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ARTICLE

BUNDLING AND ENTRENCHMENT

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Because corporate charters can be amended only with shareholder approval, it is widely believed that new charter provisions appear in midstream only if shareholders favor them. However, the approval requirement may fail to prevent the adoption of charter provisions disfavored by shareholders if management bundles them with measures enjoying shareholder support. This Article provides the first systematic evidence that managements have been using bundling to introduce antitakeover defenses that shareholders would likely reject if they were to vote on them separately. We study a hand-collected dataset of 393 public mergers announced during the period from 1995 through 2007. While shareholders were strongly opposed to staggered boards during this period and generally unwilling to approve charter amendments introducing a staggered board on a stand-alone basis, the deal planners often bundled the mergers we study with a move to a staggered-board structure. In mergers in which the combined firm was one of the parties, a party's odds of being chosen to survive as the combined firm were significantly higher if it had a staggered board and the other party did not. Similarly, in mergers that combined the parties into a new firm, the new firm was significantly more likely to have a staggered board than the merging parties. Overall, we demonstrate that management has the practical ability to use bundling to obtain shareholder approval for pro-management arrangements that shareholders would not support on a stand-alone basis. We discuss the significant implications our findings have for corporate law theory and policy.

I. INTRODUCTION

A widely shared premise in the literature on corporate law and corporate governance is that charter provisions are those viewed by shareholders as efficient. The basis for this view is the assumption that these provisions receive explicit or implicit shareholder support.

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When firms go public, investors are presumed to price the provisions contained in the company's charter; as a result, the founders who take the company public have an incentive to take shareholders' preferences fully into account. After the company goes public, any amendment to the charter requires shareholder approval. This procedure is presumed to ensure that amendments to the charter are those favored by shareholders.

This rosy view of charters ignores, however, the concern that management could use its agenda control to obtain shareholder consent to a charter amendment that shareholders disfavor by bundling the amendment with a sweetener. As long as the package is on the whole value-increasing for shareholders, shareholders will vote for it.

The practice of bundling is well known to political scientists,[1] and concerns that bundling is also used in firms have been expressed in the corporate law literature.[2] Thus far, however, it has remained unclear whether bundling by corporate managers is a mere theoretical possibility or a practically significant issue. This Article is the first attempt to assess the issue empirically. Our findings indicate that bundling is indeed a problem of practical significance that deserves the attention of policymakers.

Our empirical study focuses on one type of bundling: bundling a move to a staggered-board structure with a merger. We test whether bundling has enabled management to obtain the protection of staggered boards — boards divided into three classes of directors with staggered terms, which can delay a hostile takeover by a year — during a period in which shareholders would not support stand-alone proposals to stagger the board.

As we discuss in Part II, during the past fifteen years, institutional investors have been strongly opposed to staggered boards. They have been unwilling to vote for stand-alone charter amendments to stagger

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[1] *See, e.g.*, R. DOUGLAS ARNOLD, THE LOGIC OF CONGRESSIONAL ACTION 102–03, 219, 255–56 (1990) (discussing, respectively, omnibus bills generally, the passage of the Tax Reform Act of 1986, and the passage of the Natural Energy Act of 1978); *see also* Martin Tolchin, *In the Face of Controversy, Packaging*, N.Y. TIMES, Feb. 21, 1983, at B6 (providing examples of legislative package deals).

[2] *See* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 864–65 (2005) (discussing charter amendments and reincorporations); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1475 (1992) [hereinafter Bebchuk, *Federalism and the Corporation*] (discussing reincorporations); Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1839–40 (1989) [hereinafter Bebchuk, *Limiting Contractual Freedom in Corporate Law*] (discussing charter amendments); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1577–79 (1989) (discussing charter amendments).

boards, and companies have not been adopting such amendments.[3] On the contrary, companies with staggered boards have been moving in the opposite direction by repealing their staggered-board structures in response to shareholder pressure.[4] Nevertheless, we show that, during this very period, directors and executives not enjoying the protection of staggered boards have often been able to obtain this protection through bundling.

We study this issue using a hand-collected dataset of the governance consequences of 393 mergers of companies of similar size during the period from 1995 through 2007. In this type of transaction, the assets of two firms are put under one management and the parties to the transaction decide how to divide the economic pie and who will run the combined firm. Whatever choices are made with respect to these key issues, the deal can be designed in a number of ways that enable the combined firm to have a staggered board even if only one of the parties, or neither party, has a staggered board prior to the merger.

We begin by examining mergers in which the combined firm inherited the charter of one of the parties and retained its original board structure. These deals increased the incidence of staggered boards by about 8% (from about 61% to about 66%). The trend of moving from nonstaggered boards to staggered boards is even stronger when we focus on deals in which one party had a staggered board while the other did not, that is, the deals in which the choice of the party that remained public determined the combined firm's board structure. In these deals, the party with a staggered board was about 62% more likely than the other party to become the combined firm. These findings hold true when we control for other factors affecting this choice.

We continue with mergers in which the combined firm's board structure was independent of the parties' charters, either because the combined firm was a new holding company or because the combined firm was one of the parties that modified its board structure through a charter amendment in the course of the deal. In each of these categories, we find that the mergers resulted in a significant increase in the incidence of staggered boards. Taken as a whole, these deals increased the incidence of staggered boards by about 31% (from about 58% to about 76%). This increase is larger than the increase in deals in which the combined firm inherited the charter of one of the parties, presum-

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[3] *See, e.g.*, Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713, 723–28 (2003); Michael Klausner, *Institutional Shareholders, Private Equity, and Antitakeover Protection at the IPO Stage*, 152 U. PA. L. REV. 755, 759–61 (2003).

[4] *See, e.g.*, Mira Ganor, *Why Do Managers Dismantle Staggered Boards?*, 33 DEL. J. CORP. L. 149 (2008) (documenting management initiatives to destagger boards following shareholder pressure); Bhattiprolu Murti, *More Boards May End Staggered Terms*, WALL ST. J., June 8, 2005 (LEXIS) (same).

ably because the parties assigned greater weight to their preferences regarding board structure when they designed the board from scratch.

Our results have important implications for corporate law theory and policy. Staggered boards are the key antitakeover defense and have been the subject of widespread criticism. This criticism, however, has to reply to the claim that staggered boards are legitimate because they receive shareholder consent.[5] We find that, in a significant number of cases, the adoption of a staggered board is due to bundling rather than to genuine shareholder support.[6] While this finding does not prove that staggered boards are inefficient, it suggests that shareholder consent cannot guarantee their efficiency.

Beyond the particular issue of staggered boards, our results indicate that bundling, which has thus far been viewed as a mere theoretical possibility, is a real-world phenomenon that deserves attention. We show that managers have made significant use of their bundling power to gain an economically meaningful increase in the incidence of staggered boards during a period in which shareholders have been opposed to this antitakeover protection. This evidence suggests that control of the corporate agenda enables management to win approval of measures that shareholders would not approve on a stand-alone basis.

These findings call for a reconsideration of fundamental corporate law principles. In particular, they suggest that charter provisions should not always be presumed to be efficient, and they make a case for reforms that would constrain management's ability to manipulate shareholder approval through bundling. One possible reform is to expand the judicial review of shareholder-approved arrangements in general and of stock mergers in particular. Given the understandable reluctance of courts to overrule corporate decisions, however, our preferred reform is to enable shareholders to unbundle merger proposals by, for example, authorizing shareholders to undo charter changes introduced through bundling. If one is concerned that the inability to bundle would discourage managers from pursuing some value-creating mergers, the concern can be addressed by going further and granting shareholders general power to initiate charter amendments.

[5] *See, e.g.*, Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 801–02 (2007).

[6] One might argue that the motivation for staggering the board in some of these mergers was to prevent one party's representatives on the combined firm's board from unseating the other party's representatives, rather than to prevent ouster of the entire board by a hostile bidder. Once in place, however, a staggered board retards both types of control changes, and it is forced upon shareholders as part of the deal, rather than as a feature they may choose to leave out.

Beyond charter provisions, our findings have implications for shareholder approval of management proposals in general.[7] Legislators, regulators, and judges considering rules that require or encourage management to obtain such approval should be aware of the possibility that management may use bundling to circumvent these rules.

Finally, our findings warrant further empirical work on the bundling phenomenon. Bundling mergers with moves to a staggered-board structure may well be only the tip of the iceberg. Future work should examine whether management uses bundling to pass changes other than board staggering and whether it bundles these changes with sweeteners other than mergers. Identifying the full scope and consequences of bundling is important for understanding the effectiveness of shareholder approval requirements and legal policies relying on them.

The remainder of this Article is organized as follows. Part II describes the important role of charter provisions in corporate law theory. It summarizes the standard view that charter provisions are grounded in shareholder consent and thus should be presumed to be efficient, and it explains the theoretical possibility of bundling. It also discusses why staggered boards and mergers provide a fitting setting to test whether bundling occurs. Part III presents our data and our empirical analysis. Part IV examines the implications of our findings for corporate law policy and theory and for further empirical work. Part V concludes.

II. BUNDLING AND CORPORATE LAW

This Part lays out the theory underlying our empirical study. We begin by hypothesizing that shareholder approval of charter amendments or other management proposals will fail to protect shareholders if management can bundle proposals that shareholders disfavor with proposals that they welcome and get shareholders to approve them as a package. We then explain our choice of testing this hypothesis using a particular bundle, in which shareholders are asked to stagger the board in the charter as part of a merger.

A. The Bundling Problem

The foundational document defining how a firm is governed is its charter. Because shareholders know what is in the charter before buying their shares and can veto any charter amendment thereafter, it is commonplace to assume that the charter embodies their preferences. But this assumption fails if management can obtain shareholder ap-

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[7] For example, shareholder approval is required for reincorporation, and commentators have inferred from this requirement that reincorporations take place only when favored by shareholders. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 18–19 (1993).

proval for an amendment that shareholders disfavor by bundling it with a sweetener. Below we elaborate on this possibility.

1. Charter Provisions and Shareholder Consent. — Every company has a charter setting forth how the company is organized and run.[8] This charter is the corporate equivalent of a constitution. Charter provisions stand above bylaws and board decisions.[9] They also receive judicial deference as long as they do not contradict the express language of the law.[10] In the context of hostile takeovers, for example, courts do not scrutinize charter-based antitakeover defenses.[11]

Consistent with the fundamental nature of the charter, the shareholders' right to vote on charter amendments is viewed as an important element of the corporate structure.[12] Under state corporate law, once the corporation issues stock, its charter can be amended only if the board proposes the amendment and shareholders vote to approve it.[13] This means that charter provisions must be present when a company goes public or be approved by shareholders if added later. One way or another, it might be argued, shareholders at least implicitly consent to the provisions, and their consent makes the provisions likely to be value-maximizing.[14]

2. Bundling. — Some commentators have argued, however, that while management must obtain shareholder approval for changes in

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[8] *See, e.g.*, DEL. CODE ANN. tit. 8, § 101 (2001).

[9] *See, e.g.*, *id.* § 109 (providing that the charter stands above the bylaws); *id.* § 141(a) (providing that the charter stands above board decisions).

[10] For an example of a charter provision read narrowly to avoid conflict with the language of the code, see *Waltuch v. Conticommodity Services, Inc.*, 88 F.3d 87 (2d Cir. 1996), which applied Delaware law. Board actions, in contrast, are subject to fiduciary-duty review even when they violate no statute. *See, e.g.*, Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) ("Management contends that it has complied strictly with the provisions of the new Delaware Corporation Law in changing the by-law date. The answer to that contention, of course, is that inequitable action does not become permissible simply because it is legally possible.").

[11] *See, e.g.*, Seibert v. Gulton Indus., Inc., 5 DEL. J. CORP. L. 514 (Del. Ch. June 21, 1979), *aff'd*, 414 A.2d 822 (Del. 1980) (dismissing a challenge to the validity of a charter-based antitakeover defense).

[12] *See* ROBERT CHARLES CLARK, CORPORATE LAW 94 (1986) (describing the right to vote on charter amendments as one of the basic rights of shareholders).

[13] *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b).

[14] *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 7, 17–22 (1991) (arguing that shareholders price charter provisions when the firm conducts an initial public offering); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1736–44 (2006) (same); Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1601–02 (1989) (arguing that shareholders price charter provisions when the firm conducts an initial public offering and approve only value-increasing amendments thereafter); Stout, *supra* note 5 (arguing that the presence of staggered boards in the charters of firms conducting initial public offerings suggests that staggered boards are efficient). *But see* Bebchuk, *supra* note 3 (discussing reasons to doubt the efficiency of charter provisions of firms conducting initial public offerings).

the charter, it can secure this approval even for changes that shareholders disfavor by bundling the changes with measures that shareholders welcome.[15] What allows management to do so is its control of the corporate agenda. Only the board is authorized under state corporate law to bring proposals for fundamental changes before shareholders for approval.[16] Shareholders lack parallel authority to propose these changes and must vote on the board's proposals on an up-or-down basis.[17]

Consider a charter amendment desired by management that would lower the firm's value by $100 million. Suppose that shareholders know it would have this effect. In this case, management would not be able to obtain shareholder approval of the change on a stand-alone basis. However, suppose that management bundles the amendment with an unrelated measure that would produce a benefit of $110 million to shareholders. Because the overall effect of the package on shareholder wealth is positive, shareholders may rationally vote for the package. They face a take-it-or-leave-it offer that they would rather take than leave. And once they approve the amendment, they are stuck with the provision they disfavor because they cannot initiate charter amendments.

