty, 15 *Cardozo L. Rev.* 909, 944–45 (1994).

Recent significant contributions to this literature include Subramanian, Herscovici & Barbetta, Is Delaware's Antitakeover Statute Unconstitutional?, *supra* note 5, and responses to that article in a recent *Business Lawyer* symposium, see *supra* note 46 and sources cited therein, as well as Guhan Subramanian, Delaware's Choice, 39 *Del. J. Corp. L.* 1 (2014), which argues that Delaware's business-combination statute, unless amended, risks invalidation on Supremacy Clause grounds.

58. Articles that discuss state-law poison-pill rules include Lyman Johnson & David Millon, Does the Williams Act Preempt State Common Law in Hostile Takeovers?, 16 *Sec. Reg. L.J.* 339, 341 (1989), and Ribstein, *supra* note 7, at 794–95.

59. See Allen, Kraakman & Subramanian, *supra* note 2, at 594; see also Michael Klausner, GIGO: A Functional Analysis of Corporate Governance Indices 9 (Apr. 21, 2014) (unpublished manuscript), available at [https://www.stern.nyu.edu/sites/default/files/assets/documents/con\\_047439.pdf](https://www.stern.nyu.edu/sites/default/files/assets/documents/con_047439.pdf) (on file with the *Columbia Law Review*) ("With few exceptions, state antitakeover statutes were dominated by the poison pill and therefore became irrelevant once the pill was adopted . . .").

## II. THE TRANSFORMATIVE EFFECT OF THE POISON PILL

In this Part, we show that state-law rules authorizing unlimited use of the poison pill have drastically transformed the landscape that Congress contemplated when passing the Williams Act. Current state laws authorize boards to use poison pills to block outside tender offers from reaching shareholders indefinitely—or, at least, for a very long period of time. Indeed, as explained below, these laws impede outside tender offers to an even greater extent than the laws invalidated by the Supreme Court in *MITE*. Moreover, recent changes in state law—including the increased prominence of state statutes endorsing use of the poison pill and the elimination of careful review of the use of the pill in the Delaware courts—have increasingly brought state law into tension with the purposes and objectives of the Williams Act.

In Part II.A below, we explain the legal and economic tender-offer landscape that the drafters of the Williams Act faced when the statute was enacted in 1968. In Part II.B, we explain how state law empowers directors to use the pill to block outside tender offers. Finally, Part II.C shows how these state-law developments have altered the landscape that lawmakers considered when they first designed the Williams Act.

*A. The Tender-Offer Landscape at the Time of the Williams Act*

When Congress passed the Williams Act, cash tender offers were virtually unregulated. At the time Senator Williams's proposal was adopted, state law gave outside investors considerable freedom with respect to the acquisition of public-company stock. In particular, outside investors were virtually assured that, so long as they abided the Act's requirements with respect to the terms and conditions of a tender offer, their offer would eventually be considered by shareholders.

To be sure, Senator Williams sought to eliminate the abusive, coercive tender offers that had become commonplace in the years before the passage of the Act.<sup>60</sup> That is why the statute extensively regulates the terms of such offers. Provided, however, that outside investors followed these rules, the drafters of the Williams Act expected, in light of the law in place in 1968, that managers and outsiders would have an opportunity to “fairly present their case” to investors, who could then decide whether to tender their shares.<sup>61</sup>

The structure and provisions of the statute and related regulations show that the Williams Act is designed to facilitate the choice that lawmakers presumed shareholders would have in the event of a tender offer. These rules include elaborate provisions that require bidders to provide extensive information to investors and the incumbent board to provide a recommendation

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60. See *supra* note 19 and accompanying text (discussing tender-offer landscape prior to enactment of Williams Act).

61. S. Rep. No. 90-550, at 1–6 (1967) (describing legislative debate preceding passage of Williams Act); see also *Edgar v. MITE Corp.*, 457 U.S. 624, 639 (1982) (“Congress intended for investors to be free to make their own decisions.”).

to shareholders as to whether to accept the tender offer.<sup>62</sup> The rules contemplate that, whether or not the board favors the offer, shareholders will be free, informed by the bidder's disclosures and the board's recommendation, to decide whether to accept the offer.<sup>63</sup> Clearly, the drafters of the Williams Act did not contemplate the possibility that shareholders could be prohibited from making that decision in any cases in which incumbents prefer that result. As explained in the next section, however, current state law empowers incumbents to block tender offers from reaching shareholders for a significant period of time.

### B. State-Law Licenses to Use Poison Pills

As we have noted, the drafters of the Williams Act did not expect that state law would give directors the power to block tender offers. Nearly two decades after the Act was passed, however, corporate lawyers introduced the poison pill—a security that incumbents can issue to make the buying of shares beyond a specified threshold prohibitively costly and thereby prevent a takeover opposed by the board.<sup>64</sup> The laws of a majority of the states now give directors the power to use this mechanism.<sup>65</sup>

When adopting a poison pill, companies issue securities to their investors that give shareholders the right to purchase the company's stock at a significant discount from prevailing market prices.<sup>66</sup> This right is triggered only if an investor crosses a specified ownership threshold—for example, twenty percent—of the company's stock. Critically, however, any rights held by the investor who crosses the threshold are immediately voided, so that all shareholders *other than the offending investor* retain the right to acquire the company's stock at a discount. The economic effect of triggering the poison pill for the investor crossing the ownership threshold is disastrous, resulting in an immediate decrease in the value and proportion of her stake in the company.

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62. See 17 C.F.R. § 240.14d-6(d)(1) (2014) (requiring disclosure of identity and financing of hostile tender offerors); *id.* § 240.14e-2 (giving incumbent directors facing a hostile tender offer ten days to provide a statement indicating whether they recommend that shareholders accept or reject the offer).

63. Indeed, the SEC rules that require the incumbent board to make a recommendation to shareholders with respect to tender offers, see *id.* § 240.14e-2, assume that incumbents will be permitted only to *recommend* whether shareholders should accept a tender offer—not *decide* whether shareholders will be prohibited from even considering such an offer, as current state law empowers incumbents to do.

64. See Allen, Kraakman & Subramanian, *supra* note 2, at 521–24 (recounting the history of the invention of the poison pill). The poison pill, also known as a “rights plan,” permits directors to issue rights that allow shareholders to purchase the company's stock at a discounted price if someone acquires more than a certain percentage of that stock.

65. In a 2009 review of all fifty states' takeover laws, Michal Barzuza demonstrated that a majority of states have adopted statutes expressly authorizing the use of the poison pill. Barzuza, *supra* note 44, at 1988.

66. For a detailed description of the poison pill's structure and operation from the pill's inventors, see 1 Martin Lipton & Erica H. Steinberger, *Takeovers & Freezeouts* § 5.01, at 5-2 to 5-4 (2014).

For this reason, the poison pill—and state laws authorizing its use—is by far the most effective way for incumbent directors to block tender offers they disfavor.<sup>67</sup>

Indeed, many states' corporation statutes have been amended to expressly authorize directors to use the poison pill. Furthermore, these statutes often mandate that the directors' choice to use the pill may be reviewed by the courts only through the lenient business-judgment standard that any choice by directors must satisfy. In our view, because the poison-pill rules established by the statutes of these states are especially straightforward and clear, parties considering a challenge on the basis of Williams Act preemption should focus first on these jurisdictions.

In Delaware, the State whose law governs more than half of all publicly traded companies in the United States, the use of the poison pill is instead governed by case law. Initially, after the well-known case of *Moran v. Household International* was decided in 1985,<sup>68</sup> several commentators expressed the hope that the Delaware courts would develop substantial limits on the power of incumbents to use a pill to block a tender offer they disfavored.<sup>69</sup> However, over time, Delaware's judges instead adopted a deferential approach to incumbents' use of poison pills, and have followed such an approach since the early 1990s. Indeed, during the last twenty years, despite the near-universal use of the poison pill, there has not been a single case in which Delaware law was held to require directors to redeem a poison pill.

For instance, in an early example of the ability of Delaware corporations to use poison pills to block unsolicited offers for lengthy periods, Circon blocked an offer from U.S. Surgical for nearly two years.<sup>70</sup> In a more recent example, Airgas blocked an offer from Air Products for more than a year.<sup>71</sup> In that case, when the retention of the poison pill was litigated in the Delaware Court of Chancery, Chancellor Chandler concluded that the preceding delay had already given Airgas directors ample time to educate the company's shareholders on the merits of the hostile offer and that, in his "personal view, Airgas's poison pill ha[d] served its legitimate purpose."<sup>72</sup> Yet Chancellor Chandler held that, notwithstanding his view that the poison pill had served its legitimate purpose, Delaware state law compelled him to allow the Airgas

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67. See *id.* § 6.03[4], at 6-56 to 6-58 (describing poison pills as the "most effective device yet developed in response to abusive takeover tactics and inadequate bids").

