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What Do Corporate Default Rules and Menus Do? An Empirical Examination

Yair Listokin *

Much of corporate law consists of nonmandatory statutes. Although scholars have examined the effect of nonbinding corporate law from a theoretical perspective, only inconclusive event studies explore the real-world impact of these laws. This article empirically examines the impact of nonmandatory state anti-takeover statutes. Several conclusions emerge. Despite its nonbinding nature, corporate law makes an enormous difference in outcomes, contradicting those who claim that corporate law is trivial. Two types of nonmandatory corporate laws have particularly important effects. Corporate default laws that favor management are considerably less likely to be changed by companies than default laws favoring investors, supporting those who believe that corporate default laws can ameliorate asymmetries in incentives or bargaining power between managers and investors. Corporate “menu” laws—opt-in laws that are drafted by the state but do not apply as default rules—also facilitate the use of some provisions, supporting those who believe that nonmandatory corporate law reduces transaction costs, such as the cost of updating corporate charters to reflect developments in the economy.

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I. INTRODUCTION

Much of corporate law consists of nonmandatory “enabling” statutes.¹ These nonbinding statutes fall into two categories. Some corporate enabling statutes create default rules—if the corporate documents are silent, then the default statutory terms apply.² Other statutes create “menu” options.³ These statutes do not apply to corporations unless corporations explicitly signal that they wish to be bound by the terms of the “menu” statute by “opting-in” to the terms of the statute.⁴

Scholars debate the purpose and value of corporate enabling statutes, focusing on the choice of default rules. Some, following the logic of the Coase theorem, say that corporate enabling statutes establishing default rules or menus are irrelevant—if investors and managers desire a certain corporate arrangement, then they will write corporate contracts to obtain that outcome, with or without “enabling” statutes.⁵ Others (transaction-cost

¹Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 *Colum. L. Rev.* 1416, 1417 (1989).

²For a seminal discussion of default rules, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale L.J.* 87 (1989). Because this article focuses on default laws, the terms “default law” and “default rule” will be used interchangeably.

³Menus operate at several levels of abstraction. First, all of corporate law is a menu, with companies “opting in” to the corporate code through the act of incorporation. Second, once a company has chosen to incorporate, the state may provide further menu options by writing statutes that apply to a corporation only if the corporation explicitly opts in to the corporate menu statute. This article examines the second type of menu, although the results are relevant to the first type of menu as well. For discussions of the types of menus emphasized here, see Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 *U. Chi L. Rev.* 1391, 1416 (1992) [hereinafter, Ayres, *Making a Difference*]; Ian Ayres, *Menus Matter*, 73 *U. Chi L. Rev.* 3 (2006). See also Robert Rasmussen, *Debtor’s Choice: A Menu Approach to Corporate Bankruptcy*, 71 *Tex. L. Rev.* 51 (1992) (discussing menus in the context of bankruptcy); Alan Schwartz & Robert Scott, *Contract Law and the Limits of Contract*, 113 *Yale L.J.* 541 (2003).

⁴A statutory scheme may be considered a menu if it offers even one option that does not apply as a default rule. Thus, the “menu” might be very short, consisting of only one opt-in option (as well as a default rule). This differs from the common-sense notion of menus as offering a wide variety of options.

⁵See, e.g., Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis*, 84 *Nw. U.L. Rev.* 542 (1990).

minimizers) claim that corporate enabling statutes reduce transaction costs.⁶ Instead of requiring parties to draft and negotiate similar provisions time after time, the state should provide the public good of enabling statutes to reduce the time and expense of creating and revising corporate arrangements. State-provided enabling statutes also reduce transaction costs by reducing the cost of adjusting outdated rules and facilitating network effects.⁷ Still others, called “principal-agent minimizers,” argue that drafting and negotiation costs are relatively inconsequential in corporate law settings, and emphasize the importance of corporate laws that create default rules as opposed to menu laws.⁸ Well-chosen statutory default rules enhance efficiency by mitigating principal-agent problems between managers and investors.⁹

The stakes in this theoretical debate are high, but relatively little empirical evidence exists to support or refute the various arguments.¹⁰

⁶See, e.g., Easterbrook & Fischel, *supra* note 1, at 1444–45.

⁷See Henry Hansmann, *Corporation and Contract*, 8 *Am. L. & Econ. Rev.* 1 (2006) (corporate law reduces the cost of continually updating corporate arrangements); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting* (or “The Economics of Boilerplate”), 83 *Va. L. Rev.* 713 (1997) (examining the value of network effects for standardized law and corporate documents); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 *Va. L. Rev.* 757 (1995) (same).

⁸See Ayres, *Making a Difference*, *supra* note 3, at 1397; see also Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 *Nw. U.L. Rev.* 489 (2002) (advocating nonmajoritarian default rules but accepting that corporate laws may reduce transaction costs); Roberta Romano, *The Genius of American Corporate Law* 68 (1993) [hereinafter Romano, *Genius*].

⁹A fourth opinion emphasizes the importance of the status quo bias for default laws in contract law. These scholars believe that default laws alter preferences and change outcomes because individuals tend to believe that the default rule is better than alternatives. See Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 *Cornell L. Rev.* 608 (1998). The status quo bias is unlikely to be important in corporate law, however. The subjects of corporate law, such as corporate executives and institutional investors, are sophisticated parties with financial expertise. Moreover, these subjects tend to be repeat players, facing the same types of decisions multiple times. These factors tend to reduce the status quo bias, as parties learn to pursue the efficient outcome. See Alan Schwartz & Robert Scott, *supra* note 3, at 551–52 n.18.

¹⁰Some exceptions that deal with related topics include Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 *J. L., Econ., & Org.* 83 (2001) (examining use of various anti-takeover provisions, including anti-takeover statutes, by firms going public); Raphael De Coninck, *Do Firms Sufficiently Opt Out of Non-Mandatory Laws? Evidence from Business Combination Statutes* (Working Paper, NYU Law School, 2005) (examining anti-takeover statute opt-out rates).

Several event studies examine the impacts of the enactment of opt-out anti-takeover statutes on the stock market value of companies incorporated in the enacting state.¹¹ These studies have the advantage of directly addressing the efficiency question. Their results are somewhat inconclusive, however. Although the most comprehensive studies show slightly negative stock price effects of anti-takeover statutes,¹² Bhagat and Romano note that “there are findings of negative, positive, and insignificant price effects [of state anti-takeover statutes].”¹³

As with all event studies, the interpretation of these results is fraught with difficulty. Market prices respond to new information only and anti-takeover statutes are not written and passed in one day. Inconclusive results may show that the statutes are irrelevant, or they may show that the statutes were anticipated, or they may show that the statute increased value for some companies and decreased it for others. Similarly, a positive stock price effect on the announcement of an anti-takeover statute may reflect a positive market assessment of the statute, or it may reflect the fact that the announced statute was less restrictive of efficient takeover bids than the anticipated statute. Moreover, stock price movements reflect the market’s best guess of the actual impacts of the statute; the market may be wrong. Finally, event studies do not reveal the mechanism whereby a statute might add or detract from market value. Given the flaws of event studies, another approach to the question of the true impact of anti-takeover statutes is warranted.