3. Is Bundling a Problem? — Some argue that the possibility of bundling does not raise significant concerns because shareholders would still be made better off by the package as a whole, and this is what counts.[18] In the example above, even though shareholders end up with a charter provision they do not favor, they still benefit overall.

We disagree. Management should *maximize* shareholder value, not just increase it.[19] In the above example, it would be desirable for management to produce a gain of $110 million for shareholders by

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15 *See* Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 2, at 864–65 (discussing charter amendments and reincorporations); Bebchuk, *Federalism and the Corporation*, *supra* note 2, at 1475 (discussing reincorporations); Bebchuk, *Limiting Contractual Freedom in Corporate Law*, *supra* note 2, at 1839–40 (discussing charter amendments); Gordon, *supra* note 2, at 1577–80 (discussing charter amendments).

16 *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (Supp. 2008) (setting forth the procedures for proposing mergers); DEL. CODE ANN. tit. 8, §§ 242(b)(1), 271(a) (2001) (setting forth, respectively, the procedures for proposing charter amendments and asset sales); *id.* § 275(a), *amended by* Act of Apr. 10, 2009, ch. 14, § 14, 77 Del. Laws, 2009 Del. ALS 14, *14 (LEXIS) (setting forth the procedures for proposing dissolutions).

17 The only fundamental change that shareholders can propose is to amend the bylaws. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(a) (2001). Even this power, however, is limited because the bylaws must agree with the charter. *See, e.g.*, *id.* § 109(b). Thus, for example, shareholders cannot repeal a charter-based staggered-board structure through a bylaw amendment. Shareholders can also unanimously initiate a dissolution. *See, e.g.*, *id.* § 275(c). But this power is impractical in public firms with numerous shareholders.

18 *See* Romano, *supra* note 14, at 1612.

19 *See* ROMANO, *supra* note 7, at 2.

enabling shareholders to capture the benefit without bundling it with the disfavored charter amendment. The bundling of the charter amendment, which reduces shareholder value by $100 million compared with the best state of affairs, is a deviation from shareholder interests.

Moreover, to the extent that some charter provisions owe their existence to bundling, they are not ones that are favored by shareholders and should not be presumed to be value-maximizing. Thus, bundling is important because it has implications for assessing the merits of existing charter provisions.

4. Does Bundling Occur? — The literature has thus far identified one period, dating back three decades, in which there was a significant incidence of bundling. From the late 1970s through the mid-1980s, managements obtained shareholder approval for dozens of dual-class recapitalizations despite their entrenching effect.[20] Typical dual-class recapitalizations offered public shareholders increased dividends in return for exchanging their stock for a new class of low-voting stock, thereby leaving management with high-voting stock and a lock on control. About a hundred dual-class recapitalizations were proposed in those years, and consistent with their entrenching effect they were associated with significant stock price declines.[21] Nevertheless, shareholders routinely approved them. Although the antitakeover properties of dual-class recapitalization were known, shareholders were willing to trade voting rights of uncertain future value for immediate dividends.[22]

Before long, however, dual-class recapitalizations disappeared from the corporate landscape. At first, the Securities and Exchange Commission (SEC) adopted a rule prohibiting the practice in 1988.[23] In 1990, a federal court held that the SEC lacked authority to adopt the rule.[24] By the end of 1994, however, the SEC had convinced the main stock exchanges to incorporate a similar ban into their listing require-

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[20] *See* Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1, 48–49, 80–85 (1988); Gregg A. Jarrell & Annette B. Poulsen, *Dual-Class Recapitalizations as Antitakeover Mechanisms: The Recent Evidence*, 20 J. FIN. ECON. 129 (1988).

[21] *See* Jarrell & Poulsen, *supra* note 20, at 130.

[22] Once the plan was approved, individual shareholders were typically given the choice whether to exchange their stock for the new class of low-voting stock. It was rational for all individual stockholders to do so because their choice would have no impact on the likelihood of a takeover. *See* Richard S. Ruback, *Coercive Dual-Class Exchange Offers*, 20 J. FIN. ECON. 153, 164–65 (1988).

[23] *See* Voting Rights Listing Standards; Disenfranchisement Rule, 53 Fed. Reg. 26,376 (July 12, 1988) (codified as amended at 17 C.F.R. § 240.19c-4 (2009)), *invalidated by* Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

[24] *See Bus. Roundtable*, 905 F.2d 406.

ments, sidestepping the issue of the SEC's lack of authority.[25] With dual-class recapitalizations gone, the question remains whether bundling occurs in other contexts.[26] This empirical question is the one we investigate in this Article.

B. Testing the Existence of Opportunistic Bundling

To test empirically whether bundling occurs, we focus on one type of governance change — the adoption of a staggered-board structure — and on one type of sweetener with which it can be bundled — a merger. We explain our choice below.[27]

1. Staggered Boards as a Case Study. — Although state laws provide for the annual election of the entire board as the default arrangement, they permit company charters to divide the board into three classes of directors serving for staggered three-year terms, so that each year only a third of the board comes up for election.[28] Staggered board terms are ordinarily inconsequential because personnel changes on the board are slow and gradual anyway. However, staggered terms are important in control contests. When a company has a staggered

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[25] *See* Order Granting Approval to Rule Changes Relating to the Exchanges' and Association's Rules Regarding Shareholder Voting Rights, Exchange Act Release No. 35,121, 59 Fed. Reg. 66,570, 66,570 (Dec. 27, 1994).

[26] Some may think that bundling has been precluded by SEC Rule 14a-4(a)(3), which is known as the "unbundling rule." *See* 17 C.F.R. § 240.14a-4(a)(3) (2009). Despite its name, however, this rule does not prevent management from presenting proposals to shareholders for approval as a package. The unbundling rule permits management to condition the adoption of one proposal on the approval of another proposal. The rule requires only that shareholders be able to vote on the proposals separately — even if the approval of only one means that neither is implemented. Moreover, even this weak rule does not cover charter amendments effected through the merger of firms with different charters. *See* DIV. OF CORP. FIN., U.S. SEC. & EXCH. COMM'N, MANUAL OF PUBLICLY AVAILABLE TELEPHONE INTERPRETATIONS (5th Supp. 2004), http://www.sec.gov/interps/telephone/phonesupplement5.htm.

[27] Prior research has documented the emergence of charter-based antitakeover defenses in midstream, but not through bundling. Thus, it is now known that in corporate spinoffs (in which public firms take their subsidiaries public), staggered boards are more common among the spinoff firms than among their parents. *See* Robert Daines & Michael Klausner, *Agents Protecting Agents: An Empirical Study of Takeover Defenses in Spinoffs* (Stanford Law Sch. John M. Olin Program in Law & Econ., Working Paper No. 299, 2004), *available at* http://ssrn.com/abstract=637001. Spinoffs, however, do not involve bundling because they are effected either through a distribution of the subsidiary's shares to the parent's shareholders or through a sale of those shares in a public offering. *See id.* at 9 (reporting that from a sample of 277 spinoffs from mid-1993 through 1997, 91 were share distributions and 186 were public offerings). In a share distribution, shareholders have no say. In a public offering, shareholders can price the offered shares and are not limited to accepting or rejecting the deal on management's terms.

[28] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d) (Supp. 2008). Although this statute also permits company bylaws to stagger the board, this option is less commonly used than staggering the board in the charter because shareholders can amend the bylaws to eliminate the staggered structure. *See* John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CAL. L. REV. 1301, 1392–93 (2001). Some states permit staggered boards with four classes. *See, e.g.*, N.Y. BUS. CORP. LAW § 704(a) (McKinney 2003).

board, replacing a majority of directors and gaining control of the board requires winning two consecutive elections that are one year apart. This delay will doom most hostile takeovers because it prevents bidders from taking control of the board and deactivating the company's antitakeover defenses, including its poison pill.[29]

(a) Shareholder Opposition to Staggered Boards. — We focus on moves to staggered boards because shareholders were strongly opposed to staggered boards during the period we study. Shareholders were willing to vote for proposals to stagger boards during the 1980s and the beginning of the 1990s, before the transformation of staggered boards into a powerful antitakeover device was complete.[30] Eventually, however, shareholders caught on. By the beginning of our study period and throughout that period, shareholders were strongly opposed to staggered boards, and firms that did not already have a staggered board in their charter were generally unable to adopt one.[31] Indeed, during the period we study, shareholders were persistently pressuring firms that had staggered boards to dismantle them.[32] From 1995 through 2007, shareholders voted on more than four hundred proposals to dismantle a staggered board.[33] Over roughly the same period, the average percentage of votes cast in favor of these proposals increased steadily, from 45% in 1996 to 68% in 2007.[34] In many of these

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[29] A poison pill is a dividend of rights allowing all shareholders other than the hostile bidder to buy additional shares at a deep discount if the bidder crosses a threshold of share ownership, which dramatically raises the cost of the takeover. *See* WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 522–25 (3d ed. 2009) (describing how poison pills work).

[30] *See* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 940–43 (2002) (reporting that 6% of staggered boards were installed before 1974, when hostile takeovers became legitimate in the corporate marketplace, that another 17% were installed before 1985, when the Delaware courts validated the use of a poison pill by the board to resist takeovers, and that another 53% were installed before 1990, when the Delaware courts permitted the board to resist takeovers indefinitely); *see also* Re-Jin Guo, Timothy A. Kruse & Tom Nohel, *Undoing the Powerful Anti-Takeover Force of Staggered Boards*, 14 J. CORP. FIN. 274, 275 n.7 (2008) (reporting that most of the firms in a sample of firms with staggered boards staggered their boards before 1990 and that most of the firms that staggered their boards later did so before going public).

[31] *See* Bebchuk, *supra* note 3, at 724–25; Klausner, *supra* note 3, at 758–59 (providing statistics); Martijn Cremers & Allen Ferrell, Thirty Years of Shareholder Rights and Firm Valuation 35 fig.3A (Feb. 1, 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1413133 (documenting a gradual increase in the incidence of staggered boards from 1978 until 1995, followed by a gradual decrease from 1996 until 2006).

[32] *See* Ganor, *supra* note 4, at 155–58; Guo et al., *supra* note 30, at 275; Murti, *supra* note 4; sources cited *supra* note 31.

[33] This statistic is based on the 1996 to 2007 editions of the Georgeson Annual Corporate Governance Review. *See* Georgeson, Annual Corporate Governance Review, http://www.georgesonshareholder.com/usa%20/acgr09.php (last visited March 27, 2010).

[34] *See* GEORGESON, 2007 ANNUAL CORPORATE GOVERNANCE REVIEW 18 (2008), *available at* http://www.georgesonshareholder.com/usa/download/acgr/acgr2007.pdf; GEORGESON

years, the shareholder approval rate for destaggering proposals was the highest for any type of shareholder proposal.[35]

Because the boards addressed in these shareholder proposals were typically staggered in the charter, which only the board can propose to amend, the proposals were by and large advisory. Nevertheless, they had an impact. Many boards initiated a charter amendment to destagger the board in response to (or in anticipation of) the passage of a shareholder destaggering proposal. During the 2006 proxy season alone, 46 companies brought to a shareholder vote proposals to destagger the board, with 45 of those companies' boards recommending that shareholders vote in favor of the change.[36] The overwhelming majority of these proposals reached the required threshold of shareholder support to make the change.[37] As a result of the significant incidence of board destaggering, the number of S&P 500 companies with staggered boards dropped from 62% to 45% between 1998 and 2006.[38]

While shareholders have probably been able to press fewer companies to abandon the staggered-board structure than they wish, managers have clearly been unable to get shareholders to approve new staggered boards on a stand-alone basis.

(b) Empirical Evidence on Staggered Boards. — Existing evidence on the effects of staggered boards suggests that shareholders' solid opposition to them is justified. To begin, a study by Professors Lucian Bebchuk, John Coates, and Guhan Subramanian shows that staggered boards have a significant effect on outcomes of unsolicited tender offers.[39] It finds that having a staggered board reduces the return to the shareholders of takeover targets both in the short run and in the long run.[40] Looking beyond companies that were the target of an unsolicited bid, a study by Professors Bebchuk and Alma Cohen finds that staggered boards are associated with lower firm value.[41] The study also finds evidence suggesting that staggered boards bring about

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SHAREHOLDER, 1996 ANNUAL MEETING SEASON WRAP-UP: CORPORATE GOVERNANCE 7 (1997), *available at* http://www.georgesonshareholder.com/usa/download/acgr/acgr1996.pdf.

[35] *See* Georgeson, *supra* note 33.

[36] *See* GEORGESON, 2006 ANNUAL CORPORATE GOVERNANCE REVIEW 3 (2007), *available at* http://www.georgesonshareholder.com/usa/download/acgr/acgr2006.pdf.

[37] *See id.* at 2–3.