68. 500 A.2d 1346, 1357 (Del. 1985).

69. 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, 274 (1989) (expressing hope that Delaware law in this area might "live[] up to its promise" of providing searching review of incumbents' decisions to use takeover defenses to block disfavored tender offers).

70. See Bebhuk, Coates & Subramanian, Powerful Antitakeover Force, *supra* note 15, at 913-14 (describing Circon's use of poison pill to block hostile offer by U.S. Surgical).

71. The circumstances of this fight are described in detail in Chancellor Chandler's opinion in *Air Products & Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 54 (Del. Ch. 2011).

72. *Id.* at 57.

directors to keep the pill in place and thus to deny shareholders an opportunity to decide whether to accept the offer.<sup>73</sup>

This pattern is consistent with the law in all states with rules authorizing the use of poison pills. Over the past two decades, despite the many cases in which incumbents have used the pill to block tender offers for an extended period of time, we are unaware of a single instance in which state-law poison-pill rules have been held to require directors to redeem a poison pill and allow an offer to be considered by shareholders.

In this Essay, we focus on the power that state-law poison-pill rules give incumbents to delay tender offers for significant periods of time. Providing insiders with the authority to delay unsolicited offers for lengthy periods is a principal source of the pill's current force as an antitakeover device. As explained below, state law purporting to give incumbents that power is in considerable tension with the Williams Act.

We would like to stress, however, that current state-law poison-pill rules may have other dimensions that run afoul of the Williams Act. For example, some state laws now authorize poison pills that cannot be redeemed even if the incumbents who adopted the pill are unseated in a proxy fight<sup>74</sup> and pills that may be used to block an outside shareholder from acquiring a significant block of stock.<sup>75</sup> The preemption analysis described in Part III below would apply to, and might well lead to invalidation of, such rules. For instance, as we plan to discuss in future work, state-law poison-pill rules that authorize pills that are triggered upon the acquisition of small amounts of the company's stock may well be preempted by the Williams Act.<sup>76</sup>

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73. See *id.* at 57–58 (“In my personal view, Airgas’s poison pill has served its legitimate purpose . . . . That being said, however, as I understand binding Delaware precedent, I may not substitute my business judgment for that of the Airgas board.”).

74. These poison pills, known as “dead-hand” pills, have been disapproved by the Delaware courts, see, e.g., *Carmody v. Toll Bros.*, 723 A.2d 1180, 1189–92 (Del. Ch. 1998), but state law gives directors the power to use these pills in Pennsylvania, Maryland, and Georgia, see *Bebchuk, Coates & Subramanian, Powerful Antitakeover Force*, *supra* note 15, at 905 n.61, 906 (citing Md. Code Ann., Corps. & Ass’ns § 2-201(c)(2)(ii) (LexisNexis 2000); *AMP Inc. v. Allied Signal Inc.*, Nos. CIV. A. 98-4405, CIV. A. 98-4058, CIV. A. 98-4109, 1998 WL 778348, at \*5–\*9 (E.D. Pa. Oct. 8, 1998); *Invacare Corp. v. Healthdyne Tech.*, 968 F. Supp. 1578 (N.D. Ga. 1997)).

75. As we have explained in recent work, companies are increasingly adopting poison pills with low acquisition triggers—an ownership threshold of fifteen percent or less—in order to use the pill to block not only disfavored tender offers but also activist investors who seek to acquire significant blocks of company stock. Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 *Harv. Bus. L. Rev.* 39, 56 & n.58 (2012) [hereinafter *Bebchuk & Jackson, Law and Economics of Blockholder Disclosure*] (noting, among 805 companies in *Sharkrepellent* dataset that had poison pills in place as of 2012, seventy-six percent had pills triggered by ownership threshold of fifteen percent or less, with fifteen percent having pills triggered by threshold of ten percent or less). The Delaware courts have recently suggested that Delaware law authorizes incumbents to use these pills to block activist investors from obtaining significant stakes. See *Third Point LLC v. Ruprecht*, Nos. 9469-VCP, 9497-VCP, 9508-VCP, 2014 WL 1922029, at \*18–\*19 (Del. Ch. May 2, 2014).

76. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Preemption and Low-Trigger Poison Pills* (Aug. 22, 2014) (unpublished manuscript) (on file with the *Columbia Law Review*).

In this Essay, however, we focus on the validity of state-law poison-pill rules that purport to give incumbents the power to block unsolicited offers for significant periods of time. As explained in the next section, that dimension of state-law poison-pill rules, standing alone, has transformed the tender-offer landscape that Congress faced when it adopted the Williams Act.

*C. The Effect of the Poison Pill on the Tender-Offer Landscape*

We now turn to the effects of these state-law rules on the modern law of tender offers. The emergence of the poison pill significantly altered the legal landscape that the drafters of the Williams Act expected to govern tender offers in 1968. The lawmakers who drafted the Act expected that, so long as outside bidders complied with the rules set forth in the Act, hostile offerors would be free to present their offer to shareholders. But because pills make it prohibitively expensive for outsiders to proceed with a tender offer without management's assent, so long as a pill is in place a hostile bidder simply cannot proceed. Under current state law, the pill effectively gives management the power to stop a hostile bidder from presenting a tender offer to shareholders.

Moreover, today state-law poison-pill rules present more powerful impediments to outside offers than those imposed by the state laws that have been the subject of Williams Act preemption challenges in the Supreme Court. The Illinois statute struck down in *MITE*, for example, enabled incumbents to block disfavored tender offers from reaching shareholders for six months.<sup>77</sup> The Supreme Court held that, because "the Williams Act and its legislative history . . . indicate that Congress intended for investors to be free to make their own decisions," state laws giving incumbents the power to delay tender offers for a period far longer than the timeframe specified in the Williams Act were preempted by the Act.<sup>78</sup> By contrast, today state law gives *incumbents* the power to block tender offers by empowering directors to adopt and keep pills in place for extended periods of time.

It is also worth noting that state-law poison-pill rules present a far greater impediment to hostile tender offers than that imposed by the Indiana statute upheld in *CTS*. By requiring hostile offers to be approved by shareholders, the Indiana statute enabled incumbents to delay tender offers for up to fifty days. The statute was substantively equivalent, then, to a poison pill that shareholders could remove through a shareholder vote after a fifty-day period. In approving the statute, the Supreme Court was careful to note the limited delay that the statute imposed, remarking that the Court could "[n]ot say that a [fifty-day] delay . . . [was] unreasonable."<sup>79</sup> By contrast, state law now empowers directors to use the poison pill to delay hostile offers for periods of time that

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77. *Edgar v. MITE Corp.*, 457 U.S. 624, 637 (1982) (opinion of White, J.) (citing Illinois Business Take-Over Act, which permitted incumbents to request state administrative hearing on fairness of tender offers opposed by incumbents).

78. *Id.* at 639 (citing H.R. Rep. No. 90-1711, at 4 (1968)).

79. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 85 (1987).



are an order of magnitude longer than fifty days—indeed, even longer than the six-month delay imposed by the Illinois statute struck down in *MITE*.

It might be argued that, despite current state-law poison-pill rules, hostile tender offerors can proceed by first replacing a majority of incumbent directors with new directors committed to redeeming the pill. However, most state antitakeover laws, like the poison pill, impose impediments only on offers not approved by incumbents.<sup>80</sup> Moreover, as a practical matter, at most public companies today, replacing incumbent directors would take a substantial amount of time.<sup>81</sup> That period would almost certainly exceed the fifty-day delay imposed by the statute approved in *CTS*—and would also likely be longer than the six-month delay imposed by the law struck down in *MITE*.

It might also be argued that, despite the existence of state-law poison-pill rules, incumbents often ultimately agree to unsolicited offers—including ones that they initially disfavor. Pressure from the marketplace as well as from investors, the argument goes, often leads incumbents to agree to allow such offers to reach shareholders.<sup>82</sup> Under this view, state-law poison-pill rules are not so draconian as to fully block unsolicited tender offers. But this observation is in no way inconsistent with the central proposition we have advanced in this Essay: that state-law poison-pill rules impede unsolicited tender offers, and tip the balance against bidders, to a greater degree than the antitakeover statutes held preempted by the federal courts.

Consider, for example, a hypothetical state where tender offers are governed by the Illinois statute invalidated in *MITE*. The six-month delay imposed by the statute would not prevent markets and investors from imposing pressure on directors to allow a hostile offer to go forward ultimately, and corporate elections might well still enable many unsolicited offers to ultimately succeed if they are favored by shareholders. Yet the six-month delay imposed by the Illinois law was nevertheless considered sufficiently substantial as to lead to its invalidation by the Supreme Court. Thus, the possibility that markets

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80. See, e.g., Del. Code Ann. tit. 8, § 203(a)(3) (2012) (permitting a business combination with an interested stockholder if the proposed combination is approved by the company's board of directors).