In addition, the event studies all examine the impact of the passage of opt-out default laws. They do not study the effect of opt-in menu statutes, an important question for corporate law. Menus may be important, or they may be irrelevant; the event studies do not address the question.

¹¹See, e.g., John S. Jahera, Jr. & William Pugh, *State Takeover Legislation: The Case of Delaware*, 7 J. L., Econ., & Org. 410 (1991); Jonathan M. Karpoff & Paul H. Malatesta, *The Wealth Effects of Second Generation Takeover Legislation*, 25 J. Fin. Econ. 291 (1989); Jonathan M. Karpoff & Paul H. Malatesta, *State Takeover Legislation and Share Values: The Wealth Effects of Pennsylvania’s Act 36*, 1 J. Corp. Fin. 367 (1995); Samuel H. Szewczyk & George P. Tsetsekos, *State Intervention in the Market for Corporate Control: The Case of Pennsylvania Senate Bill 1320*, 31 J. Fin. Econ. 3 (1992).

¹²Jonathan M. Karpoff & Paul H. Malatesta, *The Wealth Effects of Second Generation Takeover Legislation*, 25 J. Fin. Econ. 291 (1989).

¹³See Sanjai Bhagat & Roberta Romano, *Event Studies and the Law*, 4. Am. L. & Econ. Rev. 380, 390 (2002).

This article attempts to fill these gaps by examining the impact of corporate anti-takeover enabling statutes. In the late 1980s, a wave of non-mandatory anti-takeover statutes swept through many state corporate law regimes.¹⁴ “Fair price,” “business combination,” and “control share acquisition” statutes hindered the ability of hostile acquirers to take control of publicly traded corporations.¹⁵ Although the role of these statutes in preventing takeovers has now been surpassed by the poison pill, this was not obviously the case when the statutes were being enacted. When these statutes were passed, they were hotly contested and garnered considerable attention and lobbying activity from managers and investor activists.

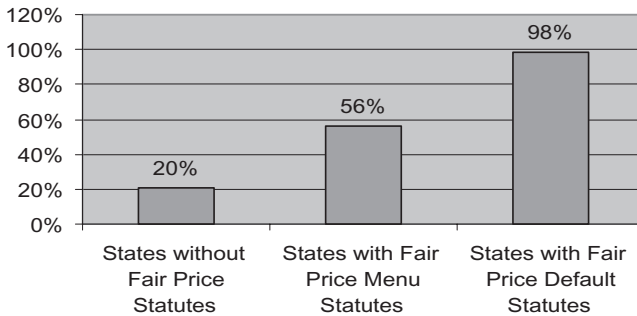
Because different states chose different statutory regimes, anti-takeover statutes offer considerable variation with which to test the different theories about nonmandatory corporate law.¹⁶ Most of the states that passed anti-takeover legislation chose to allow companies to opt-out of the statutes—the anti-takeover statutes were default laws. A number of states, by contrast, failed to pass anti-takeover legislation of any sort. A few states made the anti-takeover statutes mandatory. Finally, Georgia and Tennessee adopted some of the anti-takeover statutes but required companies to opt in to the law, offering the anti-takeover statutes as a menu option within corporate law. A data set collected by the Investor Responsibility Research Center records whether a large set of public companies chose to opt in or opt out of the anti-takeover statutes of each company’s state of incorporation. This variation in statutory regimes allows me to distinguish between different theories of corporate enabling law.¹⁷

¹⁴For discussions of anti-takeover legislation, see Jack D. Isaacs, *State Takeover Laws* (2004); Romano, *supra* note 8; Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 *Colum. L. Rev.* 1168 (1999); Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters* (Working Paper, 2005), available at <http://ssrn.com/abstract=706522>.

¹⁵See Isaacs, *supra* note 14, at A-2 to A-5.

¹⁶See Isaacs, *supra* note 14.

¹⁷De Coninck examines firms in states that allow “opting out” of default anti-takeover statutes and finds some evidence that managers in midstream companies lack incentives to efficiently opt out of business combination anti-takeover statutes. See De Coninck, *supra* note 10. Unlike De Coninck’s work, this article examines variation between opt-in and opt-out states, as well as states without any anti-takeover protections. This method permits conclusions about the efficacy of menu options and alternative default rules that are not addressed in De Coninck’s framework.

Figure 1: Corporate fair price application rates.

The data indicate that both corporate default laws and menus matter enormously (Figure 1). Only 20 percent of companies incorporated in states without “fair price” statutes choose to write fair price protection into their corporate charters. Over 50 percent of companies located in Georgia, which has an opt-in menu statute, enjoy fair price protection. Almost all companies (almost 98 percent) in states where fair price protection is the default rule have fair price protection.

These results contradict the triviality hypothesis, which predicts that none of these variations should matter because companies will always attain their desired level of corporate governance. The failure of the triviality hypothesis suggests that legislatures should continue to produce corporate law.

The difference in initial transaction costs between opting in and opting out of a statute is minimal. Therefore, the large difference in outcomes between companies incorporated in opt-in versus opt-out states is inconsistent with the transaction-cost minimization theory of corporate enabling law.

The data also indicate that anti-takeover menus facilitate the adoption of anti-takeover protections—the first time such an effect has been demonstrated. The importance of menus is inconsistent with principal-agent problem minimization theories of corporate law because menus do not change default laws and require managers to obtain shareholder approval for anti-takeover protection and therefore do not alter the “balance of power” between managers and investors. The results support transaction-cost minimization theories of corporate law, however. Menus

reduce transaction costs by reducing the amount of drafting and negotiation required to adopt anti-takeover protections. More importantly, menus reduce transaction costs by offering a delegated third party (the state) that can change outdated rules in an efficient manner.¹⁸ Menus also create a focal point that engenders the formation of a network effect, which also reduces transaction costs.¹⁹ Thus, corporate law menus may be both efficient and effective.

The article proceeds as follows. Section II discusses state anti-takeover statutes. Section III surveys the existing literature on corporate enabling law. Sections IV and V present the data sources, and derive predictions for the data based on the theoretical literature. Section VI examines the data and evaluates the performance of the hypotheses. Section VII concludes.

II. STATE ANTI-TAKEOVER LEGISLATION

Following the Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America* upholding Indiana's control share acquisition statutes,²⁰ many states passed a variety of anti-takeover statutes in the late 1980s.²¹ These statutes hindered hostile bidders from easily obtaining control of a target corporation. This article focuses on three popular anti-takeover statutes, fair price statutes, business combination statutes, and control share acquisition statutes.