[38] *See* DAVID DRAKE, GEORGESON, DISPATCHES FROM THE PROXY FRONT: SHAREHOLDER ACTIVISM AND THE 2008 PROXY SEASON 13 (2007), http://www.georgesonshareholder.com/usa/download/articles/Shareholder_Activism_and_2008_Proxy_Season120407.pdf.

[39] *See* Bebchuk et al., *supra* note 30, at 930 fig.3.

[40] *See id.* at 934–35.

[41] *See* Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 409 (2005). This association was subsequently confirmed by Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501, 509 (2007), and Michael D. Frakes, *Classified Boards and Firm Value*, 32 DEL. J. CORP. L. 113, 117 (2007).

lower firm values, rather than the other way around.[42] In another study consistent with these findings, Professors Re-Jin Guo, Timothy Kruse, and Tom Nohel report that firms' decisions to dismantle a staggered board are associated with an increase in market value.[43]

Some empirical studies shed light on the potential channels though which staggered boards bring about lower firm values. A study by Professor Olubunmi Faleye shows that firms with staggered boards are less likely to replace poorly performing managers, less likely to compensate managers based on performance, less likely to face proxy challenges, and less likely to implement advisory shareholder resolutions.[44] In addition, a study by Professors Ronald Masulis, Cong Wang, and Fei Xie finds that firms with staggered boards make worse acquisition decisions according to the marketplace: these firms' announcements of acquisition plans are associated with lower stock returns than similar announcements by firms with nonstaggered boards.[45]

The only empirical study identifying a potentially beneficial effect of staggered boards is by Professors Thomas Bates, David Becher, and Michael Lemmon.[46] This study reports that staggered boards are associated with a higher acquisition premium.[47] It also finds, however, that staggered boards are associated with a lower likelihood of receiving a bid and, more importantly, it confirms that staggered boards are overall associated with lower firm values.[48] Thus, on the whole, the empirical literature provides a strong basis for concluding that staggered boards are value-reducing.

However, the evidence that staggered boards are bad for shareholders is secondary for our purposes. What matters most is that shareholders have clearly been strongly opposed to staggered boards. Thus, to the extent that managements have introduced staggered boards using bundling, the bundling has enabled them to obtain charter provisions that shareholders disfavor.[49]

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[42] *See* Bebchuk & Cohen, *supra* note 41, at 426–28.

[43] *See* Guo et al., *supra* note 30, at 287.

[44] *See* Faleye, *supra* note 41, at 503.

[45] *See* Ronald W. Masulis, Cong Wang & Fei Xie, *Corporate Governance and Acquirer Returns*, 62 J. FIN. 1851, 1867–69 (2007).

[46] *See* Thomas W. Bates, David A. Becher & Michael L. Lemmon, *Board Classification and Managerial Entrenchment: Evidence from the Market for Corporate Control*, 87 J. FIN. ECON. 656 (2008).

[47] *Id.* at 658.

[48] *Id.* at 675–76.

[49] Even commentators who believe that a staggered board can negotiate better deals on behalf of shareholders agree that shareholders should be the judges of whether to have a staggered board, especially when the board structure is modified after the shareholders bought their shares. *See, e.g.*, Lynn A. Stout, *Do Antitakeover Defenses Decrease Shareholder Wealth? The Ex Post/Ex Ante Valuation Problem*, 55 STAN. L. REV. 845, 858–60 (2002).

2. *Mergers as a Case Study.* — Because staggered boards encountered so much opposition from shareholders during the study period, getting shareholders to agree to them as part of a package would have required the other parts of the package to be economically meaningful. Merger transactions provide such an opportunity. They are sufficiently common and standardized to study, they are big and complex enough to overshadow a move to a staggered-board structure, and they can easily incorporate such a move into the deal structure itself.

We focus in our empirical study on mergers of two public firms of comparable size, in which the shareholders of both parties retain an interest in the combined firm. Corporate law gives the designers of these transactions enough flexibility to ensure that the combined firm will have a staggered board regardless of whether either party has one before the merger. As we explain below, due to a combination of state law requirements and stock exchange listing rules, the shareholders get to vote on the merger whenever the board structure of the combined firm will be different from that of their premerger firm.[50] The transaction will therefore occur only if these shareholders believe that, perhaps due to the existence of synergies from the combination, the transaction will benefit them. But they do not get a separate vote on whether the combined firm will have a staggered board. Rather, they vote on the deal as a whole.

Consider two companies that merge: *A* and *B*. The transaction will create a combined firm, *X*, in which shareholders of both *A* and *B* will have an interest, with the shareholders of one or both companies potentially drawing cash in conjunction with the transaction. The management teams of both companies will negotiate over the division of the pie (the fraction of the stock of *X* and the other consideration that the shareholders of each company will receive) and over the management of *X* (who the officers and directors of *X* will be). Regardless of how the negotiating teams allocate the value of the combined firm between the shareholders of the two companies and allocate control between the directors and officers of the two companies, they have the flexibility to provide that the surviving entity *X* will have a staggered board. There are three main ways to do so.

One approach is to structure a merger in which one of the parties becomes the combined firm. This can be done through a merger of *A* with a subsidiary of *B* or into *B* itself, where *B* becomes the combined firm.[51] We refer to these deals as "continuing-entity mergers." In

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[50] *See infra* notes 52–53 and accompanying text.

[51] A merger of *A* into *B* itself is often referred to as a "direct merger," and a merger of *A* with a subsidiary of *B* is often referred to as a "triangular merger." A triangular merger can be structured as a merger of *B*'s subsidiary into *A* (a "reverse triangular merger") or as a merger of *A* into *B*'s subsidiary (a "forward triangular merger"). *See* Theodore N. Mirvis, *Takeover Law and Prac-*

these mergers, as long as at least one of the parties has a staggered board, the designers of the transaction can ensure that management will enjoy the protection of a staggered board after the merger by choosing that party to become the combined firm. Suppose that *A* does not have a staggered board and *B* does. The parties can specify that the deal that comes before shareholders for a vote will leave *B*, with its staggered board, as the combined firm. This can be done even if *A* is the larger party, even if *A*'s officers and directors will be the dominant players in the combined firm, and even if *A*'s name will be the combined firm's name. All the parties need to do is to specify in the merger agreement that *B* will be the party that remains public, that *B*'s board will be populated mainly or exclusively by *A*'s directors, and that *B* will change its name to *A*'s name. Because the shareholders of *A* trade their stock for the stock of *B*, they will vote on the deal as a whole.[52] However, they will not get a separate vote on the choice of *B* as the combined firm.

An alternative approach is to structure a merger in which the combined firm is a new firm. This can be done through a merger of *A* and *B* into a new firm or through a merger of *A* and *B* with subsidiaries of a new firm.[53] We refer to these deals as "new-entity mergers." In these mergers, the planners of the deal can specify that the new entity will have a staggered board even if neither *A* nor *B* has one. Here the shareholders of both companies will vote on the deal as a whole because they will all trade their stock for the stock of the new firm. But as in continuing-entity mergers, they will not get a separate vote on the choice to have a staggered board in this firm.

Bundling can also be achieved through a hybrid of a continuing-entity merger and a new-entity merger. In this hybrid structure, *A*

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tice 2008, *in* WHAT ALL BUSINESS LAWYERS MUST KNOW ABOUT DELAWARE LAW DEVELOPMENTS 2009, at 201–02 (PLI Corp. Law & Practice, Course Handbook Series No. B-1740, 2009) (describing the various merger structures).

[52] *See* DEL. CODE ANN. tit. 8, § 251 (2001 & Supp. 2008) (requiring that mergers be approved by the shareholders of the "constituent corporations"). Unlike the shareholders of *A*, the shareholders of *B* will vote on arms-length mergers only if *B* issues new stock that amounts to at least 20% of its outstanding common stock to pay the shareholders of *A*. *See id.* § 251(g) (referring to mergers of *A* into *B*); NYSE Euronext, Inc., NYSE Listed Company Manual § 312.03(c) (2008) (referring to mergers of *A* with a subsidiary of *B*); NASDAQ, Inc., NASDAQ Stock Market Rules § 5635(a)(1) (2009) (referring to mergers of *A* with a subsidiary of *B*); NYSE Euronext, Inc., NYSE Amex Company Guide § 712(b) (2008) (referring to mergers of *A* with a subsidiary of *B*). For our purposes, however, the vote of interest is the vote by the shareholders of *A* because it is *A*'s board structure that is changing. Their right to vote does not depend on how much common stock *B* will issue in the merger.

[53] This deal structure is often referred to as a "double-dummy merger." *See* Mirvis, *supra* note 51, at 202; Marie Leone, *Two Mergers Are Better than One*, CFO, Dec. 2005, at 35, 35; Allan Sloan, *The Double Dummy Can Be Very Smart*, NEWSWEEK, Mar. 19, 2007, at 26, 26; Marie Leone, *Microsoft, Yahoo: Double Dummies?*, CFO, Feb. 4, 2008, http://www.cfo.com/article.cfm/10636146.

merges with a subsidiary of *B* or into *B* as in a regular continuing-entity merger and *B* amends its charter, with the approval of this amendment being a condition to the merger. While the deal is structured as a continuing-entity merger, it resembles a new-entity merger in the flexibility it affords the parties to design the combined firm's charter as they like, rather than having to choose from their existing charters.

3. The Bundling Prediction. — The discussion thus far has established two points. First, managers enjoy enough flexibility in structuring mergers to choose whether the combined firm will have a staggered board or a nonstaggered one. Second, managers cannot generally get shareholders to agree to stagger the board on a standalone basis. This is presumably true also for combined firms that are created by mergers. If their boards are nonstaggered when formed, their shareholders will not agree to stagger them down the road because doing so would entrench management.

We therefore hypothesize that deal planners will prefer to structure mergers so that the combined firm will have a staggered board despite the negative effect of this structure on firm value. They will do so in one of three ways: by selecting the party that has a staggered board to become the combined firm, by making the merger conditional on the staggering of the board of the party that will become the combined firm, or by forming a new holding company with a staggered board and making it the combined firm.

To understand deal planners' calculations, let us suppose that the parties to the transaction are worth v_1 and v_2, respectively, and that the combined firm will be worth v_3 if it has a nonstaggered board and $v_3 - s$ if it has a staggered board. Let us also suppose that both parties' shareholders believe that $v_3 - s$ is lower than v_3. In this case, both parties' shareholders will prefer that the combined firm have a nonstaggered board because they will then have a larger pie to share. Nevertheless, as long as $v_3 - s > v_1 + v_2$ (that is, as long as the market estimates that the synergies from the transaction exceed the efficiency loss from the staggered board), the deal planners can get the shareholders to approve a deal that produces a combined firm with a staggered board. With the synergies more than compensating for the staggered board, each party's shareholders can get a portion of the pie that will make them better off compared to what they had before the deal, and they will prefer such a deal to no deal. Of course, the shareholders would rather get a similar portion of a larger pie, v_3, but this option is not on the table. The transaction offers them only a portion of $v_3 - s$, and they must either take it or leave it.[54]

The managers' calculus will be different. Consider first the managers who will stay on and run the combined firm. These managers may prefer the combined firm to have a staggered board even if it lowers the firm's value because a staggered board will increase their private benefits of control. Unlike shareholders, who look only to maximizing the value of their holdings, these managers will look to maximizing the combined value of their holdings and their private benefits of control.

Consider next the managers who will not stay on. These managers will not benefit directly from having a staggered board in the combined firm. But they will not lose either. Their holdings, like those of other shareholders, will be worth more than before the deal, and they will receive retirement benefits such as golden parachutes, consulting contracts, and the like, which can ensure that they are not worse off. Like the continuing managers, the departing managers too will thus consider the combined value of their holdings and their private benefits of control, rather than the value of their holdings alone.

This is not to say that the managers will always choose to have a staggered board in the combined firm. They may, for example, worry that shareholders will perceive $v_3 - s$ to be too low and reject the transaction. Also, if the managers own many shares, they may bear enough of the efficiency costs of a staggered board to offset their private benefits from this board structure. But as long as the managers expect shareholders to perceive $v_3 - s$ as sufficiently high, they will expect to get the transaction approved even with a staggered board and, if shareholders will bear enough of the efficiency costs of the staggered board, the managers will opt for one.

One may ask why deal planners would rather shackle the combined firm with a staggered board to benefit the continuing managers instead of simply paying them higher salaries. The answer is that shareholders are more likely to oppose cash transfers to managers than to oppose governance choices that cost the firm an uncertain amount and benefit managers to an uncertain degree. It is easier for shareholders to accept a governance choice that is built into the deal than to accept a salary demand made by managers as a condition to the deal.

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54 While we assume for simplicity that the only possible merger is between *A* and *B*, the analysis remains similar when a third party, *C*, proposes an alternative merger that is not bundled with a staggering of the board. First, to win shareholder approval, *C*'s alternative merger will have to produce synergies that exceed the net value of the merger between *A* and *B*. Second, to have its alternative merger even considered, *C* will need to overcome the array of defenses protecting the deal between *A* and *B*. In many cases, at least one of these conditions will not be met and the bundled merger between *A* and *B* will face no competition.