81. In the absence of a charter provision permitting the removal of directors without cause, a hostile bidder would be required to wait until the corporation's next annual meeting before the incumbents could be unseated—a wait that can be as long as a full year. See *id.* § 141(k) (allowing removal of directors only with cause if board is classified). Some thirty-one percent of S&P 500 companies currently permit removal of directors only for cause. Takeover Defenses, Sharkrepellent.net, <http://sharkrepellent.net> (on file with the *Columbia Law Review*) (showing search results for firms that only permit removal without cause in S&P 500 index). Moreover, at corporations with bylaw provisions requiring advance notice of director nominations, a bidder must nominate alternative directors several months before the annual meeting—and, once that deadline has passed, the bidder must wait until the year *after* the next annual meeting to unseat the incumbents. Approximately seventy percent of S&P 500 companies require at least ninety days' notice of nominees to the board. *Id.* (showing search results in S&P 500 index for firms with bylaws requiring ninety days' or more notice for nominations).

82. See, e.g., Paul H. Edelman & Randall S. Thomas, Corporate Voting and the Takeover Debate, 58 Vand. L. Rev. 453, 477 (2005) (describing this dynamic).

and investors might pressure corporate directors not to use the power that state-law poison-pill rules give them does not foreclose a successful preemption challenge against those rules.

*D. State-Law Poison-Pill Rules Versus Traditional Antitakeover Statutes*

Even though state-law rules on the poison pill provide a much more powerful impediment to tender offers than the statutes examined in *CTS* and *MITE*, it might be argued that preemption analysis does not apply to state-law poison-pill rules because, unlike state statutes, those rules address private agreements between companies and investors. As we explain in this section, however, this distinction is unlikely to convince courts that state-law poison-pill rules are immune from preemption challenges under the Williams Act.

To be sure, traditionally Williams Act preemption challenges have involved state statutes that expressly give boards of directors the power to reject disfavored tender offers. By contrast, it might be argued, the poison pill reflects an agreement among private actors that, like most such arrangements, is enforced through state-law rules that sanction the agreement.<sup>83</sup> Thus, the argument would go, the poison pill is not an appropriate subject for a preemption challenge.<sup>84</sup>

This distinction, however, makes little difference with respect to the analysis that the courts apply to preemption claims. In both cases, state-law rules play a critical role in allowing incumbents to block tender offers for long periods of time. The role of state law in giving incumbents this power is obvious when the law at issue is a state statute. But state law plays an equally critical role in empowering incumbents to block tender offers in the case of the poison pill.

For one thing, in the absence of state law sanctioning and providing for the enforcement of the pill, the pill could not give incumbents effective power to block tender offers they disfavor. Indeed, in some states the legislature affirmatively adopted statutes endorsing the poison pill before companies

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83. A related argument is that the poison pill is enforced by virtue of the common-law decisions of state courts rather than state statutes and thus is not subject to preemption analysis. The Supreme Court, however, has expressly rejected a similar argument in its preemption cases. See *Lear v. Adkins*, 395 U.S. 653, 673–74 (1969) (holding that the state common law of contracts, including principles of estoppel, cannot be applied in a manner that presents an obstacle to accomplishment of the objectives of federal patent law). Moreover, as explained below, for our purposes what is important is that state law now plays a critical role in allowing incumbents to block tender offers for lengthy periods of time. That fact alone is enough to raise serious questions as to whether the Williams Act preempts state-law poison-pill rules. See *infra* text accompanying notes 84–90; cf. *Johnson & Millon*, *supra* note 58, at 341 (“[T]here is no reason in law or policy that compels constitutional review of takeover statutes while sparing the more pervasive principles of the common law from that same scrutiny.”).

84. The Delaware Supreme Court took a similar view in concluding that state-law poison-pill rules were not preempted by the Williams Act in *Moran v. Household International*, 500 A.2d 1346, 1353 (Del. 1985) (holding preemption analysis is “not . . . applicable to the actions of private parties”).

adopted these arrangements.<sup>85</sup> But whether private actors or the state moved first to adopt poison pills is not important for purposes of this Essay. What is important is that state law is what enables incumbents to use the poison pill to block tender offers for long periods of time. To see this, note that, in jurisdictions around the world where corporate-law rules do not authorize the pill to be used in this way, incumbents cannot simply use private-law arrangements to block indefinitely offers they disfavor.<sup>86</sup> This illustrates that the pill is not merely a private-law innovation; instead, state-law rules are critical to the extent to which the pill empowers incumbents to block tender offers.

Nevertheless, it might be argued that the pill remains a private contract between the company and its shareholders, and preemption analysis typically does not apply to such arrangements. But this argument is also unlikely to persuade courts that the Williams Act does not preempt state-law poison-pill rules. To see why, consider an analogous example with respect to the preemptive scope of section 16(b) of the Securities Exchange Act of 1934, which requires executives to repay to the firm any “short-swing” profits that arise from their trading in the company’s stock.<sup>87</sup> Suppose that state law permitted companies to adopt private contracts with their executives that guaranteed insiders that any short-swing profits they paid to the company would be immediately reimbursed by the firm. Such arrangements would, of course, render section 16(b) practically meaningless. We do not believe, of course, that existing state laws permit these arrangements. But if they did, there is little doubt that such state laws would be preempted. And the fact that state law produced this result merely by sanctioning a private-law arrangement would in no way preclude a successful preemption challenge.

We are aware, of course, that section 16(b) has been the subject of considerable scholarly criticism.<sup>88</sup> Perhaps Congress should revise the statute—or even repeal it.<sup>89</sup> But the Constitution does not permit the states to take matters into their own hands and undermine the effects of a federal law—even an objectionable law—if Congress fails to address its error.

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85. See, e.g., Barzuza, *supra* note 44, at 1994 (describing states in which pill-endorsement statutes preceded widespread adoption of the pill).

86. See, e.g., Paul L. Davies, Sarah Worthington & Eva Micheler, *Gower & Davies’ Principles of Modern Company Law* 963 (8th ed. 2008) (“[T]he two central tenets of the British regulation of takeovers are that the shareholders alone decide on the fate of the offer and equality of treatment of shareholders.”).

87. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 16(b), 48 Stat. 881, 896 (codified as amended at 15 U.S.C. § 78p (2012)).

88. For a collection of the scholarly and practitioner criticism of section 16(b), see Steve Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 *Hastings L.J.* 391, 393–99 (1991).

89. See, e.g., Marleen A. O’Connor, *Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b)*, 58 *Fordham L. Rev.* 309, 312 (1989) (advocating repeal of section 16(b) to “promote the efficient regulation of insider trading”).

Similarly, federal law prohibits corporate insiders from trading on inside information, denying executives potential profits from such trades.<sup>90</sup> Suppose that, as a “private-law innovation,” boards of directors agreed that executives could inform the company of hypothetical trades they would have made in the absence of a prohibition on insider trading, and at the close of each year, the company would pay the executives an amount equal to their hypothetical trading profits.<sup>91</sup> Of course, state-law rules do not currently permit boards of directors to contract with executives in this way. But suppose that state law was changed to authorize boards and executives to enter into arrangements, like this one, that thwart the federal prohibition on insider trading. There is little doubt that such state-law rules would be preempted by federal law.

It might also be argued that preemption analysis should not apply to state-law poison-pill rules because directors’ actions pursuant to those rules are constrained by the fiduciary duties that directors owe to shareholders. For two reasons, however, the fact that directors’ use of the pill is limited by their fiduciary duties does not preclude preemption of state-law poison-pill rules. First, the board’s use of the traditional state statutes that have been the subject of preemption challenges is also limited by the directors’ fiduciary duties. Since most of these statutes do not apply if directors approve the tender offer, the statutes are typically triggered only when the board decides not to approve the offer.<sup>92</sup> Yet courts considering preemption challenges to these statutes have not said that the fact that the board’s decision is subject to the directors’ fiduciary obligations precludes a finding of preemption.<sup>93</sup> Instead, these courts proceed to determine whether other features of the challenged state law—for example, the extent of the delay that the law imposes on tender offers—are consistent with the purpose of the Williams Act.

Second, recall the examples we provided above to explain why corporations cannot enter into private arrangements that would evade the purposes of section 16(b) of the Exchange Act or the federal law prohibiting insider trading. As we have explained, the board might very well conclude, in good faith, that because those federal rules have deleterious consequences for shareholders, the directors’ fiduciary duties require that the board adopt such arrangements. Nevertheless, the fact that the directors’ fiduciary duties compel that action does not suggest that state law permits directors to take steps that would undermine the purposes of federal law. To the contrary, it is clear that

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90. See Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5 (2014).