A. Fair Price Statutes

Fair price statutes are designed to prevent coercive two-tier tender offers. In two-tier tender offers, a bidder offers a high price for a control block of shares and then buys the remaining shares for a lower price.²² Two-tier tender offers are coercive because a shareholder, when faced with such an

¹⁸See Hansmann, *supra* note 7.

¹⁹See Klausner, *supra* note 7.

²⁰481 U.S. 69 (1987).

²¹For discussions of the purpose of the statutes, see Romano, *Genius*, ch. 4.

²²Jack D. Isaacs, *State Takeover Laws A-4, A-5* (2004).

offer, feels compelled to tender his or her shares in the first tier, lest the tender offer succeed and the shareholder be forced to accept a lower price in the second tier.²³

Fair price statutes require bidders who do not pay a “fair price” for all shares to satisfy rigorous shareholder approval requirements. For example, Connecticut’s representative statute dictates that a non-“fair price”²⁴ two-tier tender offer must be recommended by the target company’s board of directors and must be approved by 80 percent of outstanding shares and two-thirds of shares not held by the bidder.²⁵

Twenty-seven states enacted fair price statutes between 1983 and 1991.²⁶ Three of these states made the fair price statute a mandatory provision. One of the states, Georgia, enacted an opt-in fair price provision.²⁷ The remaining 23 states that adopted fair price statutes allowed companies to opt out of the statute. None of the states without fair price statutes established fair-price-like protections as a default rule through judicial precedent, although a number of SEC rules deter two-tier tender offers.²⁸

B. Business Combination Statutes

Business combination statutes, also known as “freeze-out” statutes, prohibit certain types of transactions (such as mergers or asset sales) between a large shareholder and a target company for a multi-year period after the large

²³See Lucian A. Bebchuk, “The Pressure to Tender: An Analysis and a Proposed Remedy,” in J. Coffee, L. Lowenstein & S. Rose-Ackerman, eds., *Knights Raiders and Targets: The Impact of Hostile Takeovers* 371 (1988).

²⁴A fair price is defined to mean the maximum of: “(1) the highest price paid for the target company’s shares in the two years before the proposed acquisition was announced; (2) the market value per share on the date the proposal was announced; (3) the value determined in clause (2) multiplied by the highest price paid in the previous two years divided by the market value of the common stock on the first date shares were acquired in the two year period.” Conn. Gen Stat. Ann. §§ 33-840 to 33-842.

²⁵Conn. Gen Stat. Ann. §§ 33-840 to 33-842.

²⁶For details, see Isaacs, *supra* note 22.

²⁷See Ga. Code Ann. §§ 14-2-111 to 14-2-1113.

²⁸For a discussion of federal securities laws and rules regulating two-tier tender offers, see AmJur § 741, “Equal Treatment of Security Holders.”

shareholder's stake exceeds a prespecified amount. Board approval can enable the transactions to move forward during the prohibited period. Business combination statutes prevent bidders from obtaining the full benefit of an acquisition for a long period following the initial acquisition and thereby deter bids.²⁹ Many business combination statutes were passed at the same time as fair price statutes.

New York's business combination statute is representative. The statute "prevents a business combination between any 20 percent shareholder and the target company for a period of five years after the 20 percent acquisition. The law does not apply if the target company's board approves either the 20 percent acquisition or the proposed business combination before the shareholder acquired the 20 percent stake."³⁰

Thirty-two states passed business combination statutes.³¹ Four of these states mandated the business combination statutes for all companies incorporated within the state. As with fair price statutes, only Georgia passed an opt-in statute.³² The remaining 27 states allowed companies to opt out of the business combination statute. None of the states without business combination statutes established business-combination-like protections as a default rule through judicial precedent.

C. Control Share Acquisition Statutes

Control share acquisition statutes provide that acquisition of a controlling block of shares does not ensure voting control.³³ This deters the acquisition of control blocks by bidders because the bidders cannot be confident that their control can ever be exercised.

Indiana's control share acquisition (CSA) statute, at issue in *CTS*, is representative. The statute stipulates that the acquirer of 20, 33.33, or 50 percent of a company's shares must obtain the approval of a majority of the disinterested shares before the acquirer can exercise voting rights of the

²⁹See Isaacs, *supra* note 22, at A-5.

³⁰N.Y. Bus. Corp. Law § 912.

³¹See Isaacs, *supra* note 22.

³²See Ga. Code Ann. §§ 14-2-110, 14-2-1131 to 14-2-1133.

³³See Isaacs, *supra* note 22, at A-2.

control stake. If voting rights fail to be approved, the company can reacquire the shares from the bidder at the market price.³⁴

Twenty-six states adopted CSA statutes. None of the CSA statutes are mandatory. One state, Tennessee, adopted an opt-in CSA statute.³⁵ The other 25 states enacted opt-out statutes. None of the states without CSA statutes has established CSA-like protections as a default rule through judicial precedent.

At present, fair price, business combination, and CSA statutes are little noticed. Poison pills and staggered boards have become the anti-takeover mechanisms of choice. At the time the statutes were passed, however, the statutes were hotly debated. Before Delaware passed its business combination statute, for example, a combined session of both Delaware houses heard over 10 hours of testimony about the potential benefits and costs of the statute.³⁶ Opponents of the statute claimed that it would severely damage U.S. corporations, while managers testifying in favor of the statute claimed that they would reincorporate in another state if Delaware failed to pass the statute. All these actions make no sense if the business combination statutes were irrelevant at the time of passage. Given the emphasis placed on defending or attacking these statutes, it is extremely unlikely that companies that were public at the time of the statute's passage stuck with their state's default rule because it was not worth the trouble of changing the state's default.

III. TESTING THEORIES OF NONMANDATORY CORPORATE LAW

The "triviality," "transaction-cost minimization," and "principal-agent minimization" theories of corporate law make sharply contrasting predictions about the impacts of the anti-takeover statutes just described. These predictions are summarized in Table 1.

³⁴See Ind. Code Ann. §§ 23-1-42-1 to 23-1-42-11.

³⁵See Tenn. Code Ann. §§ 48-103-301 to 48-103-312.

³⁶Recordings of the hearings are available on request.