This decision to extract private benefits of control indirectly rather than directly is no different from other inefficient decisions that self-interested managers make.[55]

III. EMPIRICAL ANALYSIS

This Part presents our empirical analysis. After describing our methodology and data, we show that the mergers in our sample exhibit a strong tendency to be bundled with the introduction of a charter-based staggered board. This pattern is visible both in mergers that use the charter of one of the parties for the combined firm and in mergers that create a new charter for the combined firm. As we predict, however, the pattern is stronger in the latter type of mergers, reflecting what deal planners do when they are not limited to choosing from existing charters. We also show that mergers resulting in a move to a staggered-board structure are associated with lower stock returns and higher deal premiums. This is consistent with the view that shareholders see the bundle and are at least partly compensated for it.

A. The Universe of Transactions Studied

For the purpose of our study, we created a unique, partly hand-collected dataset of governance changes associated with mergers of public firms of comparable size announced during the period from 1995 through 2007 in which shareholders of both firms retained an interest in the combined firm. We chose this period because corporate filings for this period are available on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) website, allowing us to collect data on each deal. As we emphasized earlier, this period is also one in which institutional investors strongly resisted staggered boards and firms were unable to obtain shareholder approval for staggering a board on a stand-alone basis.[56]

We limit our study to deals between firms of comparable size on the assumption that relative size plays an important role in choosing which of the parties to a deal will remain public as the combined firm and which will become a subsidiary or disappear. As the size difference increases, deal planners' preference for choosing the larger party to remain public may become stronger and dominate any preference they have for choosing the party that has a staggered board. It is

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[55] *See, e.g.*, Yakov Amihud & Baruch Lev, *Risk Reduction as a Managerial Motive for Conglomerate Mergers*, 12 BELL J. ECON. 605, 615 (1981) (finding that managers engage in value-destroying conglomerate mergers to lower the risk of losing their job); Jarrad Harford & Kai Li, *Decoupling CEO Wealth and Firm Performance: The Case of Acquiring CEOs*, 62 J. FIN. 917, 919 (2007) (finding that managers of acquiring firms are richly compensated even for poor acquisitions).

[56] *See* sources cited *supra* note 31.

hard, for example, to imagine a $900 million firm with a nonstaggered board becoming a subsidiary of a $10 million firm only to inherit the latter's staggered board. Because we want to detect the effects of considerations other than size on deal structure, we concentrate on transactions in which neither party is more than twice the size of the other party, where size is measured by market capitalization 30 trading days before the deal is announced. We use for this purpose data from the University of Chicago's Center for Research in Securities Prices (CRSP). Below we report that, even within our sample, relative size is a strong predictor of remaining public as the combined firm.[57]

We focus on mergers in which the shareholders of both companies retain an interest in the combined firm because in these transactions both sets of shareholders have an interest in the combined firm's having value-maximizing governance arrangements. Moreover, as we explained above, any merger that can produce a combined firm with different governance arrangements from those of a party to it requires approval by that party's shareholders.[58] These shareholders thus have both a stake in the governance changes that the deal will bring and a say over whether the deal will happen.

To create our dataset, we began by identifying mergers using Thomson Reuters's Securities Data Company Platinum (SDC) database. The initial sample included all mergers among U.S. firms with a single class of publicly traded stock available on CRSP that were announced between January 1, 1995, and December 31, 2007, in which the firm identified by SDC as the acquirer owned less than 20% of the firm identified by SDC as the target before the acquisition and in which the consideration included common stock. The initial sample comprised 494 deals, including 459 deals for which SDC reports the percentage of consideration paid in stock. In 307 of these deals, stock was the only consideration. In the remaining 169 for which SDC reports the percentage of stock in the consideration, the mean stock portion was 60.74% and the standard deviation was 24.95%.

For each deal, we collected supplemental information from deal registration statements, deal proxy statements, annual proxy statements, and post-closing periodic reports available on EDGAR. Specifically, we recorded each firm's board structure and classes of outstanding stock, the deal structure, and any charter amendments proposed in connection with the deal.

We excluded 51 mergers involving firms (38 acquirers and 16 targets, as identified by SDC) with privately held voting stock that differed in its voting rights from the publicly traded stock. This exclu-

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[57] *See infra* Table 2, p. 1576, and accompanying text; *cf. infra* note 94.

[58] *See supra* notes 52–53 and accompanying text.

sion and the earlier exclusion of firms with multiple classes of publicly traded stock ensure that our sample does not contain firms with dual-class capitalization. Including such firms could muddy our analysis because deal planners might prefer that the party with dual-class capitalization remain public not necessarily to deter takeovers, as in the case of staggered boards, but to protect the investment of current stockholders. Stock with superior voting rights is worth more than stock with regular voting rights.[59] Protecting this value by ensuring that holders of this stock continue to hold it after the merger avoids the need to compensate them for the loss of their superior voting rights. Such compensation would likely be required in order to secure their support for the deal if they were to exchange their high-voting stock for the regular-voting stock of the other party.[60]

Excluding firms with dual-class capitalization, the supplemental data were available for 393 mergers, of which 305 were completed and 88 were withdrawn. Most of the withdrawn mergers were abandoned before the signing of a definitive agreement and included 29 unsolicited takeover bids that were rebuffed by the target and 20 letters of intent or publicly disclosed merger talks. For additional tests, we also collected information from pre-closing corporate filings on the makeup of the combined firm's board and the identity of its chief executive officer. This information was available for 224 mergers.

Table 1 displays summary statistics of the incidence of transactions in each year during the study period, the capitalization of merger parties, and the capitalization ratio between the parties, which is a measure of their relative size. As Table 1 shows, the number and the size of mergers in our sample change over time, with the number of mergers per year varying between 11 and 58, the median capitalization of the small party varying between $173.44 million and $901.41 million, and the median capitalization of the large party varying between $235.59 million and $1132.04 million. Nevertheless, because we limit our analysis to mergers between parties of comparable size, the relative size of the merger parties remains stable, with the median ratio of the large party's capitalization to the small party's capitalization varying only between 122.29% and 148.47%.

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59 *See, e.g.*, Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. (forthcoming 2010) (on file with the Harvard Law School Library).

60 Deal planners may prefer to keep the party with dual-class capitalization public also to avoid the need for a separate vote on the merger by each class, which would invite holdups. Some states seem to require separate class votes in such mergers. *See, e.g.*, N.Y. BUS. CORP. LAW § 903(a)(2) (McKinney 2003); MODEL BUS. CORP. ACT § 11.04(f)(1) (2008). As a precautionary measure, planners often assume that a separate class vote is needed in these states. *See* 1 LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 4.12 (2009).

TABLE 1. TRANSACTIONS AND PARTIES BY YEAR

		Large Party Capitalization ($1 Million)		Small Party Capitalization ($1 Million)		Ratio of Capitalization (%)	
Year	Obs.	Mean	Median	Mean	Median	Mean	Median
1995	31	1492.45	305.72	1061.55	279.28	136.86	130.99
1996	31	2020.59	471.26	1505.20	326.83	137.48	129.49
1997	58	889.23	280.38	655.61	226.42	147.78	141.26
1998	57	4949.99	563.52	3347.99	442.05	143.37	137.40
1999	40	1897.51	402.97	1457.03	280.60	147.07	148.47
2000	38	3338.48	776.80	2115.73	496.87	138.94	132.17
2001	33	2757.64	235.59	1679.86	195.50	138.62	131.35
2002	11	332.82	337.76	277.35	238.92	137.60	126.87
2003	19	1329.92	378.73	1115.75	314.50	132.12	122.29
2004	27	1805.01	513.26	1276.28	388.41	147.81	140.03
2005	19	2669.44	281.69	2196.64	173.44	128.73	126.68
2006	13	3123.09	1132.04	2073.76	901.41	137.44	140.88
2007	16	1488.35	835.30	1135.37	519.93	141.83	139.47
Continuing-Entity Mergers	348	2355.52	439.09	1620.00	303.96	142.80	138.58
New-Entity Mergers	45	2432.71	878.30	1874.57	655.68	129.03	122.29
All Mergers	393	2364.36	458.70	1649.15	317.35	141.22	135.09

Of 786 parties to the mergers in our sample, 477 (60.69%) had staggered boards, similar to the percentage of firms with staggered boards among large public firms in prior studies.[61] In 38.93% of the mergers, both parties had staggered boards. In another 43.51% of the mergers, only one of the parties had a staggered board. The remaining 17.56% of the mergers were between parties with nonstaggered boards.

[61] *See* VIRGINIA K. ROSENBAUM, INSTITUTIONAL S'HOLDER SERVS. INC., CORPORATE TAKEOVER DEFENSES, at vi, xi (2006) (reporting staggered boards in 59.7% of 1925 firms comprising S&P 1500 firms plus additional firms "selected primarily on the basis of market capitalization and high institutional ownership levels" in 2004, and 56.4% of these firms in 2005). For similar figures, see Bebchuk et al., *supra* note 30, at 895 & fig.1.

B. Combined Firms that Inherit One Party's Charter

We begin with mergers in which one of the parties becomes the combined firm and retains its premerger charter. Two deal forms fall under this category. The first deal form is a merger of a subsidiary of *B* into *A* (a "reverse triangular merger") or a merger of *A* into a subsidiary of *B* (a "forward triangular merger").[62] The second deal form is a merger of *A* into *B* (a "direct merger").[63] In all of these cases, the shareholders of *A* trade their shares for shares of *B* and by doing so trade the charter of *A* for the charter of *B*. Of the 393 deals in our sample, 336 deals (85.50%) were structured in one of these ways.

1. The Basic Picture. — To get a sense of the change in board structure in the course of the mergers, we compare the incidence of staggered boards among the 672 merger parties and among the 336 combined firms. The comparison reveals an 8.29% increase in the incidence of staggered boards (from 61.01% to 66.07%). This change is highly statistically significant. In a Wilcoxon signed-rank test,[64] the differences between each merger's mean of the parties' staggered board indicators and the combined firm's staggered board indicator are significant at the 1% level (meaning that there is no more than a 1% chance that this is a coincidence). The result is the same if we assume that the differences are not ordinal but rather either positive or negative and accordingly use a sign test instead of a signed-rank test.

While the 8.29% increase in the incidence of staggered boards is both statistically significant and economically meaningful — especially taking into account the fact that the shift to a staggered-board structure continues when combined firms from past mergers merge again — this increase understates the pull of staggered boards. The reason is that oftentimes both parties have a staggered board or both have a nonstaggered board, and the choice of the party that will remain public does not affect the combined firm's board structure. It is therefore more instructive to focus on the subset of cases in which one party's board is staggered and the other party's board is not. In these cases, the choice of the party that remains public determines the combined firm's board structure. There are 138 such deals in our sample.

Figure 1 displays the choices that deal planners made in these cases. When we focus on these deals, the pattern we saw above becomes

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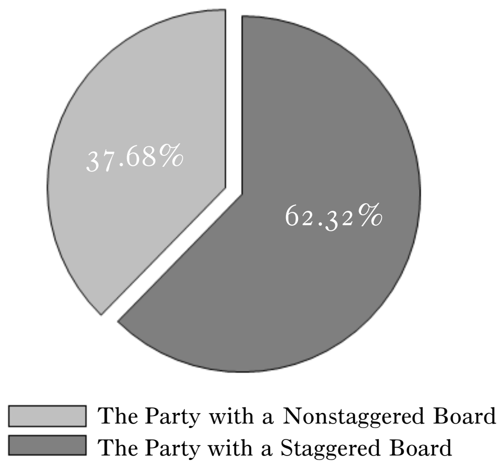
62 *See supra* note 51.

63 *See supra* note 51.

64 The Wilcoxon signed-rank test is a nonparametric statistical hypothesis test for two related samples or repeated measurements on a single sample. It is an alternative to the paired Student's *t*-test when the population cannot be assumed to be normally distributed. *See* Frank Wilcoxon, *Individual Comparisons by Ranking Methods*, 1 BIOMETRICS BULL. 80 (1945). We use it here because the mean of the parties' staggered board indicators can take only one of three values (–1, 0, or 1), and so the mean cannot be assumed to be normally distributed.

even more pronounced: the party that had a staggered board remained public in 86 (62.32%) of the deals, while the party that had a nonstaggered board remained public in only 52 (37.68%) of the deals. The difference between these percentages is statistically significant at the 1% level in a *t*-test.[65]

FIGURE 1. THE PARTY THAT BECOMES THE COMBINED FIRM WHEN ONE PARTY HAS A STAGGERED BOARD



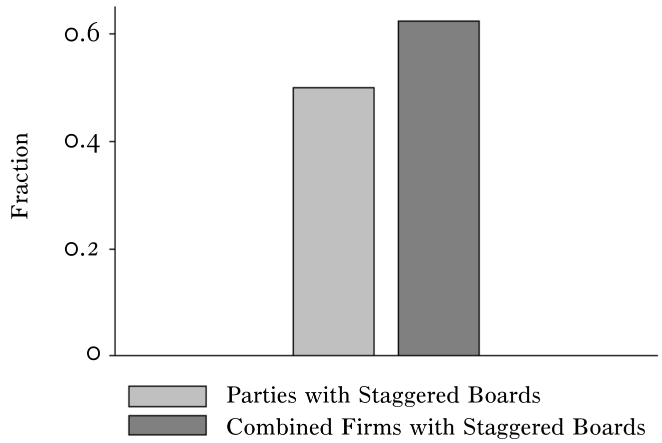
The preference for selecting the party that has a staggered board to remain public when the other party has a nonstaggered board translates into a 24.64% increase in the incidence of staggered boards (from 50.00% to 62.32%). Figure 2 presents this increase.