91. An innovation like this one might be motivated by the view that, under some circumstances, permitting insider trading might well be optimal from shareholders’ point of view. See Henry G. Manne, *Insider Trading and the Stock Market* 9–10 (1966).

92. For example, in Delaware, the board can choose to waive the protections of that State’s business-combination statute by approving the proposed transaction. See Del. Code Ann. tit. 8, § 203(a)(3) (2012).

93. See Ribstein, *supra* note 7, at 794–95 (arguing that the fact that the use of poison pill is “constrained by[] the board’s fiduciary duty to the corporation” provides only a “shaky” distinction between the pill and other state-law antitakeover devices that have been subject to preemption analysis).

such arrangements, and the state law that sanctioned them, would be preempted.

Given that the state-law rules on the poison pill have transformed the tender-offer landscape imagined by the drafters of the Williams Act, have provided incumbents with stronger antitakeover protections than those imposed by the statutes considered by the Supreme Court in *MITE* and *CTS*, and are not meaningfully different from the laws considered in those cases, an examination of the constitutional validity of these rules is necessary. Courts, commentators, and practitioners should not take for granted that state-law poison-pill rules would survive a preemption challenge. Instead, these rules should be analyzed in light of the standards the courts have provided for assessing claims that the Williams Act preempts state law. We provide such an analysis in the next Part.

### III. ARE STATE-LAW POISON-PILL RULES VALID?

Although the courts have not yet addressed the constitutionality of state-law rules on the poison pill, previous cases provide three competing approaches that the courts have used to determine the preemptive scope of the Williams Act. This Part describes those approaches and assesses how courts applying each would likely rule on claims that the Williams Act preempts state-law rules governing the pill. All courts agree that there are circumstances under which state takeover laws are preempted because they conflict with the Williams Act. The courts have diverged, however, with respect to the scope of the conflict that is necessary to convince the court that the state law must fall.<sup>94</sup>

In Part III.A below, we consider two approaches found in the cases that would likely lead courts to conclude that current state-law rules on the poison pill are preempted by the Williams Act. Part III.B explores an approach under which it is unclear whether state-law rules on the pill would survive preemption. Finally, Part III.C describes an approach that would lead the courts to conclude that state-law rules governing the pill are, as a matter of law, not preempted.

#### A. *Per Se* Preempted

Courts assessing preemption claims under the Williams Act have taken two different approaches that would likely lead to the conclusion that current

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94. The standard that courts will use to assess preemption challenges to state-law poison-pill rules will depend in part on whether such challenges are framed as facial or as-applied. See *United States v. Salerno*, 481 U.S. 739, 745 (1987) (concluding facial constitutional challenge “must establish that no set of circumstances exists under which the [challenged] Act would be valid”); see also *Wash. State Grange v. Wash. State Republican Party*, 552 U.S. 442, 449 (2008) (“[A] facial challenge must fail where the statute has a ‘plainly legitimate sweep.’” (quoting *Washington v. Glucksberg*, 521 U.S. 702, 739–40 & n.7 (1997) (Stevens, J., concurring in the judgment))). For present purposes, we put to one side the differences in the courts’ approaches to facial and as-applied challenges. To the extent, however, that courts assess whether state-law poison-pill rules that permit incumbents to delay tender offers indefinitely can ever be applied consistently with the purposes of the Williams Act, such challenges would properly be considered facial challenges.

state-law rules on the poison pill are per se invalid. In this section, we discuss each of those frameworks—which emerged in parallel in the years following the Supreme Court’s decision in *CTS*—in turn.

The first, known as the “meaningful opportunity for success” test, is derived from a series of federal-court decisions evaluating the constitutionality of state business-combination laws, including *City Capital Associates v. Interco, Inc.*<sup>95</sup> The second, the “shareholder autonomy” view, is reflected in several lower-court interpretations of the Supreme Court’s analysis in *MITE* and *CTS*, including the First Circuit’s opinion for a panel including then-Judge Breyer in *Hyde Park Partners v. Connolly*.<sup>96</sup>

1. *Meaningful Opportunity for Success*. — Four federal courts that have considered whether the Williams Act preempts state business-combination statutes have concluded that the “power of the states to regulate tender offers does not extend to complete eradication of hostile offers.”<sup>97</sup> Nevertheless, because the “states have a legitimate interest in regulating tender offers,” these courts have held, the “question [is] to what extent a state may limit them” consistent with the Williams Act.<sup>98</sup> To ascertain the scope of Williams Act preemption, then, these courts ask, among other things, whether the state law “impose[s] an indefinite or unreasonable delay on offers.”<sup>99</sup>

Under this approach, even a state law, such as Delaware’s business-combination statute, that “alters the balance between target management and the offeror, perhaps significantly,”<sup>100</sup> is constitutional “so long as hostile offers . . . enjoy a ‘meaningful opportunity for success.’”<sup>101</sup> Because state business-combination statutes typically contain exceptions that permit hostile offerors to obtain control in some circumstances, these courts have held those statutes not preempted<sup>102</sup> under the “meaningful opportunity for success” approach.<sup>103</sup>

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95. 696 F. Supp. 1551 (D. Del. 1988); see also *West Point-Pepperell, Inc. v. Farley, Inc.*, 711 F. Supp. 1096, 1102 (N.D. Ga. 1989) (“[S]tate statutes . . . do not circumvent Williams Act goals, so long as hostile offers which are beneficial to target shareholders enjoy a meaningful opportunity for success” (internal quotation marks omitted)); *RP Acquisition Corp. v. Staley Cont’l, Inc.*, 686 F. Supp. 476, 482 (D. Del. 1988); *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988). For a brief discussion of these cases, see *supra* note 46 and accompanying text.

96. 839 F.2d 837, 852 (1st Cir. 1988).

97. *BNS*, 683 F. Supp. at 468.

98. *Id.* at 468–69.

99. *Id.* at 469.

100. *Id.* at 470.

101. *West Point-Pepperell, Inc. v. Farley*, 711 F. Supp. 1096, 1102 (N.D. Ga. 1989) (quoting *BNS*, 683 F. Supp. at 469).

102. See, e.g., *BNS*, 683 F. Supp. at 470–72 (concluding that Delaware’s business-combination statute, which includes exceptions that allow hostile offerors to obtain control in limited circumstances, was not preempted under the “meaningful opportunity for success” test). All four courts that have adopted this test have left open the possibility that future evidence might show that the requirements of these statutory exceptions are met so rarely that a hostile offeror’s opportunity for success is not “meaningful,” and thus that the Williams Act preempts the state

However, courts applying this test can be expected to hold state-law rules governing the poison pill preempted by the Williams Act. As explained in Part I, these rules give hostile offerors *no* practical opportunity for success, because they allow incumbents to block a hostile offer from shareholder consideration for long periods of time. In nearly all states—like in Delaware, as the recent *Airgas* decision demonstrates—state law permits directors to use the pill to delay a tender offer for a sufficiently lengthy period that hostile bidders have no practical opportunity to acquire control.<sup>104</sup>

It might be argued that state-law poison-pill rules provide hostile tender offerors with some possibility of success because those rules authorize use of the pill only where directors can show that their decisions were the product of valid business judgment. This argument, though, will likely not persuade courts using this approach that state-law poison-pill rules currently give hostile tender offerors a meaningful opportunity for success. It is commonly understood that the business-judgment standard requires only that directors observe basic procedural obligations in connection with corporate decisions, and in fact the rule expressly prohibits courts from engaging in substantive review of direc-

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law. See, e.g., *id.* at 471–72 (noting that, if subsequent evidence demonstrates that a state law denies offerors a meaningful opportunity to succeed, the state law would be preempted by the Williams Act). As we have noted, in a 2010 article Guhan Subramanian, Steven Herscovici, and Brian Barbetta accepted the courts’ invitation to evaluate this question empirically with respect to Delaware’s business-combination statute. See Subramanian, Herscovici & Barbetta, *Is Delaware’s Antitakeover Statute Unconstitutional?*, *supra* note 5, at 686–87. The authors found that, over a period of nineteen years, no bidder had endured the statute’s three-year waiting period and succeeded in acquiring its target, and they argued that this finding cast the constitutionality of the Delaware statute into doubt under the “meaningful opportunity for success” test. See *id.* at 687. To our knowledge, however, the courts have not yet systematically revisited the claim that Delaware’s business-combination statute is preempted by the Williams Act. Regardless of how the debate over this claim is resolved, however, there can be little doubt that state-law rules on the poison pill leave *no* practical opportunity for success for a hostile tender offeror.

103. In their response to this Essay, several senior partners of Wachtell Lipton contend that the decisions of these courts are “now discredited.” Wachtell Response, *supra* note 9. We note, however, that these decisions have never been overruled by an authoritative court, and the assertion that they have been “discredited” is thus unwarranted. These decisions, and the “meaningful opportunity for success” test for determining the scope of the Williams Act’s preemptive reach, remain the law of the jurisdictions where these cases were decided.