Table 1: Theories of Corporate Enabling Law

| <i>Theory of Nonmandatory Corporate Law</i> | <i>Summary of Theory</i> | <i>Prediction for Effect of Different Default Rules</i> | <i>Prediction for Effect of Menus</i> | <i>Policy Recommendations</i> |
|---|--|--|---------------------------------------|--|
| Corporate law is trivial (Black) | “The cost of using a privately developed standard form instead of the government’s form is small.” Corporate law therefore is “not very important.” | No effect. | No effect. | |
| Transaction-cost minimization (Easterbrook & Fischel; Hansmann; Klausner) | Corporate law reduces the cost of negotiating and continually modifying corporate arrangements and facilitates the creation of network effects. | Small effect. | Large effect. | Major. default rules. Menus are helpful. |
| Minimization of principal-agent problem (Ayres, Bebchuk, & Hamdani; Romano) | “Restrictive (of management) default rules that are adopted by public officials, but that turn out to be inefficient and thus disfavored by shareholders, will be more likely to be reversed than nonrestrictive default rules that turn out to be inefficient.” | Pro-manager default rules should have a large effect. Anti-manager default rules a small effect. | No effect. | Reversible default rules. No need for menus. |

A. Predictions of the Triviality Hypothesis

According to the triviality hypothesis, corporate default rules simply “aren’t very important” because “(i) even unsophisticated decisionmakers invariably consult experts (called lawyers); (ii) the experts see similar issues repeatedly and develop standard solutions; and (iii) the cost of using a privately developed standard form instead of the government’s form is small.”³⁷

If corporate law is trivial, then none of the variations in state anti-takeover laws just described should make any difference. Companies in states with opt-in anti-takeover statutes should have the same level of protection as companies in states with opt-out protections. Indeed, companies in states without any anti-takeover statute should also enjoy the same level of protections, as companies that desire fair price, business combination, or CSA protection can add such provisions to their charter.

B. Transaction-Cost Minimization Predictions

Many scholars assert that the purpose of corporate enabling laws is transaction-cost minimization.³⁸ By offering nonmandatory corporate laws, the state saves individual parties from incurring the costs of drafting, negotiating, and continually updating a set of terms, and provides for network effects from using one set of terms widely. Transaction-cost minimizers predict that more companies in states with opt-in anti-takeover laws should enjoy anti-takeover protection than companies in no-law, no-precedent states. The opt-in laws allow parties that would like anti-takeover protection but cannot afford the transaction costs to enjoy the anti-takeover protections.

Transaction-cost minimization factors also suggest that companies in opt-in states should have lower levels of anti-takeover protection than companies in opt-out states. If a state is less likely to continually update an opt-in statute than an opt-out statute, then the advantage of delegating modifications in corporate governance to the state is limited. Likewise, opt-in statutes might be less likely to engender positive network externalities than opt-out statutes. Opting in also incurs some transaction costs (a shareholder vote), while opting out does not. The requirement to opt in therefore deters some companies from enjoying anti-takeover protections. The size of these effects

³⁷Black, *supra* note 5, at 557.

³⁸See the citations in notes 6 and 7.

should be small, however. States typically pass a limited number of opt-in options, suggesting that the delegation advantages and network enhancing effects of corporate statutes should remain. In addition, the difference in transactions costs between opting in and opting out of similar statutes are negligible (a simple bylaw amendment is all that is required to opt in). Corporations engage in many votes, and the costs of each vote should be minimal. Thus, transaction-cost minimizers would predict only a small difference in anti-takeover protection rates between companies in opt-in states and companies in opt-out states.

C. Predictions of the Theory that Corporate Enabling Law Should Mitigate Principal-Agent Problems

Principal-agent minimizers argue that transaction-cost minimization considerations are unimportant in corporate law contexts;³⁹ instead, principal-agent concerns are of paramount importance. Because of shareholder free-rider problems, superior management information, and managerial control over the process of altering corporate charters, default rules that give management considerable discretion (and are therefore favored by management) will be much harder to change than default rules constraining management, which management will seek to change if at all possible.

If transaction costs are unimportant, as argued by many principal-agent minimizers, then there should be little difference in anti-takeover protection between companies in states without anti-takeover states and states with opt-in statutes. In both types of states, the default rule is the same—managers need to obtain approval for the anti-takeover law and therefore must reveal the existence and terms of the anti-takeover law. The only difference between the two categories is the transaction-cost minimizing menu benefits of the opt-in statutes, but these are supposedly unimportant.

Principal-agent minimizers also predict that companies in opt-out states should enjoy considerably more anti-takeover protection than companies in opt-in states. Opt-in states and opt-out states have similar statutes, but different default rules. The default rule in opt-in states favors investors, while the default rule in opt-out states favors managers. As described earlier, principal-agent minimizers believe that superior information, incentives, and control over the corporate agenda enable managers to maintain a pro-manager default rule even when it is inefficient. Thus, some companies

³⁹See discussion in Section I.

in opt-out states may stick with the default rule even when it is inefficient. In opt-in states, however, managers will not be able to exploit their advantages to gain protection from the anti-takeover statutes when the statutes are inefficient. Thus, companies in opt-out states should enjoy higher rates of protection than companies in opt-in states.

These predictions, of course, reflect the principal-agent minimizers' assumption that default rules can mitigate asymmetries between managers and investors. If default rules are insufficient, then companies in opt-in and opt-out states should enjoy similar levels of protection.

IV. DATA, SUMMARY STATISTICS, AND SPECIFICATION

A. Data Sources

These predictions will be tested using data from several sources. The primary source of data is the Investor Responsibility Research Center's (IRRC) Corporate Takeover Defense Database.⁴⁰ Every other year, the IRRC gathers data on a myriad of anti-takeover features for a large group of companies. These data include information on the existence of poison pills, classified boards, supermajority provisions, and golden parachutes, among many other provisions. Most importantly for this article, the data set includes information on whether a company is incorporated in a state that has enacted a fair price, business combination, or control share acquisition statute, and whether a company has opted in or opted out of the statute if the statute exists.

The IRRC data also note whether a company has enacted a fair price charter provision. The data set does not contain information regarding business combination or control share acquisition charter amendments, however. As a result, the empirical analyses that draw on data regarding companies in no-law, no-precedent states focus on fair price provisions.

The IRRC data were supplemented with data from several other sources. The data on each company from IRRC were matched with detailed company-level data from Compustat and CRSP.⁴¹ Initial CRSP appearance dates were used to determine if a company was publicly traded when anti-

⁴⁰For a description of the data set, as well as variable definitions, see Paul A. Gompers, Joy L. Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. Econ. 107 (2003). The data set is available from the Wharton Research Database Service (WRDS).

⁴¹Compustat and CRSP can be obtained from WRDS.

takeover statutes were passed.⁴² In addition, additional data on the nature of each state's anti-takeover laws were obtained from the detailed descriptions of the anti-takeover laws that can be found in the IRRRC's series on State Takeover Laws.⁴³

B. Summary Statistics

One cannot simply compare companies in opt-out states with companies in no-law states and draw conclusions about the predictive power of different theories of nonmandatory corporate law—the differences between opt-out states and no-law, no-precedent states confound two effects. On the one hand, companies in opt-out states may adopt anti-takeover protections at greater rates than companies in no-law states because the statutes allow managers to exploit their bargaining power over investors, particularly in companies that were already public before the passage of the relevant statutes (midstream companies).⁴⁴ On the other hand, companies in opt-out states may adopt anti-takeover provisions at higher rates because of the menu effect—the existence of the statutes economize on transaction costs, enabling more companies to enjoy efficient protections.