2. Controlling for Size. — A skeptic might wonder whether the strong results we find are driven by other factors. On this theory, the choice of the party that remains public is not at all driven by a desire to have antitakeover protection in the combined firm, but rather by a desire to choose a party with some other feature that just happens to be correlated with having a staggered board.

The first candidate for such a feature is size. It might be conjectured that deal planners prefer that the larger party be the one remaining public after the merger and that, independently, this party is more likely to have a staggered board. If this is the case, our results will be driven by the correlation between size and the incidence of staggered

[65] A *t*-test is a statistical hypothesis test in which the test statistic has a Student's *t* distribution if the null hypothesis is true. It is applied when the population is assumed to be normally distributed. *See* Student, *The Probable Error of a Mean*, 6 BIOMETRIKA 1 (1908).

FIGURE 2. THE CHANGE IN BOARD STRUCTURE:
COMBINED FIRMS THAT INHERIT ONE PARTY'S CHARTER



boards rather than by deal planners' preference for having staggered boards in combined firms.

One might question this conjecture on theoretical grounds. It is not clear, given the flexibility of deal design, why it should be important to use the legal entity of the larger party. Even if the name or other attributes of that party (such as divisional structure) are worth retaining for business reasons, the planners can designate the smaller party to become the combined firm while renaming it and replicating in it any other desired attributes of the larger party. The renaming can be approved by shareholders when they approve the merger, and the replication of other attributes does not require shareholder approval.

Still, we should not dismiss this conjecture out of hand. First, renaming the smaller party and replicating in it other attributes of the larger party may involve transaction costs that the parties wish to avoid, not the least of which is the need to explain the complex structure to investors. Second, there are additional advantages to choosing the larger party as the one that will remain public after the merger, and in some deals these advantages cannot be achieved if the smaller party is chosen. For example, larger firms tend to have higher-value agreements with creditors or trade partners, which may terminate once the firm ceases to be public.[66] Keeping the larger party public and its

[66] *See* Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 614–23 (2003) (describing provisions in company agreements with third parties that make the agreements terminable or impose penalties on the companies upon a change of control).

agreements intact minimizes this loss.[67] Designating the larger party to remain public, and thus to be the one issuing stock, may also avoid the need for holding a shareholder meeting for that party: stock exchange rules require shareholder approval for issuances of 20% of the outstanding stock,[68] and this threshold is less likely to be reached when the larger party is the one issuing stock.[69] In addition, the larger party may have a more liquid market for its securities and superior access to credit and equity markets, which are likely to be tapped in the transaction.[70]

Because we cannot reject on theoretical grounds the conjecture that our results are driven by a correlation between relative size and board structure, we test this conjecture empirically. First, in unreported regressions, we test whether the larger party to each deal is more likely than the smaller party to have a staggered board. To do so, we fit an ordered probit regression model in which the dependent variable (ΔSTAGGER) is the difference between an indicator for whether a randomly selected party to each deal had a staggered board and an indicator for whether the other party had a staggered board, and the independent variable (SIZE RATIO) is the ratio of the former party's market capitalization to the latter party's market capitalization 30 trading days before the announcement of the deal.[71] To account for the possibility that the larger party is more likely to have a staggered board no matter how much larger it is, we also try using as the independent variable an indicator for whether the former party's market

[67] *See* Email from Robert J. Jackson, Associate, Wachtell, Lipton, Rosen & Katz, to Ehud Kamar, Professor of Law, University of Southern California Gould School of Law (Apr. 10, 2009) (on file with the Harvard Law School Library) [hereinafter Email from Robert J. Jackson to Ehud Kamar]; *see also* EDWARD D. HERLIHY ET AL., WACHTELL, LIPTON, ROSEN & KATZ, FINANCIAL INSTITUTIONS M&A 2009: CONVERGENCE, CONSOLIDATION, CONSTERNATION AND COMPLEXITY IN AN INDUSTRY IN TRANSITION: AN ANNUAL REVIEW OF LEADING DEVELOPMENTS 75 (2009) ("Reverse parent-to-parent mergers have been employed in a number of transactions for a variety of structural reasons. Issues that arise in connection with reverse mergers include how the acquisition will be characterized in press releases and public disclosures, which group of shareholders (if any) will be required to exchange its share certificates, whether change-of-control provisions in employment, severance and benefit plans and agreements or other agreements of either company will be triggered by the structure, and possible regulatory ramifications, including the identity of the filing parties and the information required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.").

[68] *See supra* note 52.

[69] *See* Email from Robert J. Jackson to Ehud Kamar, *supra* note 67. This consideration probably did not affect many deals in our sample, which includes only parties of comparable size.

[70] *See id.*

[71] An ordered probit model estimates the correlation between an ordinal discrete dependent variable and one or more independent variables. *See* WILLIAM H. GREENE, ECONOMETRIC ANALYSIS 831–35 (6th ed. 2008). We use this model due to the ordinal nature of ΔSTAGGER, which can equal –1 (when the party of interest does not have a staggered board and the other party does), 0 (when neither party has a staggered board or both parties have one), or 1 (when the party of interest has a staggered board and the other party does not).

capitalization is simply higher than the latter party's market capitalization 30 trading days before the announcement of the merger.

In each of these regressions we allow each deal to be represented only once. We do this to avoid overstating the relation between the independent variables and the dependent variable. Consider, for example, a deal in which the larger party has a staggered board and the smaller party has a nonstaggered board. Including this deal in a regression of ΔSTAGGER on SIZE RATIO both as a case in which the larger party is *more likely* to have a staggered board and as a case in which the smaller party is *less likely* to have a staggered board would overstate the relation between relative size and board structure because these are two manifestations of the same event. Accordingly, we follow the methodology of allowing each deal to be represented only once in each regression throughout this Article.

Neither of the regressions noted above reveals a statistically significant relation between the relative sizes of the parties to each deal and their board structures. This is true regardless of whether we examine all mergers, continuing-entity mergers, or continuing-entity mergers in which the party that remained public did not alter its board structure through a charter amendment.

Second, we test directly the conjecture that the tendency to choose the party with a staggered board to remain public is driven by a tendency of this party to be larger. To do so, we run a regression in which we control for relative size. Specifically, we fit a probit model in which the dependent variable is an indicator for whether the party that we randomly selected in each deal, as discussed above,[72] became the combined firm. The independent variables are the ones defined above, ΔSTAGGER and SIZE RATIO. The former is our key variable of interest. It is included in the regression model to detect any relation between having a staggered board and being chosen to remain public as the combined firm. The latter is a control variable. It is included to screen any relation between being the larger party and being chosen to become the combined firm. Table 2 presents the results.

As hypothesized, Table 2 shows that the larger party in each deal is indeed more likely to be chosen as the combined firm. Panel A reports this result for the entire sample. Evaluated at the means of the independent variables, a 1% increase in the size of a firm relative to the size of its merger partner is associated with a 1% increase in the firm's probability of remaining public after the merger. This effect is statistically significant at the 1% level. Even after taking relative size into account, however, board structure continues to be strongly related to

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[72] *See supra* note 71 and accompanying text.

TABLE 2. PROBABILITY OF BECOMING THE COMBINED FIRM WHEN THE COMBINED FIRM INHERITS ONE PARTY'S CHARTER

This table presents the marginal effects from estimating a probit regression in which the dependent variable is an indicator for whether a party to a direct merger or a triangular merger of two public firms of similar size involving stock consideration becomes the combined firm. Mergers in which the party that becomes the combined firm changes its board structure are excluded. ΔSTAGGER is the difference between an indicator for whether the party had a staggered board and an indicator for whether the other party had a staggered board. SIZE RATIO is the ratio of the former party's market capitalization to the latter party's market capitalization 30 trading days before the announcement of the merger.

	Panel A. All Deals		
	Marginal Eff.	Std. Error	*p*-Value
ΔSTAGGER	0.16	0.05	0.00
SIZE RATIO	0.01	0.00	0.00
Observations = 336			
Pseudo R-Squared = 0.34			
	Panel B. Friendly Deals		
	Marginal Eff.	Std. Error	*p*-Value
ΔSTAGGER	0.15	0.06	0.01
SIZE RATIO	0.01	0.00	0.00
Observations = 307			
Pseudo R-Squared = 0.37			

remaining public, as the bundling hypothesis predicts. Just like the coefficient of SIZE RATIO, the coefficient of ΔSTAGGER is positive and statistically significant at the 1% level.[73]

In terms of economic significance, the coefficient of ΔSTAGGER indicates that a party is 54.01% more likely to remain public when it has a staggered board and the other party does not than when the former party does not have a staggered board and the latter party does.[74]

[73] In unreported regressions, we divide the sample into two subsamples according to the years in which the mergers were announced. The first subsample comprises 181 mergers announced from 1995 through 1999, and the second subsample comprises 155 mergers announced from 2000 through 2007. Despite the smaller number of observations in the latter subsample, the results reported in Table 2 hold for it and even become stronger, suggesting that shareholders' growing opposition to staggered boards in recent years has not stemmed the introduction of a staggered-board structure through bundling.

[74] This is the ratio of the mean predicted likelihood of being chosen to remain public when ΔSTAGGER is set at 1 (59.31%) to the mean predicted probability of being chosen to remain public when ΔSTAGGER is set at –1 (38.49%).

Panel B includes only friendly deals, as classified by SDC. We examine these deals separately to find out whether the tendency to designate the party with a staggered board as the one that remains public after the merger is driven by unsolicited bids. Unsolicited bidders cannot propose a deal in which the target remains public and issues the target's stock to the bidder's shareholders because the target's board will not cooperate with the plan. The only structure they can use for a stock-for-stock transaction is one in which the bidder remains public and issues its own stock to the target's shareholders, because this does not require the cooperation of the target's board. Consistently, all of the deals in our sample that are classified as "Hostile" or "Unsolicited" by SDC are ones in which the party identified by SDC as the acquirer was to remain public. If unsolicited bidders are more likely to have staggered boards than the targets of their bids, their bids will tend to result in the party with the staggered board remaining public.

To test this hypothesis, we compare the board structure of the bidder with that of the target in the 29 unsolicited bids in our sample. In 12 cases, the acquirer had a staggered board while the target did not. This compares to only 4 cases in which the target had a staggered board while the acquirer did not. (In 13 cases, the parties had the same board structure.) While the numbers suggest that the bidders in these deals were more likely to be staggered than their targets, this relation is statistically insignificant in a chi-square test, probably due to the small number of observations. In Panel B of Table 2, we exclude these deals from our regression as a further check. The results are qualitatively similar to those in Panel A and are significant at the 5% level. That is, even in friendly mergers, the party that has a staggered board tends to remain public.

3. Controlling for Continuing Management. — In addition to relative size, another firm attribute that may be relevant for choosing which party will become the combined firm is which party's directors and officers play a more dominant role in the combined firm. If the combined firm will be managed primarily by party *B*'s directors, it may be conjectured that deal planners will prefer to designate this party to be the one that remains public. This choice is probably not essential because the parties can designate party *A* as the one that will remain public, establish in it positions similar to those found in party *B*, and fill these positions with directors and officers from party *B*. Still, absent reasons to mix and match one party's personnel with the other party's corporate entity, it is natural to retain the corporate entity of the party whose personnel will control the combined firm and thereby avoid the need to explain the unusual structure to shareholders.[75]

If a staggered board increases the likelihood that directors and officers will stay in office after the merger by strengthening their bargaining power, this personnel choice could contribute to our results. What appears as a preference for keeping public the party with a staggered board would be, at least in part, a preference for keeping public the party whose directors and officers will continue to run the business. This would not change the finding that deal planners bundle mergers with a move to a staggered-board structure. But it would suggest an additional reason *why* they present shareholders with this bundle.

To examine whether our results are driven by personnel preferences rather than preferences for a staggered-board structure, we examine whether merger parties with a staggered board were more likely to remain public after controlling for personnel decisions in addition to relative size. Table 3 presents the results.