104. See, e.g., *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 129 (Del. Ch. 2011) (describing current state of the law of poison pills in Delaware). As we have noted, some courts adopting the meaningful opportunity for success test have pointed out that the *CTS* Court suggested that state-law rules that block majority shareholders from obtaining control, such as those permitting staggered board elections, are not preempted by the Act. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 85–86 & n.11 (1987); see also *supra* note 42 (citing *RP Acquisition Corp. v. Staley Cont’l, Inc.*, 686 F. Supp. 476, 486 (D. Del. 1988)). Importantly, however, these courts were evaluating the constitutionality of Delaware’s business-combination statute, which, like state-law rules permitting staggered boards, blocks large shareholders from obtaining corporate control. By contrast, state-law poison-pill rules allow incumbents to block tender offerors from presenting their offers to purchase the company’s stock to its shareholders—offers that are extensively regulated by the Williams Act. Thus, the possibility that the *CTS* Court endorsed state-law rules permitting the staggered election of directors does not suggest that state-law poison-pill rules are not preempted by the Williams Act.

tors' decisions.<sup>105</sup> Thus, courts are unlikely to conclude that state law authorizing directors to permanently block tender offers on the basis of such a limited showing gives offerors the meaningful opportunity for success necessary to avoid Williams Act preemption.

2. *Shareholder Autonomy*. — Other lower federal courts have held that, because Congress's purpose in passing the Williams Act was to protect investors' freedom to decide whether to accept a tender offer, the Williams Act preempts state laws that compromise shareholders' autonomy in that context. These courts emphasize language in the Supreme Court's decisions in *MITE* and *CTS* that focuses on the potential effects of state law on shareholders' freedom to receive, and to decide whether to accept, a tender offer.<sup>106</sup>

For example, a First Circuit panel concluded in *Hyde Park Partners v. Connolly* that a Massachusetts antitakeover statute was likely preempted because the law interfered with investors' freedom to determine whether to accept a tender offer.<sup>107</sup> One of the members of the panel that issued this opinion was then-Judge Stephen G. Breyer, now a Justice of the Supreme Court of the United States. The First Circuit took the view that the law "only serve[d] to decrease [shareholders'] ability to take advantage of tender offers" and thus could not be reconciled with Congress's purpose in adopting the Williams Act; a state law that "lets management decide for investors instead of letting investors decide for themselves,"<sup>108</sup> the court concluded, was preempted.<sup>109</sup>

Accordingly, courts applying the shareholder-autonomy framework can be expected to hold state-law rules governing the poison pill preempted by the Williams Act. As we have explained, state-law rules today empower directors to adopt arrangements that permit incumbents, rather than investors, to decide

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105. See, e.g., Allen, Kraakman & Subramanian, *supra* note 2, at 250 ("[T]he business judgment rule means that courts will not decide . . . whether the decisions of corporate boards are either substantively reasonable . . . or sufficiently well informed . . .").

106. See *CTS*, 481 U.S. at 84 (1987) (concluding that a state law was not preempted by Williams Act because it "allows *shareholders* to evaluate the fairness of the offer collectively" (emphasis in original)); *Edgar v. MITE Corp.*, 457 U.S. 624, 634 (1982) (holding state takeover statute preempted because the drafters of the Williams Act envisioned that "the investor, if he so chose, and the takeover bidder should be free to move forward [with the tender offer] within the time frame provided by Congress").

107. 839 F.2d 837, 852 (1st Cir. 1988).

108. *Id.* at 853; see also *RTE Corp. v. Mark IV Indus., Inc.*, No. 88-C-378, 1988 WL 75453, at \*3 (E.D. Wis. May 6) (holding Wisconsin law preempted by Williams Act because the *CTS* Court held the "primary purpose of the Williams Act [was] the promoting of investor choice," and the "Wisconsin act . . . gives to the management of target companies a virtual veto power over the outcome of a tender offer contest" (citing *CTS*, 481 U.S. at 84)), vacated as moot, 1988 WL 75453 (June 22, 1988).

109. Wachtell Lipton's response to this Essay downplays the significance of the *Hyde Park* decision, and indeed does not identify the case by name or acknowledge that the opinion was joined by then-Judge Breyer. See Wachtell Response, *supra* note 9 (referring to the decision only in a hyperlink). In our view, *Hyde Park*—especially given that it was joined by a judge who is now a sitting Justice of the Supreme Court—is a significant decision that is likely to be part of the mix of considerations that will influence future courts' assessments of the proper scope of the Williams Act.



whether shareholders may accept a tender offer.<sup>110</sup> We acknowledge, of course, that supporters of these state-law rules contend that denying shareholders this choice ultimately benefits investors. Many, including one of us, have disputed that claim.<sup>111</sup> For purposes of the shareholder-autonomy view, however, the merits of that debate are irrelevant. Instead, what is important is that courts applying a shareholder-autonomy framework to the Williams Act have held that state laws that limit investors' freedom to accept tender offers are preempted. Because state-law poison-pill rules currently deprive shareholders of the freedom to accept hostile tender offers, courts adopting this approach can be expected to conclude that state-law rules governing the poison pill are preempted.

### *B. Preemption Depends on Overall Effect on Shareholder Value*

Some courts examining the preemptive scope of the Williams Act have concluded that whether a particular state takeover law is preempted depends on whether, in fact, the law enhances shareholder protection. Under this approach, which emphasizes the shift in the Supreme Court's analysis between *MITE* and *CTS*,<sup>112</sup> courts hold that the Williams Act establishes a lower bound for shareholder protection in the tender-offer context. The states are free, under this view, to provide additional protection for investors. But for state-law regulation of tender offers to survive Williams Act preemption, the evidence

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110. See, e.g., *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 55 (Del. Ch. 2011) (“[A]s Delaware law currently stands . . . the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors.”).

111. Compare, e.g., Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 Harv. L. Rev. 1028, 1030 (1982) [hereinafter *Bebchuk, The Case for Facilitating Competing Tender Offers*] (“[F]acilitating competing tender offers is desirable both [for] targets’ shareholders and . . . society.”), and Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819, 821 (1981) [hereinafter *Gilson, The Case Against Defensive Tactics*] (contending that management should have a “substantially more limited role” than they have under current law in determining whether a hostile tender offer should be accepted), with Lipton, *Takeover Bids*, supra note 16, at 104 (arguing that short-term investors do not share the “long-term interests of other shareholders and . . . concern of corporate management with the need for long-term planning”).

112. The *MITE* Court expressly emphasized shareholder autonomy rather than shareholder protection as a principal purpose of the Williams Act. *Edgar v. MITE Corp.*, 457 U.S. 624, 640 (1982) (concluding that a state may not “offer[] investor protection at the expense of investor autonomy” and therefore striking down a law that the state characterized as providing investors with critical protection against coercive tender offers (internal quotation marks omitted)). By contrast, the *CTS* Court held that states may protect investors by depriving them of choice in the tender-offer context so long as the “principal result” of the state law is to protect shareholders. *CTS*, 481 U.S. at 82 n.7; see also *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 35 (1977) (“The legislative history . . . shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer.”); *Veere, Inc. v. Firestone Tire & Rubber Co.*, 685 F. Supp. 1027, 1030 (N.D. Ohio 1988) (comparing the Court’s opinions in *MITE* and *CTS* and concluding that the *CTS* majority viewed the Williams Act “not as a guarantee of a level playing field for offeror and management in the take-over game,” “but as protection for the investor while management and offeror are on the field”).

must indicate that the statute generally protects investors—that is, that the law, on average, enhances shareholder value.

Courts applying this approach to claims that the Williams Act preempts state-law poison-pill rules will have to form a judgment on whether state laws that give directors the power to permanently block tender offers enhance shareholder value. Those defending these rules would have to engage substantively with the costs of allowing management to block tender offers, and particularly the possibility that permitting management to do so increases agency costs and managerial slack—and the accumulating evidence that these costs are significant. We note that, for example, in a study coauthored by one of us, takeover targets with staggered board elections—which are able to make the most effective use of state-law poison-pill rules in order to turn away hostile tender offers—provided lower returns to shareholders in the face of a takeover bid.<sup>113</sup> These companies were able to use the power conferred upon directors by state law to remain independent much more often than companies that were less able to take advantage of those rules. The study found that, on average, remaining independent reduced shareholder value at these firms.<sup>114</sup> Furthermore, another study coauthored by one of us found that, going beyond takeover targets, companies with staggered boards are generally associated with lower firm value.<sup>115</sup>

Of course, a complete analysis of the empirical evidence on the shareholder-value implications of empowering managers to block hostile offers is beyond the scope of this Essay. We expect that this question will be hotly debated if the federal courts adopt a shareholder-value approach to Williams Act preemption in litigation over the constitutionality of state-law poison-pill rules. In the course of such litigation, the parties will likely arrange for experts to opine on the effects of such state-law rules on shareholder value, and the courts will have to review those opinions as well as the extensive body of theoretical and empirical literature on this question to determine whether, in the view of the court, state-law poison-pill rules do, in fact, protect shareholders.<sup>116</sup>

A comprehensive analysis of this question is beyond the scope of this Essay. In previous work, one of us has presented a detailed review of the overall effect of these rules on shareholders.<sup>117</sup> For purposes of this Essay, we

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113. See Bebchuk, Coates, & Subramanian, *Powerful Antitakeover Force*, *supra* note 15, at 891 (reporting that effective staggered boards “reduced returns . . . for shareholders of hostile bid targets”).