Opt-in rules allow me to distinguish between these two effects. The difference in outcomes between opt-in states and no-law states is unlikely to be the result of bargaining imbalances; in both states, managers must reveal information and obtain investor approval. A difference between opt-in states and opt-out states, by contrast, is unlikely to be the result of transaction-cost minimization; in both cases, the state provides the benefits of delegation of modification and enhancement of network effects. Table 2 presents mean adoption rates for fair price, business combination, and CSA statutes in companies that passed statutes as opt-out, opt-in, or mandatory rules, as well as fair price charter provision rates for companies in states with no fair price statute. Because a number of theories of corporate law emphasize the distinction between midstream and closely held companies, Table 2 presents

⁴²To prevent time trends in anti-takeover protection adoption provisions from affecting the results, midstream companies are defined to be the same for all states. Midstream status means that the company went public before 1989.

⁴³See Isaacs, *supra* note 22.

⁴⁴For more on the distinction between already public (midstream) companies and companies that go public after a statute is passed, see Easterbrook & Fischel, *supra* note 1.

Table 2: Summary Statistics

| | Companies Going Public After the Passage of the Statute | | | All Companies | | |
|--------------------------------|---|-----------------------------------|--|--|----------------------------------|---|
| | <i>I</i> Fair Price Adoption Rate | <i>II</i> CSA Adoption Rate | <i>III</i> Business Combination Adoption Rate | <i>IV</i> Fair Price Adoption Rate | <i>V</i> CSA Adoption Rate | <i>VI</i> Business Combination Adoption Rate |
| States with opt-in statutes | 57.1% (13.7%) [14] | 0% (0%) [12] | 50.0% (13.8%) [14] | 56.4% (8.0%) [39] | 13.8% (6.5%) [29] | 35.9% (7.8%) [39] |
| States with opt-out statutes | 97.0% (1.3%) [169] | 83.4% (2.8%) [165] | 95.2% (0.7%) [1039] | 98.4% (0.4%) [766] | 82.9% (1.3%) [754] | 96.9% (0.3%) [2725] |
| States with mandatory statutes | 100% (0%) [29] | N/A [0] | 100% (0%) [27] | 100% (0%) [130] | N/A | 100% (0%) [139] |
| States with no statute | 9.5% (1.0%) [954] | N/A | N/A | 20.4% (08%) [2216] | N/A | N/A |

NOTE: Each row presents results for groups of states with different statutory anti-takeover protection regimes. Each column presents data for all companies (midstream and nonmidstream) in the sample, or for nonmidstream companies exclusively. Each cell presents the proportion of companies in the relevant state/midstream status that enjoy the anti-takeover protections specified in the columns. Standard errors in parentheses; number of observations in brackets; data described in the text. There are no observations for control share acquisition protection or business combination protection in states without CSA or BC statutes because the IRRC data do not record whether or not companies adopted such protections via charter or bylaw amendments. There are no states with mandatory control share acquisition statutes, and therefore no observations to record.

results for two sets of companies. Columns I–III of Table 2 present data for companies that were not yet public when the wave of anti-takeover statutes were passed. Columns IV–VI present data for all companies, including midstream companies.

Table 2 and Figure 1 show large differences in outcomes between companies in opt-in, opt-out, and mandatory law states, and states without statutes. These differences exist for companies that went public after the passage of the statutes, as well as midstream companies. For example, 57 percent of Georgia companies that went public after Georgia passed its opt-in fair price law opt in to the statute (Column I), and 56 percent of all Georgia companies opt in to the fair price statute (Column IV and Figure 1). These numbers are dramatically and statistically significantly less than the adoption rates for companies in opt-out states. Fair price statutes apply to 97 percent of companies incorporated in opt-out states that went public after the passage of the statute, and 98 percent of all companies incorporated in these states fail to opt out of the fair price statutes. These differences in protection rates between opt-in and opt-out states are significant at the 5 percent level.

The fair price protection rate for Georgia companies, however, far exceeds the rate of fair price protection enjoyed by companies forced to draft their own charter provisions. In no-law states, only 20 percent of all companies and less than 10 percent of new companies draft fair price charter provisions. The difference in protection rates between the Georgia companies and the no-law companies is also significant at the 5 percent level.

C. Identification Strategy

These results support the argument that default rules and menus matter enormously for corporate law. They are hardly definitive, however. Selection bias and omitted variable bias may cause systematic differences in anti-takeover adoption rates between companies in different states.⁴⁵ Simply put, companies in states with one type of default rule or menu option may be systematically different from companies in states with other legal regimes. If

⁴⁵Note that the differences are unlikely to be the result of differences in statutory language between the states because the anti-takeover statutes within a given class are very similar across states. See Isaacs, *supra* note 22, at A-2 to A-6.

this is the case, then differences in anti-takeover provision adoption rates cannot be attributed to differences in corporate laws.

To control for the impacts of other variables, the article tests the effects of default rules and menus using the following “random effects” specification. (Results are provided for both a random effects logit model and for a random effects linear probability model.⁴⁶)

$$Y_{ct} = \alpha + X'_{ct}\beta + \delta * default_rule_{ct} + \phi * opt_in_{ct} + \alpha_c + \varepsilon_{ct} \quad (1)$$

where Y_{ct} indicates whether company c has a particular anti-takeover protection in time t , X_{ct} is a vector of control variables, including company size, profitability, Census division dummies, year dummies, debt levels, industry dummies, a dummy for whether the company went public before or after the passage of the statute, and measures of other governance features,⁴⁷ including the existence of golden parachute provisions, a measure of directorial independence, the existence of secret balloting, and the existence of cumulative voting provisions. ε_{ct} is a mean zero, serially uncorrelated error term and α_c is a time-invariant company-specific “random effect” that is uncorrelated with ε_{ct} or any of the other variables in the regression. The primary variables of interest are *default_rule_{ct}*—a dummy variable indicating whether the company is located in a state with an anti-takeover default statute—and *opt_in_{ct}*—a dummy variable indicating whether the company is located in a state with an opt-in anti-takeover statute. The effect of having an opt-in statute will be estimated from this dummy.