As Table 3 shows, while all of the control variables are significantly related to being chosen to remain public, having a staggered board is still significantly related to this choice at the 5% level. This effect is not only statistically significant, but also economically meaningful: the regression reported in Table 3 predicts that, in a merger between a party with a staggered board and a party with a nonstaggered board, the former party is 30.52% more likely to remain public.[76]

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[75] The parties may also choose the firm whose management team will run the combined firm to be the one that remains public to ensure that the other firm's managers, who will depart, receive the benefits that their employment agreements promise them upon a change of control. *See* HERLIHY ET AL., *supra* note 67, at 75. Executive employment agreements typically include one or more triggers for these payments. Common triggers are (1) an acquisition of a block of shares by a single buyer; (2) a change of the majority of the directors; or (3) a merger in which the firm is not the surviving entity or after which another firm or its shareholders directly or indirectly own half of the firm's stock. *See* RICHARD L. ALPERN & GAIL MCGOWAN, GUIDE TO CHANGE OF CONTROL: PROTECTING COMPANIES AND THEIR EXECUTIVES 59–61 (3d ed. 2001) (reporting that 90% of executive employment agreements in 150 large public corporations include the first trigger, 86% include the second, and 80% include the third). In a stock merger between two public firms of comparable size, the first two triggers may or may not be activated. A simple way to activate the third trigger is to ensure that the firm whose change of control is sought does not remain public. However, this consideration is relevant only in a small number of deals because the combined firm's management typically comes from the party whose shareholders receive the majority of the combined firm's stock in the merger. This is enough to trigger the change-of-control benefits for the management of the other party regardless of which party remains public. *See* Email from Robert J. Jackson to Ehud Kamar, *supra* note 67.

[76] This is the ratio of the mean predicted likelihood of being chosen to remain public when ΔSTAGGER is set at 1 (59.02%) to the mean predicted probability of being chosen to remain public when ΔSTAGGER is set at –1 (45.22%).

TABLE 3. PROBABILITY OF BECOMING THE COMBINED FIRM WHEN THE COMBINED FIRM INHERITS ONE PARTY'S CHARTER

This table presents the marginal effects from estimating a probit regression in which the dependent variable is an indicator for whether a party to a direct merger or a triangular merger of two public firms of similar size involving stock consideration is selected to become the combined firm. Mergers in which the party that becomes the combined firm changes its board structure are excluded. ΔSTAGGER is the difference between an indicator for whether the party had a staggered board and an indicator for whether the other party had a staggered board. SIZE RATIO is the ratio of the former party's market capitalization to the latter party's market capitalization 30 trading days before the announcement of the merger. BOARD is the ratio of the party's representatives on the board of the combined firm. CEO is an indicator for whether the chief executive officer of the combined firm was an executive of the party.

	Marginal Eff.	Std. Error	*p*-Value
ΔSTAGGER	0.17	0.09	0.05
SIZE RATIO	0.01	0.00	0.00
BOARD	1.84	0.42	0.00
CEO	0.31	0.11	0.00
Observations = 224			
Pseudo R-Squared = 0.60			

In 34 of the mergers examined in Table 3, the party that had a nonstaggered board remained public after the merger (without changing its board structure), while the party that had a staggered board disappeared. However, in each of these cases, considerations of relative size, management control, and board control explain the choice: the party that remained public was the larger party in 26 of the 34 mergers that resulted in a move to a nonstaggered board, including 24 mergers in which that party's chief executive officer remained in office and 23 mergers in which that party's directors remained the majority. The smaller party remained public in only 8 mergers that resulted in a move to a nonstaggered board, and in each of these mergers that party's chief executive officer remained in office. Furthermore, in 5 of these mergers that party's directors remained the majority.

The bundling of mergers with a move to a staggered-board structure may be even stronger than the regressions let on. The reason is that the choice of the management team for the combined firm may in itself be correlated with board structure. If managers of merging firms with staggered boards are more likely to fill top posts in the combined firm (despite the lack of evidence directly showing this), our regression contains two competing variables reflecting which party had a staggered board in addition to ΔSTAGGER — BOARD and CEO — and these variables capture some of the effect of ΔSTAGGER.

4. *Example*. — To illustrate the reality behind the numbers, consider the following example. On June 10, 1998, Health Care and Re-

tirement Corp. (HCR), a nursing home operator based in Ohio, agreed to merge with Manor Care Inc., a nursing home operator based in Maryland. The combined firm had a market value of about $4 billion and total revenue of $2.26 billion.[77] It tapped the HCR chief executive officer to be its chief executive officer and the Manor Care chief executive officer to be its chairman, while filling its board with an equal number of directors from each party.[78] According to CRSP data, at a stock market value of $2.23 billion, Manor Care was 20% bigger than HCR. Nonetheless, it was HCR — the party with a staggered board — that was picked to remain public after the merger.

Because the deal was structured as a merger of Manor Care with a subsidiary of HCR and involved the issuance of HCR stock to the shareholders of Manor Care as consideration, it resulted in these shareholders trading their nonstaggered board for HCR's staggered board.[79] This change was built into the deal and required no separate vote. Thus, Manor Care's shareholders were advised matter-of-factly:

> The HCR Charter provides that the HCR Board shall have three classes, which shall be as nearly equal in number as possible. The directors of each class shall serve for a term ending at the third annual meeting following the annual meeting at which they were elected. The Manor Care Charter does not provide for a classified board and, accordingly, all directors are elected annually for a term of one year or until a successor is duly qualified and elected.[80]

The shareholders were never asked to approve the switch from a nonstaggered board to a staggered board. Instead, they were simply asked to approve "the Merger and the transactions contemplated by the Merger Agreement."[81] Staggering the board was part of this package, and so it was approved — by a wide margin.[82]

C. Combined Firms with New Charters

We now turn to mergers in which the combined firm's charter is new rather than inherited from either party. This can be the case in one of two scenarios.[83] The first and more common scenario is where both parties merge with a new holding company or with subsidiaries

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[77] *See* Bloomberg News, *Two Big Nursing Home Operators Reach Agreement To Merge*, N.Y. TIMES, June 11, 1998, at D2.

[78] *See id.*

[79] *See* Health Care & Ret. Corp., Registration Statement (Form S-4), at 4 (Aug. 17, 1998).

[80] *Id.* at 90.

[81] *Id.* at 95.

[82] *See id.* at 106 (reporting that 63,695,583 Manor Care shares were outstanding at the signing of the merger agreement); HCR Manor Care, Inc., Quarterly Report (Form 10-Q), at 19 (Nov. 16, 1998) (reporting that 53,727,551 Manor Care shares were voted for the merger and 257,510 shares were voted against it).

[83] *See* section II.B.2, *supra* pp. 1563–65.

of such a company. We labeled this structure above as a "new-entity merger." The second and less common scenario is where one of the parties remains public (a "continuing-entity merger") but amends its charter in the course of the merger.

Examining whether the combined firms in these transactions have staggered boards is of particular interest to our inquiry because here, unlike the case of continuing-entity mergers that occur without charter amendment, the parties are free to choose the board structure they like and are not limited to choosing from their existing structures. As a result, the parties can install a staggered board in the combined firm even if neither of them has a staggered board. Conversely, they can install a nonstaggered board even if both of them have staggered boards.

1. The Basic Picture. — Of 393 deals, 57 (14.50%) were structured in one of these ways, including 45 new-entity mergers and 12 continuing-entity mergers in which the party that remained public amended its charter in the course of the merger. Thus, 114 merger parties went into these transactions and 57 combined firms were created.

We first look at the percentage of companies among the 114 merger parties with staggered boards and compare it with the percentage of the 57 combined firms with staggered boards. The comparison reveals a 31.25% increase in the incidence of staggered boards (from 58.18% to 76.36%). This pattern is present in both types of deals that create a combined firm with a new charter. In new-entity mergers, the change constitutes a 19.31% increase (from 63.33% to 75.56%). In continuing-entity mergers with charter amendments, the change constitutes a 79.99% increase (from 41.67% to 75.00%).

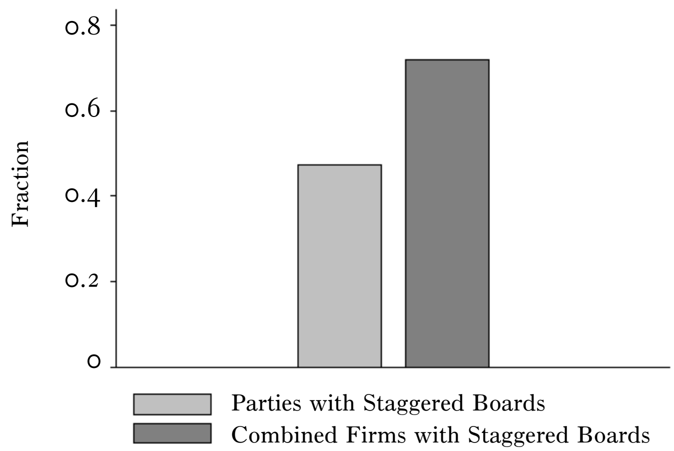
The large increase in the incidence of staggered boards through the channel of charter amendments reflects the fact that, of 12 deals in this category, in 9 the amendment was to stagger the board, while in only 3 was the amendment to destagger it. In all but one of the 9 board-staggering deals, the proxy statement sent to the shareholders either stated that staggering the board was a condition to the merger or did not say whether it was a condition, allowing shareholders to believe that it was.[84]

The increase in the incidence of staggered boards is especially pronounced when we examine only the 39 mergers out of 57 in this category that changed the incidence of staggered boards. These transac-

[84] Indeed, the shareholders approved both the merger and the staggering of the board in each of these 9 deals except for the deal in which they were advised that the staggering of the board was not a condition to the merger. In that deal, the $1.3 billion merger of semiconductor industry suppliers Entegris, Inc. and Mykrolis Corporation in 2005, only the merger was approved. *See* Entegris, Inc., Annual Report (Form 10-K), at 23 & exhibit 3A(3) (Nov. 23, 2005).

tions increased the incidence of staggered boards by 51.33% (from 47.44% to 71.79%).[85] Figure 3 presents this increase.

FIGURE 3. THE CHANGE IN BOARD STRUCTURE: COMBINED FIRMS WITH NEW CHARTERS



2. *Examples.* — When both of the parties merge into a new holding company or with subsidiaries of such a company, the combined firm can have a staggered board even if neither party had one.

Consider first the $1.14 billion merger of rival makers of computer network equipment Apex Inc. and Cybex Computer Products Corporation in 2000.[86] The transaction was structured as simultaneous mergers of the parties with subsidiaries of a newly formed holding company, Aegean Sea Inc.[87] Neither equipment maker had a staggered board. The new holding company, however, did.[88] And because the parties became its subsidiaries, their shareholders traded their non-

[85] This change is highly statistically significant. In a Wilcoxon signed-rank sum test, the differences between the mean of the parties' staggered-board indicators and the combined firm's staggered-board indicator are significant at the 1% level. The result is the same if we assume that the differences are merely positive or negative and accordingly use a sign test. We do not estimate a multivariate regression model for the mergers examined here because, unlike the case of mergers in which the combined firm inherits one party's charter, the creation of a new charter allows planners to choose a staggered board for the combined firm independently from any other choice. Thus, whether the planners choose to have a staggered board should not be expected to depend on the parties' relative size or their representation on the combined firm's management team.

[86] *See* Bloomberg News, *Two Makers of Computer Network Equipment To Merge*, N.Y. TIMES, Mar. 9, 2000, at C4.

[87] *See* Aegean Sea Inc., Registration Statement (Form S-4), at 5 (Mar. 31, 2000).

[88] *See id.* at 91.

staggered boards for the holding company's staggered board. While the proxy statement alerted shareholders to this change, they voted only on the merger. A separate vote on the move to a staggered-board structure was not needed.[89]

In another deal, the same result was achieved by keeping public one of the parties while amending its charter to stagger its board. On June 15, 1999, American Oncology Resources, Inc. (AOR) and Physician Reliance Network, Inc. (PRN) completed a stock-for-stock merger of equals. The new company, held roughly in equal parts by the former shareholders of the two parties, had a pro forma revenue and market capitalization of approximately $1 billion and billed itself as "the nation's largest network of physicians, clinicians, nurses, and administrators focused exclusively on oncology."[90] Neither of the two parties to this merger had a staggered board. But the combined firm did. It was formed through the merger of PRN with a subsidiary of AOR and the amendment of AOR's charter to stagger the board.[91] The amendment was a condition to the deal. It was described in the proxy statement sent to the shareholders of AOR as follows:

> The AOR board of directors believes that a staggered system of electing directors would help assure continuity and stability of AOR's business strategies and policies. Because at least two stockholder meetings will generally be required to effect a change in control of the board, a majority of directors at any given time will have prior experience as directors of AOR. This is particularly important to a growth-oriented organization, such as AOR. In addition, in the event of an unfriendly or unsolicited proposal to take over or restructure AOR, the staggered board system would give AOR time to negotiate with the sponsor, to consider alternative proposals and to assure that stockholder value is maximized.[92]

The proxy statement was clear about the entrenchment effect of this move, explaining:

> A staggered board of directors may be deemed to have an anti-takeover effect because it may create, under certain circumstances, an impediment which would frustrate persons seeking to effect a takeover or otherwise gain control of AOR. A possible acquirer may not proceed with a tender offer because it would be unable to obtain control of AOR's board of directors for a period of at least two years. Generally, approximately one-third of the sitting board of directors would be up for election at any annual meeting of the stockholders.[93]

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[89] *See id.* at 6.

[90] Press Release, Am. Oncology Res., Inc., American Oncology Resources Completes Merger with Physician Reliance Network 2 (June 15, 1999), *reprinted in* US Oncology, Inc., Amended Current Report (Form 8-K/A), at exhibit 99.2 (June 17, 1999).