114. See *id.* at 891, 934-35 (finding that “the substantial increase in the likelihood of remaining independent . . . is rather costly for target shareholders”).

115. See Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 *J. Fin. Econ.* 409, 430 (2005) (reporting that the “reduction in firm value associated with staggered boards is economically meaningful”).

116. For early contributions to this literature, see Easterbrook & Fischel, *supra* note 15, at 1164; see also, e.g., Bebchuk, *The Case for Facilitating Competing Tender Offers*, *supra* note 111, at 1031; Gilson, *The Case Against Defensive Tactics*, *supra* note 111, at 821-22; Lipton, *Takeover Bids*, *supra* note 16, at 102-04.

117. Bebchuk, *The Case Against Board Veto*, *supra* note 15, at 995-1026.

note only that, at a minimum, the arguments that state-law poison-pill rules in fact reduce shareholder value should be taken seriously. In particular, the courts will have to consider the agency costs that result from such rules, which insulate incumbent managers from the possibility of a hostile takeover and thus give rise to considerable managerial slack. In sum, if courts considering preemption challenges to state-law poison-pill rules emphasize shareholder value, there is a substantial likelihood that they will conclude that such rules are preempted.

### C. *Per Se Valid*

The courts might also adopt an approach to Williams Act preemption that would lead them to conclude that state-law poison-pill rules are generally not preempted. Under this view, the Williams Act preempts only those state laws that directly conflict with the procedures mandated by the Act. Thus, under this framework the Williams Act imposes virtually no limits on the power that state law may give directors with respect to tender offers. Although this approach would shield state-law poison-pill rules from Williams Act preemption, as we explain below, few courts have adopted it.<sup>118</sup>

The judges who have adopted this framework have given three principal reasons for interpreting the Williams Act's preemptive scope narrowly. First, they note that, when Congress added the Williams Act to the Securities Exchange Act of 1934, the legislation did not remove a provision from the Exchange Act stating that nothing contained in the Exchange Act "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security . . . insofar as it does not conflict with the provisions of this chapter," suggesting that Congress did not intend for the Williams Act to preempt state law.<sup>119</sup> Second, they note that, in general, the federal courts presume that state law is not preempted by federal law, particularly in areas in which states have traditionally had significant authority.<sup>120</sup> Finally, Judge Easterbrook has argued that the Williams Act

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118. As we have noted, Judge Frank Easterbrook described this approach in an opinion for a unanimous panel of the Seventh Circuit, see *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 498–99 (7th Cir. 1989), and in that opinion Judge Easterbrook indicated that, under this view, state-law poison-pill rules "could [not] be thought preempted" by the Williams Act, *id.* at 504. As noted above, the Fourth Circuit adopted a similar view in *WLR Foods, Inc. v. Tyson Foods, Inc.*, 65 F.3d 1172, 1180 (4th Cir. 1995), and, in that case, rejected a broad challenge to a Virginia statute permitting the adoption of rights plans. See *supra* note 49. Justice Antonin Scalia described a similar view in a separate opinion in *CTS*, but no other Justice joined that opinion. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987) (Scalia, J., concurring in part and concurring in the judgment).

119. 15 U.S.C. § 78bb(a) (2012); see also *CTS*, 481 U.S. at 96 (Scalia, J., concurring in part and concurring in the judgment) ("Unless it serves no function, that language forecloses preemption on the basis of conflicting 'purpose' as opposed to conflicting 'provision.'"); *Amanda Acquisition*, 877 F.2d at 502 (arguing that Williams Act "[p]reemption has not won easy acceptance among the Justices for several reasons," including 15 U.S.C. § 78bb(a)).

120. *Amanda Acquisition*, 877 F.2d at 502 ("Then there is the traditional reluctance of federal courts to infer preemption of state law in areas traditionally regulated by the States . . . .

merely “regulates the *process* of tender offers,” including “timing [and] disclosure”; thus, only a state law that “alter[s] . . . the procedures governed by federal regulation” should be held preempted.<sup>121</sup> A broader approach, Judge Easterbrook has explained, would improperly lead courts to question the constitutionality of basic state corporate-law rules governing matters such as shareholder voting.<sup>122</sup>

In the event that a preemption challenge to state-law poison-pill rules reaches the Supreme Court, we do not expect that these arguments will ultimately prevail.<sup>123</sup> With respect to the claim that the Exchange Act’s provision preserving the authority of state securities agencies reflects congressional intent to avoid preemption of state law, although Justice Scalia described this view in a separate opinion in *CTS*, no other Justice joined that opinion. To be sure, all eight of the Justices who declined to join Justice Scalia’s opinion in *CTS* have since been replaced. Nevertheless, the fact that Justice Scalia’s opinion drew no additional support at the time *CTS* was decided suggests that this view is unlikely to persuade a majority of today’s Court. Furthermore, the language used in the provision differs markedly from the language Congress customarily uses to express its intent to avoid preemption of state law.<sup>124</sup>

The provision’s language and legislative history suggest that it was intended simply to preserve state securities agencies’ jurisdiction, not limit the preemptive scope of federal securities law.<sup>125</sup> Moreover, even when Congress

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States have regulated corporate affairs, including mergers and sales of assets, since before the beginning of the nation.” (quoting *California v. ARC Am. Corp.*, 490 U.S. 93, 101 (1989)) (internal quotation marks omitted)).

121. *Id.* at 503–04.

122. *Id.* (arguing that, on a broader view of Williams Act preemption, state laws governing shareholder voting could be preempted).

123. For purposes of this Essay, we put to one side whether this approach to Williams Act preemption is normatively desirable, although other commentators have urged that this view be adopted. See, e.g., Stephen Bainbridge, *The Constitutionality of the Delaware Takeover Statute*, ProfessorBainbridge.com (Nov. 10, 2009, 12:46 PM), <http://www.professorbainbridge.com/professorbainbridge.com/2009/11/the-constitutionality-of-the-delaware-takeover-statute.html> (on file with the *Columbia Law Review*) (arguing that “courts today would follow *Amanda Acquisition*” rather than other approaches to Williams Act preemption); see also Ribstein, *supra* note 7, at 790–92 (contending that using the “meaningful opportunity for success” test would lead courts into a “daunting thicket” of issues regarding the relationship between the Williams Act and state corporate law). For present purposes, we note only that the doctrinal arguments presented in support of this approach are in some tension with the text and legislative history of the Williams Act and have not enjoyed widespread support among the courts.

124. When Congress intends to limit the preemptive scope of its acts, it typically does so with standard language that explicitly protects state law from preemption rather than language preserving the jurisdiction of state administrative agencies. For a recent example, see Consumer Product Safety Improvement Act of 2008, Pub. L. No. 110-314, § 231, 122 Stat. 3016, 3070 (codified at 15 U.S.C. § 2051 (2012)) (“Nothing in this Act . . . shall be construed to preempt or otherwise affect any warning requirement relating to consumer products or substances that is established pursuant to State law . . .”).

125. Adolph C. Johnson, the Chief Counsel of the Public Service Commission of Wisconsin, suggested that this language be added to the Exchange Act in order to ensure only that

does employ standard language expressing an intent to avoid preemption, the courts have increasingly concluded that ordinary preemption analysis—including an assessment whether state law is an obstacle to Congress’s objectives—should still apply.<sup>126</sup> Thus, courts are unlikely to conclude that this provision forecloses analysis whether state-law poison-pill rules frustrate Congress’s objectives with respect to the Williams Act.

The courts are also unlikely to be persuaded to adopt a narrow view of the Williams Act’s preemptive scope by arguments that courts typically presume that state law is not preempted by federal law, particularly in areas—such as substantive corporate law—where the states have traditionally had significant authority. For one thing, it is far from clear that the presumption against preemption, which has been the subject of considerable criticism from several commentators, remains a valid principle of constitutional law;<sup>127</sup> indeed, the Supreme Court has expressly declined to apply the presumption in several recent cases.<sup>128</sup> Moreover, while the States have traditionally had significant authority in the area of corporate law, the Supreme Court has limited this presumption to areas that involve the States’ police powers, which are not

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each state was “left with authority to regulate in accordance with its laws and practices of persons engaged in strictly intrastate business within its borders,” not to limit the preemptive scope of the Williams Act. Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the H. Comm. on Interstate and Foreign Commerce, 73d Cong. 669 (1934).