An important concern about this specification (and any random effects specification) is that it identifies the effects of the differences in legal rules through (in part) cross-sectional variation. The cross-sectional variation occurs at the state-level—the level of the differences in statutory regimes. As a result, state-specific effects that impact anti-takeover protection levels and are not controlled for by other variables (such as Census division effects)

⁴⁶Linear-probability models are far easier to interpret than logit models and often provide more policy-relevant estimates, but suffer from the obvious disadvantage of predicting that some events occur with negative probability while others occur with probability greater than one. For more details, see Angus Deaton, *The Analysis of Household Surveys* 85–92 (1998). Deaton concludes that limited dependent variable models such as the logit or tobit are often (though not always) “artificial and unnecessarily elaborate.”

⁴⁷Poison pills and staggered board controls are not included in most specifications due to the fact that these might act as substitutes for the anti-takeover protections studied here.

Table 3: Corporate Governance Measures

| <i>Provision</i> | <i>Companies in States with No Fair Price Statute</i> | <i>Georgia Companies</i> | <i>Companies in States with Fair Price Default Law</i> |
|-------------------------------------|---|------------------------------|--|
| Adjusted corporate governance index | 7.3 (005) | 7.8 (040) | 7.7 (009) |
| Poison pill adoption rate | 53.8% (1.1%) | 56.4% (8.0%) | 55.2% (1.8%) |
| Classified board adoption rate | 56.7% (1.1%) | 56.4% (8.0%) | 60.4% (1.8%) |

NOTE: Each column presents results for groups of states with different statutory anti-takeover protection regimes. Each row presents data for all companies (midstream and nonmidstream) in the sample. Each cell presents the proportion of companies in the relevant state/midstream status that enjoy the anti-takeover protections specified in the columns. Standard errors in parentheses.

cannot be distinguished from the impacts of the statutes. This concern is heightened by the paucity of states (only one) with opt-in statutes.⁴⁸

Several arguments suggest that these concerns do not undermine the identification strategy. First, to this point no one has suggested that Georgia's companies are unique with respect to corporate governance, certainly not when compared with companies in, say, North Carolina or Florida, and after controlling for factors such as industry and company size. Georgia companies pushed for the fair price and business combination statutes, much as companies elsewhere did.⁴⁹ Empirical evidence supports the argument that there are no obvious and important Georgia idiosyncrasies aside from the existence of the opt-in statute. For example, Georgia companies have enacted other important anti-takeover protections at the same rate as companies in other states.⁵⁰ Table 3 shows that Georgia companies adopt poison pill and staggered board protections, for example, at comparable rates to companies in opt-out states or mandatory law states (Columns

⁴⁸Relatively few "treatment" companies will also lead to higher standard errors, but this does not address the concern about unobservable state effects independent of the statutes.

⁴⁹See Letter of William Carney (Apr. 7, 2005).

⁵⁰Table 1 displays results for both pre and post-IPO companies in Georgia, but the results are very similar for pre-IPO companies alone. Tennessee companies also have standard rates of adoption for these anti-takeover provisions.

II–III).⁵¹ One popular index of the quality of corporate governance, the Gompers-Ishii-Metrick Corporate Governance Index,⁵² suggests that Georgia companies have comparable corporate governance quality to companies in other states. In some versions of Equation (1), I include other corporate governance indexes to control for the possibility that Georgia companies have idiosyncratic corporate governance features, although this addition introduces the possibility of endogeneity bias because of substitution between different anti-takeover measures such as fair price provisions and poison pills.

I also run analogues of Equation (1) with other corporate governance variables as the dependent variable. If Georgia firms are unique with respect to corporate governance after controlling for other factors, then we would expect a Georgia dummy variable to have important predictive effects for many corporate governance measures, including, among others, the presence of a poison pill, existence of a classified board, and measures of directorial independence. In none of these specifications is the Georgia dummy even close to significant—in both statistical and economic senses. These results provide further evidence that Georgia companies are not unique with respect to most measures of corporate governance.

Another reason to doubt the uniqueness of Georgia is that Georgia's opt-in rule was the result of a little noted compromise within the Georgia bar to support the enactment of fair price and business combination statutes but not to make the statutes the default rules.⁵³ For example, the opt-in status of the rule went unmentioned in a comprehensive law review of the anti-takeover statutes written by two Georgia practitioners.⁵⁴ If Georgia's opt-in rule was not viewed as singularly important within Georgia, then there is less chance that Georgia is unique.

⁵¹Doctrinally, the Georgia legislature and courts accept the poison pill. See *Invacare Corp. v. Healthdyne Techs., Inc.*, 968 F. Supp. 1578, 1582 (N.D. Ga. 1997).

⁵²The governance index is adjusted to exclude the presence or absence of fair price, CSA, or business combination protections.

⁵³One factor in the opt-in statutes of the rule may be Professor William Carney's prominent role on the committee drafting the statute. Professor Carney had earlier published an article favoring opt-in statutes. See Letter of William Carney (Apr. 7, 2005). See Paul Quiros & Donna Ruth Jones, *Business Associations*, 40 *Mercer L. Rev.* 61, 74 (1988).

⁵⁴See Paul Quiros & Donna Ruth Jones, *Business Associations*, 40 *Mercer L. Rev.* 61, 74 (1988).

A voluminous literature suggests that firms that incorporate in Delaware are distinct from firms that incorporate in other locations.⁵⁵ Differences between Delaware incorporated firms' and other firms' fair price provision take-up rates may be caused by different state laws, or they might be caused by other unobservable differences in Delaware firms. To address the concern that unobservable differences in Delaware firms cause results, I present results including and excluding Delaware firms.

To assuage remaining doubts about disentangling idiosyncratic characteristics of Georgia companies from the effect of opt-in statutes, I also present a specification resembling a differences-in-differences analysis. Although the data set includes no observations before the enactment of the statutes around 1986–1989, it does include data about the existence of corporate charter amendments that provided fair price protection. The large majority of these fair price charter amendments were enacted before fair price statutes were passed. After the statutes were enacted, the large majority of firms with fair price protection chose to use their state's fair price statute rather than an individual amendment.⁵⁶ At the same time, however, the data indicate that very few corporations chose to remove these charter amendments from their charters after the enactment of the statutes.⁵⁷ As a result, if a company has a fair price charter or bylaw amendment in the data set, it is quite likely that this amendment was enacted before the passage of a fair price statute. This enables me to “look back” and see whether a firm had fair price protections before the enactment of the fair price statutes. Note, however, that this specification falls short of a true differences-in-differences because the “before” observations are artificial and undoubtedly measured with error.⁵⁸ As

⁵⁵See, e.g., Feng Chen, Kenton K. Yee & and Yong Keun Yoo, *Are Delaware Firms Oranges? Fundamental Attributes and the Delaware Effect* (1st Annual Conference on Empirical Legal Studies, 2006), available at (<http://ssrn.com/abstract=912942>).

⁵⁶Firms that went public after the passage of their states' fair price statute promulgated fair price charter amendments less than 10 percent of the time, while firms that were public before the passage of the statute enjoyed fair price charter provisions over 30 percent of the time, providing indirect evidence that most fair price charter amendments were enacted before the passage of the statutes.