[91] *See* Am. Oncology Res., Inc., Registration Statement (Form S-4), at 1, 8–9 (May 10, 1999).

[92] *Id.* at 85.

[93] *Id.*

Still, the transaction was approved.[94]

D. The Overall Increase in Entrenchment

We can now put together the pictures emerging from our separate examinations of mergers that retain in the combined firm the charter of one of the parties and mergers that create for the combined firm a new charter. Our dataset includes 393 mergers. Together they increased the incidence of staggered boards by 11.11% (from 60.69% to 67.43%). In both a sign test and a signed-rank test, this change is highly statistically significant, at the 1% level. But this increase is particularly impressive given that 216 deals had no effect on the incidence of staggered boards. The entire effect was due to the remaining 177 deals, which increased the incidence of staggered boards by 30.31% (from 49.43% to 64.41%). Figure 4 presents this change.

E. Stock Market Reaction to Merger Proposals

We conclude our empirical analysis by investigating the extent to which stock market reactions to the announcement of merger proposals depend on whether the proposed merger is bundled with board staggering.

Stock price reaction to company news is a barometer of shareholder sentiment. When the market reacts to the announcement of a transaction with more buy orders than sell orders and the stock price consequently increases, one can conclude that shareholders view the news favorably. Conversely, when the market reacts to the news with more sell orders than buy orders and the stock price consequently decreases, one can conclude that shareholders view the news unfavorably. We therefore compare stock price movements around the announcements

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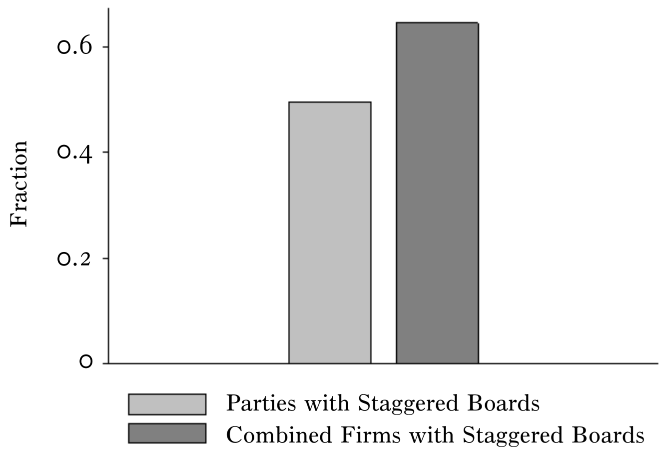
[94] The proxy statement filed in connection with another transaction, the acquisition of Oryx Energy Company by the much larger Kerr-McGee Corporation in 1998, offers a glimpse into the planning of board staggering through a bundled charter amendment:

> On October 2, members of Kerr-McGee's and Oryx's senior management and their counsel had a telephone conference to discuss legal issues regarding the form and other terms of the transaction and the status of due diligence efforts. During the call, Oryx's representatives encouraged Kerr-McGee's representatives to consider structuring the transaction as a merger of Kerr-McGee into Oryx. Among other things, Oryx believed that Oryx's certificate of incorporation, including provisions therein for a classified board and certain related corporate governance provisions that were not contained in Kerr-McGee's certificate of incorporation, would provide greater protections to stockholders of the combined company. Kerr-McGee believed that it was important that the financial community not perceive the merger as an acquisition of Kerr-McGee by Oryx and that Kerr-McGee continue as the surviving corporate entity. . . . It was agreed that Oryx would merge into Kerr-McGee and that Kerr-McGee's certificate of incorporation would be amended to include the specified corporate governance provisions from Oryx's certificate of incorporation.

Kerr-McGee Corp., Amended Registration Statement (Form S-4/A), at 25 (Jan. 27, 1999).

FIGURE 4. THE CHANGE IN BOARD STRUCTURE:
ALL MERGERS RESULTING IN A CHANGE



of mergers that staggered the target firm's board (staggering mergers) with stock price movements around the announcements of mergers that did not (nonstaggering mergers).

We examine this subject only briefly because the bundling hypothesis does not necessarily predict that the market will react to staggering mergers less favorably. To begin, the market reaction reflects not only what shareholders think of the proposed merger. It also reflects what they learn about the firm from the fact that a merger was proposed and whether they expect the merger to be completed. These three factors can offset each other.[95] Moreover, management may select more attractive mergers (including mergers that pay higher premiums) for bundling and avoid bundling in less attractive mergers. This possibility provides another reason not to view any difference in stock market reaction as being driven by shareholder assessment of the consequences of moving to a staggered-board structure. Still, we offer some

[95] *See* Sanjai Bhagat, Ming Dong, David Hirshleifer & Robert Noah, *Do Tender Offers Create Value? New Methods and Evidence*, 76 J. FIN. ECON. 3, 4–5 (2005) (estimating the difference between returns calculated conventionally and returns that exclude both the probability of deal completion and information about the value of each party revealed by the announcement); *see also* Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 10–15 (1983) (summarizing studies that report different announcement returns for completed mergers and abandoned ones); Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 201–02 (1986) (arguing that announcement returns reflect new information about the preannouncement value of the acquirer and the probability of deal completion).

preliminary analysis of the subject below and leave a fuller analysis to subsequent research.

1. Methodology and Data. — We follow the standard methodology used in the corporate finance literature on market reactions to acquisition announcements.[96] First, we collect daily stock prices for a year ending one trading day after the deal announcement for our sample firms from CRSP. Next, we estimate the extent to which the price of each stock usually correlates with the market index by regressing daily percentage changes in stock prices on the corresponding changes in the New York Stock Exchange index starting 253 trading days (about one year) and ending 127 trading days (about six months) before the announcement of the deal, provided that prices are available for at least 100 trading days over this period. Finally, we compare the cumulative percentage change in stock prices over three trading days around the deal announcement day with the predicted change based on the change in the market index over this period and the estimated past correlation of this stock price with the market index. The difference between the actual change and the predicted one is the cumulative abnormal return and it reflects shareholder reaction to the deal announcement. We are able to calculate cumulative abnormal returns using this method for both parties in 340 mergers.

For each of these mergers, we also calculate the premium, defined as the ratio of the deal price reported by SDC to the value of the target's stock 30 trading days before the announcement day. Finally, for each of these mergers, we collect from SDC information on whether the merger was completed or withdrawn and use corporate filings to fill in missing information. This information can shed more light on whether shareholders price the staggering of the board in the deal. To the extent that shareholders price the board staggering and are not compensated for this change in board structure, we can expect them to block staggering mergers more often than they block nonstaggering mergers.

2. Results. — The summary statistics of stock returns for the full sample are consistent with prior studies. As reported in the extant finance literature, the mean stock return of the parties identified by SDC as targets is positive and significant (7.4%, significant at the 1% level in a *t*-test).[97] This reaction reflects the fact that most of the firms

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[96] *See, e.g.*, G. William Schwert, *Markup Pricing in Mergers and Acquisitions*, 41 J. FIN. ECON. 153, 161–62 (1996).

[97] The median target return for our sample is 7.5%. Also consistent with the literature, the returns to acquiring firms are significantly lower: the mean and the median acquirer returns are –3.4% and are significant at the 1% level. *Cf.* Gregor Andrade, Mark Mitchell & Erik Stafford, *New Evidence and Perspectives on Mergers*, J. ECON. PERSP., Spring 2001, at 103, 111–12 (finding that the three-day abnormal returns around merger announcements average 13% for targets

were sold at a hefty premium: the mean premium was 142% of the preannouncement market price (the median was 130%). Of the 340 mergers examined, 263 (77.4%) were completed and the remainder were withdrawn. Most of the withdrawn deals comprised preliminary letters of intent or unsolicited takeover bids that did not result in definitive merger agreements.

We break down the sample into two subsamples, one comprising staggering mergers and another comprising nonstaggering mergers, and compare the two. Table 4 presents the results of this comparison.

Panel A of the table includes all of the mergers for which the variables of interest were available. It does not provide reliable evidence that these variables are related to board staggering. While the 93 staggering mergers exhibit lower stock returns and completion rates and higher premiums than the 247 nonstaggering mergers, the differences are not statistically significant.[98] That the results are not sufficiently pronounced to be statistically significant may be due to the fact that management is more likely to bundle the merger with a move to a staggered-board structure in mergers that are otherwise more beneficial to shareholders than other mergers.

Panel B of the table focuses on poorly received mergers — mergers associated with negative target stock returns. Here there are significant differences between staggering and nonstaggering mergers. Target stock returns are significantly lower in staggering mergers (–13%) than in nonstaggering mergers (–8%), with the difference being significant at the 5% level. Acquirer stock returns are also lower in staggering mergers (–11%) than in nonstaggering mergers (–7%), with the difference being significant at the 10% level. Premiums, in contrast, are higher in staggering mergers (143%) than in nonstaggering mergers (121%), with this difference being significant at the 10% level. Finally, completion rates are lower in staggering mergers (67%) than in non-

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and –1.5% for acquirers in mergers completed between 1973 and 1998 that included stock consideration).

[98] We test the difference in the means of stock returns and premiums both using Student's two-sample *t*-test, which assumes that the variables are normally distributed, and using a Wilcoxon rank-sum test, a nonparametric test for assessing whether two independent samples of observations come from the same distribution, which does not assume that the variables are normally distributed. We test the differences in completion rates using a chi-square test, which is used to detect a relationship between two categorical variables (here, whether the deal was a staggering merger and whether it was completed).

The means are also not significantly different when targets are divided into three groups: the 48 targets that traded a staggered board for a nonstaggered one, the 199 targets that did not change their board structure, and the 93 targets that traded a nonstaggered board for a staggered board. For this comparison we use a one-way analysis of variance and the Kruskal-Wallis test, which generalize Student's two-sample *t*-test and the Wilcoxon rank-sum test, respectively, for more than two samples.

TABLE 4. RETURNS, PREMIUMS, AND COMPLETION RATES

This table compares target stock returns, acquirer stock returns, premiums, and completion rates between mergers in which targets with nonstaggered boards moved to a staggered-board structure (staggering mergers) and mergers that did not have this effect (nonstaggering mergers). Panel A includes all mergers for which target stock returns, acquirer stock returns, premiums, and completion rates were available. Panel B includes only mergers associated with negative target stock returns. TCAR is the cumulative abnormal return of the target calculated over three days around the deal announcement. ACAR is the cumulative abnormal return of the acquirer calculated over three days around the deal announcement. PREMIUM is the ratio of the deal value reported by SDC and the stock capitalization of the target 30 trading days before the deal announcement. The identification of a party as a target or as an acquirer is based on SDC. COMPLETE is an indicator for mergers that were completed. *T*-test is the statistical significance of the difference in means between staggering mergers and nonstaggering mergers using Student's two-sample *t*-test. Wilcoxon (Wilcox.) is the statistical significance of the difference in means between staggering mergers and nonstaggering mergers using a Wilcoxon rank-sum test. Chi-Square (Chi-Sq.) is the statistical significance of the difference in completion rates between staggering mergers and nonstaggering mergers using a chi-square test.

	Panel A. All Mergers								
	Staggering Mergers			Nonstaggering Mergers			Significance of the Difference		
	Obs.	Mean	Std. Dev.	Obs.	Mean	Std. Dev.	*t*-Test	Wilcox.	Chi-Sq.
TCAR	93	0.06	0.18	247	0.08	0.13	0.26	0.23	
ACAR	93	–0.04	0.11	247	–0.03	0.11	0.70	0.92	
PREMIUM	93	1.45	0.53	247	1.41	0.56	0.52	0.30	
COMPLETE	93	0.73		247	0.79				0.25

	Panel B. Mergers with Negative TCAR								
	Staggering Mergers			Nonstaggering Mergers			Significance of the Difference		
	Obs.	Mean	Std. Dev.	Obs.	Mean	Std. Dev.	*t*-Test	Wilcox.	Chi-Sq.
TCAR	27	–0.13	0.14	67	–0.08	0.07	0.01	0.03	
ACAR	27	–0.11	0.13	67	–0.07	0.12	0.08	0.07	
PREMIUM	27	1.43	0.59	67	1.21	0.49	0.07	0.09	
COMPLETE	27	0.67		67	0.81				0.15

staggering mergers (81%), but the difference is not statistically significant. Our findings for poorly received mergers are consistent with the view that shareholders price the staggering of the board in these mergers but still approve the merger most of the time, perhaps due to the higher premium they are offered. For the reasons we explained above, however, this supportive evidence is not central to the bundling hypothesis.

IV. IMPLICATIONS

This Part discusses some of the implications of our findings for corporate law analysis and policy. The evidence of routine and successful bundling of mergers with board staggering casts doubt on the conventional wisdom that charter provisions and other shareholder-approved measures seen today are generally ones that enjoy shareholder support. This evidence also has implications for understanding the evolution of charter provisions and for future empirical research. Furthermore, our findings warrant a reconsideration of courts' review of merger decisions and a new look at merger rules, at management's monopoly over the initiation of charter amendments, and at legal policies relying on shareholder approval.