126. See, e.g., *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 869 (2000) (concluding explicit federal antipreemption provision did not limit operation of ordinary preemption principles).

127. The traditional formulation of the presumption is that the courts should “start with the assumption that the historic police powers of the States were not to be superseded by [a] Federal Act unless that was the clear and manifest purpose of Congress.” *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). If it continues to apply at all, the presumption is limited to “field[s] which the States have traditionally occupied.” *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996). Commentators have variously criticized the presumption for being unfaithful to the text of the Supremacy Clause, for inviting the courts to disregard congressional intent to preempt state law, and for being applied inconsistently. See Viet D. Dinh, *Reassessing the Law of Preemption*, 88 *Geo. L.J.* 2085, 2092 (2000) (arguing that the presumption would “disrupt the constitutional division of power between federal and state governments, rewrite the laws enacted by Congress, or both”); Nelson, *supra* note 17, at 293 (arguing that the Supremacy Clause itself “rejects a general presumption that federal law does not contradict state law”); see also Christopher R. Drahozal, *The Supremacy Clause: A Reference Guide to the United States Constitution* 115 (2004) (collecting criticisms). “In short, it seems that no one is happy with the presumption except perhaps the Supreme Court itself.” *Id.*

128. See, e.g., *Buckman Co. v. Plaintiffs’ Legal Comm.*, 531 U.S. 341, 348 (2001) (holding, “in contrast to situations implicating federalism concerns and the historic primacy of state regulation of matters of health and safety[,] no presumption against pre-emption obtains in this case” (citation omitted) (internal quotation marks omitted)); *Geier*, 529 U.S. at 874 (refusing to apply “special burden” to those attempting to show federal law preempts state law). The Court did apply the presumption in a more recent case, see *Wyeth v. Levine*, 555 U.S. 555, 565 (2009), but three Justices vigorously dissented from its application, see *id.* at 604, 622–24 (Alito, J., dissenting) (noting that the Court has “specifically rejected the argument . . . that the ‘presumption against pre-emption’ is relevant” in cases involving preemption on the theory that state law frustrates the purposes and objectives of federal law (quoting *Geier*, 529 U.S. at 906–07)).

implicated by state regulation of corporate law.<sup>129</sup> Finally, although the Court has twice addressed the preemptive scope of the Williams Act, none of the nine opinions issued in those cases even mentioned this presumption.<sup>130</sup>

It is also unlikely that the courts will be persuaded to limit the preemptive reach of the Williams Act by Judge Easterbrook's view that the Act merely prescribes federal procedures for tender offers and that any state law that does not directly conflict with those procedures should not be held preempted. Under this framework, virtually no state law—including, for example, a punitive tax on tender offers—would be preempted by the Williams Act. While this view is certainly consistent with Justice Scalia's opinion in *CTS*, as we have noted, no other Justice joined that opinion.

Moreover, this approach is inconsistent with the extensive analysis of congressional intent joined by all eight of the other Justices in both *MITE* and *CTS*.<sup>131</sup> None of that analysis—and similar analysis conducted by nearly every federal court to consider the preemptive scope of the Williams Act—would be necessary if this view were the law. And while several Justices, and particularly Justice Thomas, have often urged that the Court should not attempt to assess congressional purpose in preemption cases, a majority of the Court has consistently rejected that argument.<sup>132</sup>

In our view, the narrow approach to the Williams Act's preemptive scope has not gained widespread support among federal courts because this view rests upon an unusually formal distinction that leads to puzzling results that are inconsistent with the Act's purpose. Specifically, this approach would require courts to invalidate state laws with virtually no influence on the frequency or operation of tender offers while giving the states license to render the Williams Act a dead letter.

Suppose, for example, that a state adopted a law requiring a tender offeror to close an offer within nineteen days after initiating the offer. Because the Williams Act already mandates that such offers be kept open for twenty days, such a law would likely have a trivial effect on tender offers, reducing the period during which offers are kept open by just one day. Courts adopting the narrow view of the Williams Act's preemptive reach, however, would almost certainly invalidate such a law. As Judge Easterbrook explained in *Amanda*

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129. Drahozal, *supra* note 127, at 113 (“The Court has not adopted a test for identifying areas traditionally regulated by the states, but it has linked the requirement to the state police power . . .”).

130. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987) (separate opinions of White, Powell & Scalia, JJ.); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) (separate opinions of White, Marshall, Powell, Rehnquist, Stevens & O'Connor, JJ.).

131. See, e.g., *CTS*, 481 U.S. at 82–83; *MITE*, 457 U.S. at 631–34.

132. See, e.g., *Wyeth*, 555 U.S. at 588 (Thomas, J., concurring in the judgment) (“Preemption analysis should not be a freewheeling judicial inquiry into whether a state statute is in tension with federal objectives” (citation omitted) (internal quotation marks omitted)); see also *Arizona v. United States*, 132 S. Ct. 2492, 2524 (2012) (Thomas, J., concurring in part and dissenting in part) (“I have explained that the ‘purposes and objectives’ theory of implied preemption is inconsistent with the Constitution because it invites courts to engage in freewheeling speculation about congressional purpose that roams well beyond statutory text.”).

*Acquisition*, even on a narrow view of the Act's preemptive scope, state laws that are inconsistent with the Williams Act's procedural requirements must fall.<sup>133</sup>

On the other hand, state laws that would make the Williams Act virtually irrelevant to the tender-offer landscape would be upheld under this view. Suppose, for example, a state enacted a law authorizing a poison pill providing that, on the day any shareholder makes an unsolicited offer for control, that investor's shares are immediately cancelled for no consideration, and the shareholder's stake becomes worthless. Suppose, too, that most firms in this jurisdiction adopted such a pill. The effect of this development would be to eliminate virtually all tender offers. Yet because there is no direct conflict between that law and the "process of tender offers," jurists taking a narrow approach to the preemptive scope of the Williams Act would uphold such a law.<sup>134</sup>

In our view, an analysis of the Williams Act's relationship to state law that would invalidate rules with a trivial influence on tender offers but sustain laws that render the Act irrelevant to the tender-offer landscape is unpersuasive. Such an approach ignores the important purpose served by preemption doctrine and the Supremacy Clause itself: to prohibit the States from interfering with federal policy in an area where Congress has spoken. This view gives little weight to the objectives and purposes of the Act—even though standard preemption analysis requires close analysis of those considerations.<sup>135</sup>

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133. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 503–04 (7th Cir. 1989) (concluding that state laws cannot “tinker[] with any of the procedures established in federal law”).

134. See *id.* (arguing that the Williams Act “regulates [only] the *process* of tender offers”).

135. As we have explained, see *supra* note 17, the courts have made clear that conflict preemption exists where “*either* (1) compliance with both the state and federal law is ‘a physical impossibility’ or (2) state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” Nelson, *supra* note 17, at 228 (emphases added) (quoting *Boggs v. Boggs*, 520 U.S. 833, 844 (1997)). Some commentators have urged that this second category of preemption—requiring analysis of the purposes and objectives of Congress—be curtailed or eliminated. See *id.* at 279 n.173. A majority of the current Justices of the Supreme Court have repeatedly rejected this view, however, making clear that the Supremacy Clause requires courts to undertake careful analysis of the objectives and purposes of Congress when examining preemption claims. See, e.g., *Wyeth*, 555 U.S. at 604 (Thomas, J., concurring in the judgment) (setting forth Justice Thomas’s conclusion that he can “no longer assent to a doctrine that pre-empts state laws merely because they ‘stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives’ of federal law,” a view joined by no other Justice (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

We note that the narrow view of the Williams Act's preemptive scope advanced by Judge Easterbrook suggests that the Act only preempts those state laws that make it impossible for companies to comply with both the Act and the challenged state law. See *Amanda Acquisition*, 877 F.2d at 504 (rejecting a challenge to a Wisconsin law because it did “not . . . alter any of the procedures governed by federal regulation”). The Supreme Court has made it clear, however, that federal law also preempts any state laws that stand as an obstacle to the accomplishment of federal purposes and objectives. See *Wyeth*, 555 U.S. at 573–75. Thus, the narrow view of the Williams Act's preemptive scope is difficult to reconcile with the Court's current preemption jurisprudence.