⁵⁷Almost no companies go from having a fair price charter amendment to not having an amendment in later years.

⁵⁸Because I do not know the year in which a fair price provision presumed to be adopted before the statute was actually adopted, I cannot utilize control variables that change from year to year.

a result, this specification should be viewed more as a robustness check than a source of good estimates of the effect of different statutes. The “differences-in-differences” specification is as follows:

$$\Delta Y_c = \alpha + \beta * \text{default_rule}_c + \delta * \text{opt_in}_c + \gamma' x_c +, \quad (2)$$

where ΔY_c represents the change in fair price protection status from “before” fair price statutes were enacted to “after,” default_rule_c is a dummy variable indicating whether company c is in a state with a default rule statute, opt_in_c is a dummy variable indicating whether company c is in a state with an opt-in fair price statute, and x_c is a vector of control variables for company c . The differences-in-differences analysis is run as a linear probability model.⁵⁹ If companies in states with fair price statutes are different with respect to fair price protections, then we would expect them to have unusual levels of fair price protection both before and after a fair price statute is passed. If the passage of a statute has an important impact, by contrast, then the coefficients on the default rule and *opt_in* variables should be significant.

V. RESULTS AND INTERPRETATION

A. Regression Results

Table 4 presents regression results for the specification described in Equation (1).⁶⁰ The results indicate that both opt-in menu statutes and default fair price statutes have important effects on the amount of fair price protection enjoyed by companies. The linear-probability random effects regression estimates that a company in a state with an opt-in fair price statute (in Georgia) has a 0.22 greater chance of having fair price protection than an otherwise similar company in a state without a statute. This difference is significantly different from zero at the 5 percent level. The difference is also economically significant—Georgia companies are much more likely to have fair price protection than their counterparts in states without fair price statutes.

In addition, the probability that a company with access to a fair price default statute has fair price protection is 0.67 higher than it would be if the same company was located in a state with no statute, and 0.45 higher than it

⁵⁹The results are similar when a fixed effects logit model is applied.

⁶⁰The estimates presented in Table 4 are robust to many changes in specification.

Table 4: Random Effects Regression Outcomes

| | 1 | 2 | 3 | 4 |
|--|-------------------------|---|----------------------|---------------------|
| | Random Effects | | Random Effects | |
| | Linear-Prob. Model | Linear-Prob. Model (DE Firms Excluded) | Logit Model | Logit Model |
| Opt-in fair price law | 0.225 (0.054)*** | 0.256 (0.0501)*** | 7.298 (1.353)*** | 7.650 (0.857) |
| Fair price default law | 0.669 (0.015)*** | 0.6380 (0.0162)*** | 14.460 (0.825)*** | 15.464 (0.723) |
| Market to book ratio | 0.0000385 (0.000246) | -0.0000524 (0.000398) | 0.00754 (0.0160) | 0.00595 (0.0160) |
| Log market value | 0.00694 (0.0032)** | -0.00247 (0.00349) | 0.187 (0.146) | 0.225 (0.138) |
| Log value of debt | 0.00232 (0.00182) | 0.00199 (0.00201) | 0.1150 (0.0708) | 0.161 (0.124) |
| Log of income | 0.00159 (0.00253) | 0.00116 (0.00267) | -0.084 (0.128) | -0.048 (0.124) |
| South Atlantic Census dummy | -0.0421 (0.034) | 0.121 (0.034) | -1.673 (1.459) | -1.74 (1.12) |
| Company went public after statute passed (dummy) | -0.092 (0.0144)*** | -0.0258 (0.0165) | -2.116 (0.375) | -2.22 (0.314) |
| Classified board | 0.0793 (0.0100)*** | 0.0169 (0.0101)* | 2.375 (0.336) | |
| Poison pill | 0.00940 (0.00670) | 0.0155 (0.0071)** | 0.710 (0.278) | |
| Industry dummies | Yes | Yes | Yes | Yes |
| Year dummies | Yes | Yes | Yes | Yes |
| Other Census division dummies | Yes | Yes | Yes | Yes |
| Other corporate governance variables | Yes | Yes | Yes | No |
| Delaware firms included | Yes | Yes | Yes | Yes |
| Observations | 6,296 | 3,047 | 6,296 | 6,296 |

*Denotes significant at 5 percent level; **denotes significant at 1 percent level.

NOTE: Results of random effects regressions with fair price protection as the dependent variable, corresponding to Equation (1). Column 2 excludes Delaware firms, which may be different in unobservable ways from firms that do not incorporate in Delaware. Columns 3 and 4 present random effects logit regressions. Column 4 excludes corporate governance values due to endogeneity concerns. Column 2 includes these values.

would be if the same company had access to Georgia's opt-in statute. Again, all these differences are significantly different from zero at the 5 percent level and economically significant as well. Fair price protection rates for otherwise similar companies are much higher when the company is incorporated in a state with a fair price default law.

The results change little when Delaware companies are excluded (Column 2 of Table 4), suggesting that the impact of opt-in and default law fair price statutes are not caused by unobservable Delaware-company-specific characteristics. Fair price protection rates for non-Delaware companies in default rule states are much higher than fair price protection rates for companies in opt-in states (Georgia companies), which in turn are much higher than fair price protection rates for companies in states with no statute.

Columns 3 and 4 of Table 4 present random effects logit specifications. Although the logit coefficient estimates are difficult to interpret, the logit specification estimates that both fair price default statutes and opt-in statutes have positive effects on fair price protection rates that are statistically significant at the 1 percent significance level. This indicates that the large impacts of the fair price statutes are not artifacts of the linear-probability model. The coefficient estimates for Column 3 (which includes corporate governance variables) and Column 4 (which excludes corporate governance variables) are extremely similar, suggesting that endogeneity between corporate governance variables and fair price protection rates is not the sole cause of the importance of fair price statutes for fair price protection rates.

Companies that went public after the statute was passed have lower fair price protection rates than otherwise similar companies. This finding is consistent with the prediction that "midstream" companies are more affected by corporate laws than otherwise similar companies that go public after a statute was passed. Companies with classified boards and poison pills are also more likely to have fair price protection, suggesting that fair price anti-takeover protection is correlated with other forms of anti-takeover protection. Most other control variables do not have consistently noteworthy effects on the probability of fair price protection.