A. Understanding Charters and Shareholder-Approved Measures

The immediate lesson from our findings is that the shareholder approval requirement is less effective than is commonly believed at ensuring that new charter provisions and other measures that require shareholder approval emerge only if they enjoy shareholder support. The bundling we document may be just one example of a broader practice. Future empirical research should explore other examples.

1. The Assumed Optimality of Shareholder-Approved Measures. — Our findings have important implications for two propositions that are widely accepted among corporate law scholars. The first is that shareholder approval requirements ensure that only management initiatives welcomed by shareholders will pass. The surface appeal of this premise is strong. What, after all, can be a better way to protect shareholders than to require their approval of major corporate plans? Indeed, with the growth of institutional investor holdings in public corporations, reliance on shareholder approval as the ultimate protection of shareholder interests is growing as well.[99] The second premise — which follows from the first — is that charter provisions reflect shareholder preferences. Charter provisions are in place before shareholders invest in the firm or are added with shareholder approval thereafter. Because shareholders can refrain from investing in firms whose charters they dislike and can block unwanted charter amendments after they invest, anything found in the corporate charter is presumed to have passed shareholder muster.

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[99] *See, e.g.*, *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 445–46 (Del. Ch. 2002) (holding that a noncoercive tender offer made by a controlling shareholder provides sufficient protection for shareholders); *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 607 (Del. Ch. 2005) (proposing to extend *Pure Resources* to shareholder approval of a minority squeeze-out merger); Order Approving NYSE and Nasdaq Proposed Rule Changes Relating to Equity Compensation Plans, 68 Fed. Reg. 39,995, 39,997 (July 3, 2003) (requiring shareholder approval of equity compensation plans); Andrea Fuller, *House Backs Limits on Pay to Executives*, N.Y. TIMES, Aug. 1, 2009, at B1 (reporting on a bill requiring an advisory shareholder vote on executive pay packages).

We find that both of these premises are mere idealizations of reality. The ability to bundle measures that shareholders welcome with governance changes they disfavor allows managers to induce shareholders to approve changes that shareholders would reject if they voted on them on a stand-alone basis. In the case of charter provisions bundled with mergers, the crux of the problem is that shareholders cannot initiate proposals for either mergers or charter amendments. Only the board can initiate such proposals. Shareholders must wait for management to propose the merger and then accept it exactly as proposed — or reject it altogether. And if the merger they accepted entails a change in the corporate charter, shareholders must live with this change. They cannot undo it.

As long as management decides which mergers come before shareholders for approval, it may pass a value-creating merger even if the merger could create more value by being structured differently. Bundling mergers with charter provisions favored by management but not by shareholders is thus similar to bundling them with managerial change-of-control benefits: both extract from shareholders a price for enjoying a value-increasing transaction and that price is limited only by the value that the transaction creates.[100]

Beyond the case of charter provisions bundled with mergers, our findings raise a concern about the effectiveness of shareholder approval in any other context in which it is used. To the extent that management can use bundling to induce shareholders to vote for measures they would reject on a stand-alone basis, the value of shareholder approval as a protective device is impaired. As we discuss below, assessing the magnitude of this problem warrants additional empirical research.

2. *Survival of the Inefficient.* — As long as the law does not effectively address the bundling problem, our findings have implications for the direction in which corporate charters evolve. Given the strong and persistent shareholder opposition to staggered boards, which is grounded in the empirical evidence that staggered boards adversely affect firm value and performance, one would expect the incidence of staggered boards to decline over time. Indeed, with increasing numbers of companies destaggering their boards under shareholder pressure, some predict that at least for large companies, staggered boards will soon be

[100] *See* Jay C. Hartzell, Eli Ofek & David Yermack, *What's in It for Me? CEOs Whose Firms Are Acquired*, 17 REV. FIN. STUD. 37, 39 (2004) (finding that higher change-of-control benefits for departing chief executive officers are associated with lower merger premiums); *cf.* Marcel Kahan & Edward B. Rock, *How I Learned To Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 899, 915 (2002) (arguing that change-of-control benefits are a market response to management's control over the decision to sell the firm).

a thing of the past.[101] But merging firms seem to be headed in the other direction. As we have shown, combined firms resulting from mergers tend either to preserve the strongest takeover defenses used by the parties (when the combined firm inherits one party's charter) or to adopt stronger defenses than either party's charter contains (when the combined firm has a new charter).[102]

More generally, given the shareholder approval requirement, it might be presumed that the corporate governance arrangements of existing firms would evolve over time toward arrangements that better reflect shareholder preferences and serve shareholder value. Our analysis casts doubt on this presumption. It shows that, as a result of bundling, some midstream changes in the charter provisions governing public firms may introduce arrangements that shareholders disfavor.

3. Future Empirical Research. — Our findings call for further empirical study of bundling in corporate law. This Article has taken the first step toward understanding how managerial agenda control limits the efficacy of shareholder approval requirements as a protective device. Using the staggering of corporate boards in the course of mergers as a case study, we have demonstrated that bundling is a real problem affecting issues of significant concern to shareholders.

However, our analysis does not enable us to determine the full scope of this problem. Board staggering is just one example of an arrangement favored by management but disfavored by shareholders, and mergers are just one example of a change with which a shareholder-disfavored arrangement can be bundled. To gain a full picture of the extent to which bundling takes place, future empirical work should examine other instances in which a measure brought before shareholders for approval is bundled with a sweetener.

B. Rethinking Legal Policy

The bundling of merger transactions with board staggering that we document warrants a reexamination of some established principles of corporate law. Below we discuss possible reforms concerning courts' review of merger decisions, merger rules, management's monopoly

[101] *See* Marcel Kahan & Edward B. Rock, *Embattled CEOs*, 88 TEX. L. REV. (forthcoming 2010) (manuscript at 21, on file with the Harvard Law School Library) ("The tide on staggered boards has turned and, at least for the largest companies, the day is not far off when staggered boards will be the rare exception.").

[102] *Cf.* Michal Tsur, The Internal Replicative Force of Strategies: Evolutionary Insights into the Widespread Use of Anti-Takeover Defenses (Sept. 1, 2002) (unpublished manuscript, on file with the Harvard Law School Library), *available at* http://ssrn.com/abstract=350042 (developing an evolutionary model of the survival of entrenched firms and the spreading of entrenchment devices).

over the initiation of charter amendments, and the reliance on shareholder approval as a protective device.

1. Judicial Scrutiny of Merger Decisions. — Our findings call into question a distinction in existing case law between the board's duties in stock mergers and its duties in nonstock mergers. According to this case law, the board is free to pursue the deal of its choice when that deal does not involve a change of control but must seek the highest price available when it contemplates a deal that would transfer control to a new owner.[103] The reason is that only the former deal leaves management subject to the discipline of the market and shareholders with the ability to be paid a control premium in the future.[104]

So far, the courts have focused on voting rights to define a change of control and have accordingly regarded deals as not involving a control change if after the deal the shareholders retain an interest in a widely held firm.[105] Consequently, stock mergers are subject to weaker judicial scrutiny than nonstock mergers as long as the combined firm has no controlling shareholder.[106] However, we find that even stock mergers that produce widely held combined firms can lower the likelihood that shareholders will receive a control premium in the future and that management will be subject to the discipline of the market.

When the combined firm has stronger antitakeover defenses than one of the parties to the merger, the likelihood that shareholders of that party will sell their stock at a premium drops once those shareholders have traded the stock of their company for the stock of the combined firm. At the same time, the management of the combined firm is less subject to the discipline of the market than the management of the party that had weaker antitakeover defenses. Given that courts apply greater scrutiny to management decisions in mergers involving a change of control, they should also consider closely scrutinizing mergers that are bundled with entrenching arrangements like board staggering.

2. Unbundling. — The discussion above assumed that managements would retain the ability to bundle entrenching arrangements with merger proposals and focused on how this ability should affect judicial scrutiny of merger decisions. We now turn to the possibility of

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103 *See generally* Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).

104 *See id.* at 42–43.

105 *See* Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289–90 (Del. 1994) (holding that even a stock merger with a much larger firm is not considered a change of control when both firms are widely held).

106 *See Paramount*, 637 A.2d at 42–43 (holding that a widely held firm undergoes a change of control when it enters into a stock merger producing a combined firm with a controlling shareholder).

enabling shareholders to unbundle merger proposals, that is, to take the merger without the entrenchment. One way of doing so is to give shareholders the power to rid the combined firm of the entrenching arrangement after the merger if at least one party to the deal lacked this arrangement before the merger.

Consider the case of staggering mergers. Under existing rules, once shareholders approve a merger that is bundled with board staggering, they are stuck with the new board structure for as long as management wants to keep it. Because shareholders lack the power to initiate charter amendments, they cannot undo the disfavored governance change even if they accepted it only because it was bundled with the merger.

Allowing shareholders to undo the governance change within a specified period after the merger would address this problem. If a merger were to result in board staggering that shareholders disfavored, shareholders would be able to initiate and adopt a charter amendment to destagger the board. In fact, whenever board staggering is not favored by shareholders, the knowledge that shareholders could destagger the board would discourage management from bundling the merger with board staggering in the first place.

If one is concerned that collective action problems might stand in the way of shareholders proposing such charter amendments, the law can provide that a staggered-board structure introduced through bundling will expire at a specified time after the consummation of the merger, so that management would need to propose a charter amendment at an annual meeting following the consummation of the merger to extend the duration of the staggered-board structure.

The above arrangements need not apply to mergers in which shareholders have a separate vote on staggering the board and are expressly told that this choice is not a condition to the merger. When shareholders vote in favor of board staggering on a stand-alone basis, the staggering can be presumed to enjoy shareholder support.

3. Shareholder Initiation of Charter Amendments. — Some might be concerned that preventing management from bundling mergers with governance changes could discourage the initiation of some value-increasing deals. The private interests of management, so the argument goes, might sometimes not be served by a merger unless the merger is bundled with a governance change. This could happen, for example, if one party to the deal has a staggered board while the other does not. Because shareholders would be able to destagger the board following the merger but not otherwise, the former party's management might forgo the deal to retain its antitakeover protection. In such a case, preventing bundling would not bring to shareholders a merger without a staggered board but rather would leave them with no merger at all.[107]

It is uncertain whether this concern is practically important. If it is, however, it could be addressed by enabling shareholders to initiate charter amendments generally, rather than only to undo provisions that were introduced through bundling. The case for general shareholder power to amend the charter can be based on a variety of reasons.[108] Addressing the bundling problem, however, provides another good reason to grant shareholders this power. In a world in which shareholders could initiate and adopt charter amendments, most parties to mergers would probably have nonstaggered boards and the combined firms produced by their mergers would inherit this structure. Managers would not worry about losing their staggered-board protection in mergers because they would rarely have this protection in the first place. And if they did have this protection, it would be because shareholders let them have it — and would likely let them keep it after the merger.

4. Beyond Charter Provisions. — Our analysis has implications not only for the adoption of charter provisions but also for any legal arrangement that relies on shareholder approval of management proposals. This is the case whether the arrangement *requires* shareholder approval, like state law rules that make shareholder approval a condition for reincorporation,[109] or merely *encourages* obtaining shareholder approval, like state law rules that grant conflict transactions some insulation from judicial scrutiny when they are approved by shareholders.[110]

These legal policies are based on the premise that shareholder support for a given change can reliably be inferred from shareholders' vote to approve the change. As we have shown, however, this link may not exist when management uses bundling to obtain approval for changes that shareholders would block on a stand-alone basis. Our findings thus carry a lesson for state and federal public officials who adopt or apply legal arrangements relying on shareholder voting. In

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[107] This argument is similar to claims that golden parachutes are desirable as a means of inducing management to support mergers that serve shareholder interests but not management's private interests. *See, e.g.*, Kahan & Rock, *supra* note 100, at 899, 915.

[108] A general case for allowing shareholders to initiate charter amendments is developed in Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 2, at 865–75. *Cf.* Unisuper Ltd. v. News Corp., 31 DEL. J. CORP. L. 1186, 1199 (Del. Ch. Dec. 20, 2005) (holding that, as fiduciaries of shareholders, directors must respect shareholders' governance preferences).

[109] Reincorporations are effected through a direct merger into a firm incorporated in the destination state or a triangular merger with a subsidiary of such a firm. In either case, the shareholders of the reincorporating firm must approve the merger as they would approve any merger. *See supra* notes 51–52 and accompanying text. Some commentators argue that this ensures that reincorporations benefit shareholders. *See, e.g.*, ROMANO, *supra* note 7, at 18–19.

[110] *See, e.g.*, DEL. CODE ANN. tit. 8, § 144(a)(2) (2001).

any context in which shareholder approval of management proposals is used, it is important to be mindful of the potential bundling problem and take the necessary steps to prevent it from undermining the value of shareholder voting as a protective device.

V. CONCLUSION

This Article provides the first systematic empirical evidence that managements have been using bundling to introduce governance arrangements that shareholders would likely reject if they were to vote on them separately. Studying a hand-collected dataset of mergers announced during the period from 1995 through 2007, we have demonstrated the practical significance of bundling. Our findings have implications for understanding the evolution of charter provisions and the effectiveness of shareholder approval and warrant a reconsideration of basic corporate law principles.