For present purposes, however, the merits of a narrow approach to federal preemption doctrine in general, and to Williams Act preemption in particular, are not important. What is important is that this approach has not carried the day among jurists considering preemption challenges to state law based on the Williams Act. Thus, we think that the courts are unlikely to adopt this approach should they systematically consider such a challenge to state-law poison-pill rules. Although those rules would survive a constitutional challenge if the courts do adopt this framework, the constitutionality of state-law poison-pill rules is much less certain under the alternative approaches that the courts have used to address these challenges.

#### IV. CHANGING STATE LAW TO AVOID PREEMPTION

Thus far we have taken current state-law poison-pill rules as given and have shown that they might well be invalidated in the event that they were challenged on preemption grounds. State-law rules, however, may evolve—and, indeed, have evolved—considerably over time. Following the invalidation of some state-law poison-pill rules—or if state lawmakers recognize the risk that these rules will be invalidated—states may consider altering their corporate law to avoid preemption. This Part describes changes to state law that would make reviewing courts less likely to conclude that the Williams Act preempts state-law poison-pill rules.

Before proceeding, we note that a comprehensive analysis of the alternative approaches that lawmakers might consider to state-law poison-pill rules is beyond the scope of this Essay. In light of the significant risk that the courts might hold current state-law poison-pill rules preempted by the Williams Act, however, lawmakers may seek to alter state corporate law to avoid preemption. Thus, this Part provides a preliminary assessment of how lawmakers might shield state corporate law from the Williams Act.

Although courts have taken a wide variety of approaches when interpreting the preemptive scope of the Williams Act, most judges considering constitutional challenges to state antitakeover statutes have focused on the length of time state law enables incumbents to block a tender offer from reaching shareholders. For example, in *MITE* the Supreme Court concluded that the Illinois statute challenged there was preempted in part because of the “extended delay” that the law might impose on the tender-offer process.<sup>136</sup> And the Court upheld the Indiana statute challenged in *CTS* in part because the Justices were convinced that the potential fifty-day delay imposed by that law was “reasonable.”<sup>137</sup>

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136. *MITE*, 457 U.S. at 637–38 (“In enacting the Williams Act, Congress itself recognized that delay can seriously impede a tender offer, and sought to avoid it.” (quoting *Great W. United Corp. v. Kidwell*, 577 F.2d 1256, 1277 (5th Cir. 1978), rev’d, *Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979))) (internal quotation marks omitted).

137. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 82 n.7 (1987); see also *id.* at 85 (noting, by contrast, that the Illinois statute struck down in *MITE* had the “potential [to impose] indefinite delay” on the tender-offer process).



Similarly, lower courts considering preemption challenges to state antitakeover statutes have emphasized the period of time that state law allows incumbents to delay a tender offer. For example, those courts that have required state laws to provide bidders with a meaningful opportunity for success have suggested that, to preserve a meaningful opportunity for hostile bidders, state law must not impose such a lengthy delay on tender offers that bidders would be deterred from proceeding.<sup>138</sup> And the courts that have held that state laws must preserve some shareholder autonomy with respect to tender offers have indicated that state laws that impose lengthy delays compromise shareholders' freedom to decide whether to accept an offer.<sup>139</sup>

Moreover, we think that courts focusing on whether state takeover law enhances or reduces shareholder value would be more likely to uphold laws that do not empower directors to impose lengthy delays on the tender-offer process. The principal costs that state-law poison-pill rules impose upon investors are the agency costs that arise when incumbents use these rules to perpetuate themselves in office despite the presence of a hostile bidder.<sup>140</sup> It follows, then, that laws that permit incumbents to block hostile bids for lengthy periods of time will expose investors to more significant agency costs and thus will be less likely to enhance shareholder value.

Taken together, in our view the cases interpreting the preemptive scope of the Williams Act suggest that state-law poison-pill rules that limit the period of time during which directors can use the pill to block a disfavored tender offer would be more likely to survive constitutional scrutiny. Thus, lawmakers seeking to shield these rules from preemption should consider placing meaningful limitations on how long directors may keep poison pills in place. For example, state law could stipulate that a pill may be kept in place for only a specified period of time without shareholder approval.

Although the precise scope of such time limits is beyond the scope of this Essay, we note that corporate law in several jurisdictions outside the United States limits the amount of time during which boards may use a poison pill to block a tender offer from shareholder consideration. For example, Canadian law provides that a poison pill may not be kept in place without shareholder approval if regulators conclude that the pill has given directors sufficient time to consider alternatives to the hostile offer.<sup>141</sup> Similarly, Japanese law allows

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138. See, e.g., *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988) (determining whether bidder has been given meaningful opportunity for success depends, among other things, on whether state law “impose[s] an indefinite or unreasonable delay on offers”).

139. See, e.g., *Hyde Park Partners v. Connolly*, 839 F.2d 837, 852–53 (1st Cir. 1988) (concluding that the Massachusetts law challenged in that case was likely preempted because it “alter[ed] the balance between management and offerors in a manner that ultimately . . . work[ed] to the detriment of investors”).

140. See, e.g., *Bebchuk et al.*, *supra* note 15, at 792 (describing standard agency costs that accompany use of poison pills).

141. See, e.g., *Canadian Jorex Ltd. (Re)* (1992), 15 O.S.C. Bull. 257 (Can. Ont. Sec. Com.) (holding that a poison pill has “outlived its usefulness” when directors have had sufficient time to consider bid).

companies to adopt poison pills only if there is some mechanism for shareholders to eliminate them, including a sunset provision limiting the time during which the pill may be kept in place without shareholder approval.<sup>142</sup> Thus, as experience in other jurisdictions has shown, legal arrangements limiting the time during which directors may use a poison pill to block a tender offer from being considered by shareholders can be successfully implemented.

Indeed, even in the United States, many once believed that state law would develop, over time, to require that poison pills include a mechanism enabling shareholders to redeem poison pills after a limited period of time. Anticipating that the law might move in that direction, in 1987 the creators of the original poison pill designed a second-generation pill that allowed “qualified” bidders to call a special shareholder meeting within 90 to 120 days following the bidder’s request—and that provided that shareholders could, by majority vote at the special meeting, redeem the pill.<sup>143</sup>

Of course, since 1987 state law has taken a different path, leading practitioners to drop the special-meeting procedure from subsequent versions of the pill. State law today authorizes incumbents to use the pill to delay hostile offers for lengthy periods of time without shareholder approval. As we have explained, however, this shift brings state-law poison-pill rules into significant tension with the Williams Act. Lawmakers seeking to address that tension would do well to recall that the creators of the pill itself initially contemplated limits on the amount of time that incumbents could use the pill to block a tender offer. By changing state-law poison-pill rules to authorize the use of pills only for a limited period of time, lawmakers could render the rules more likely to be held consistent with the Williams Act.

#### CONCLUSION

In this Essay, we have challenged the widely shared view that the significant line of cases in which federal courts reviewed the constitutionality of state antitakeover laws is no longer practically relevant. We have shown that, by contrast, the principles developed in these cases raise serious questions about the validity of the state-law rules authorizing the use of the poison pill, the antitakeover device that plays a key role in the corporate landscape. We have conducted a systematic analysis of the validity of these rules and have provided a framework for assessing preemption challenges to them.

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142. See, e.g., Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from Air Line Pilots Ass’n, International v. UAL Corp.*, 120 Harv. L. Rev. 1239, 1243 (2007) (citing Ministry of Econ., Trade & Indus. & Ministry of Justice, *Guidelines Regarding Takeover Defenses for the Purposes of Protection and Enhancement of Corporate Value and Shareholders’ Common Interests* 9 (2005)).

143. See Memorandum from M. Lipton, Wachtell, Lipton, Rosen & Katz, to clients, *A Second Generation Share Purchase Rights Plan* (July 14, 1987) (on file with the *Columbia Law Review*) (describing this mechanism); see also Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. Pa. L. Rev. 1, 70 (1987) (“[T]he new pill provides that, under certain circumstances, a special shareholders meeting will be held to determine whether the pill should be redeemed.”).

Our analysis indicates that challenges to the validity of state-law poison-pill rules would likely have major consequences. We have shown that such challenges could well result in the invalidation of the current state-law rules governing poison pills on grounds of Williams Act preemption. Furthermore, while state lawmakers could change these rules to enable them to survive a preemption challenge, the changes necessary to accomplish this—imposing significant limits on the length of time during which incumbents may use a poison pill to block an unsolicited offer—would themselves bring about major changes to how American corporations are governed and acquired.

Either way, recognizing the tension between current state-law poison-pill rules and the Williams Act could have profound implications for the corporate landscape. We expect that litigation over these questions will have a significant effect on mergers and acquisitions practice, the vigor with which the market for corporate control operates, and how the possibility of a hostile offer affects the decisions of incumbent managers and directors throughout American corporations. We hope that our analysis will contribute to the recognition of this critical tension, and that the framework we have developed will prove useful to scholars, lawmakers, and courts in their future examination of this important subject.