The artificial "differences-in-differences" estimates in Table 5 are generally consistent with the random effects specification results in Table 4. Even after controlling for company fixed effects, which should prevent bias caused by unobservable time-invariant company traits that are correlated with incorporation in a state with fair price laws, both the opt-in and default fair price laws significantly raised the probability of a company incorporated in a given state enjoying fair price protection. A default rule fair price statute

Table 5: Quasi “Differences-in-Differences”
Regression Outcomes

| | <i>1</i> |
|----------------------|--|
| | <i>Random Effects</i> <i>Linear-Prob. Model</i> |
| Default rule statute | 0.715*** (0.0102) |
| Opt-in statute | 0.120** (0.0529) |
| Constant | 0.279*** (0.00343) |
| Observations | 4008 |
| Number of companies | 2004 |
| R^2 | 0.711 |

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$.

NOTE: Results of differences-in-differences regressions with change in fair price protection as the dependent variable, corresponding to Equation (2). Standard errors in parentheses.

is associated with a 0.71 increase in the probability of having fair price protection compared to incorporating in a state with no fair price laws, after controlling for company fixed effects. This estimate, which is significant at the 1 percent level, is almost identical to the estimates presented in Table 4. The existence of an opt-in fair price statute raises the probability of fair price protection by 0.12 relative to the absence of any statute. This estimate, which is statistically significant at the 5 percent level, is approximately half the absolute value of the random effects regressions, suggesting that unobserved differences between Georgia firms and firms in states without fair price statutes caused some, but not all, the difference in fair price protection rates between the two groups of firms. Although the artificial nature of this differences-in-differences estimation cautions against taking these estimates too seriously, the broad similarity between these estimates and the cross-sectional ones above suggests that the cross-sectional outcomes are not merely the result of “other” factors correlated with fair price statutes but not included in the regression estimates.

B. Interpretation

The results presented in Tables 3, 4, and 5 strongly refute the triviality hypothesis. According to the triviality hypothesis, differences in default rules or the availability of menu options should not matter. Similar companies

incorporated in states with different menu options or default rules should have similar levels of anti-takeover protections. In fact, however, the differences in fair price availability matter enormously. Companies in the states with a fair price menu statute are more likely to have fair price protection than companies in states without statutes (the opt-in dummy has a positive and significant marginal effect), but are much less likely to enjoy fair price protection than companies in states where there is fair price default protection (the marginal effect of the default dummy is considerably higher than the marginal effect of the menu dummy).

The results also help refute a subtle variant of the triviality hypothesis—that these statutes are partially irrelevant in the era of the poison pill. If fair price statutes truly were irrelevant, then why would so many Georgia companies take the trouble to opt in to them—even those that went public after the poison pill was firmly entrenched? If the response is that around 50 percent of companies care enough to opt in and the other half view the statute as irrelevant,⁶¹ the next question is, why do not 50 percent of companies in states with no statute adopt fair price charter amendments? In fact, only 20 percent do;⁶² if 50 percent of companies care about fair price protection, then they should pursue fair price protection regardless of whether an opt-in menu statute exists. In the data, however, the fair price menu statute dummy has a significantly positive marginal effect, which it should not under the irrelevancy theory. This piece of evidence, along with the fact that corporations aggressively pursued the enactment of all the anti-takeover statutes analyzed here and the fact that a number of companies continued to opt in to or write fair price provisions during the 1990s, suggests that, at least at the time of enactment, the anti-takeover provisions were salient considerations to many corporations rather than irrelevant or partially irrelevant.⁶³

⁶¹None of the Georgia companies in the sample have a controlling shareholder, so it is not the case that some Georgia companies failed to opt in because they were closely controlled and therefore did not need fair price protection.

⁶²Corporations in these states may have slightly different preferences, which may explain some of the distinction, but unless companies in Florida (an opt-out state) are radically different from companies in Georgia (an opt-in state), which in turn are very different from companies in Texas (a no-law state), then it is hard to understand such large differences stemming from differences in state corporate preferences.

⁶³See, e.g., Audio Recording of DE Hearings on the Adoption of DE's Opt-Out Business Combination Statutes (1988) (on file with author) (recording the threats of

The results only partially comport with the transaction-cost minimization rationale for corporate enabling laws. On the one hand, both opt-in and opt-out states have drafted laws allowing companies to enjoy anti-takeover protection. The costs of negotiating and drafting terms have been incurred by the state in both cases and the network and delegation of modification benefits should be comparable for both opt-in and opt-out statutes. Thus, it is very difficult to explain the difference in outcomes between opt-in and opt-out states in terms of transaction-cost minimization.

The effect of Georgia's opt-in menu statute relative to the absence of any statute, however, supports a transaction-cost minimization explanation. Instead of drafting and modifying the terms of fair price protection, companies in Georgia can enjoy fair price protection through a simple vote to opt in to Georgia's ready-made statute and can rely on the state to modify the provision in the future if necessary. This reduction in cost enables Georgia corporations that desire fair price protection but might be deterred by the cost of creating or modifying such protection to enjoy fair price protection. Similar companies in no-law, no-precedent states, by contrast, might choose to economize on these costs by foregoing fair price protection. Thus, the large impacts of corporate law menus support the transaction-cost minimization rationale for corporate enabling laws, contradicting those who have argued that transaction-cost minimization is irrelevant for corporate law.⁶⁴

The principal-agent mitigation theory of corporate law also receives partial support. The large difference in outcomes between opt-in and opt-out states is easy to understand from a principal-agent minimization perspective, however. Investors are more poorly informed than managers. In addition, attempts by investors to overturn inefficient default rules are plagued by free-rider problems and managerial control over the corporate charter amendment process. Thus, anti-takeover default rule protections persist, even when they are inefficient. It is no surprise that over 97 percent of companies in opt-out states stick with the pro-manager default rule. Managers, by contrast, are not hindered by these factors. So long as they can convince shareholders to vote for changing the default rule, they will succeed in altering the default. The data indicate that managers are successful in changing the default rule reasonably frequently. The fact that

companies to reincorporate in states outside Delaware if the business combination statute was not passed).

⁶⁴See, e.g., Ayres, *Making a Difference*, *supra* note 3.

managers in opt-in states are not always successful in changing the default rule, however, indicates that anti-manager default rules are capable of constraining managers.⁶⁵ The importance of opt-in menus, by contrast, contradicts a narrow principal-agent minimization perspective. The default rule in opt-in states and no-law, no-precedent states—nonapplication of fair price provisions—is the same. In both categories of states, managers must convince shareholders to alter the default rule and approve the fair price protections, thereby protecting investors. Thus, the difference in outcomes between the two categories cannot be attributed to differences in bargaining power, incentives, or corporate agenda control.

Thus, the impacts of menu statutes and default rules discovered here are likely due to the combined effect of the transaction-cost-reducing and principal-agent-problem mitigating aspects of the different statutes. The effects of the default rules may also be the result of behavioral effects, although these effects are unlikely to be particularly salient in this context.⁶⁶

VI. CONCLUSION

The data examined above have several implications for theories and policies of nonmandatory corporate law.

⁶⁵Another interpretation of these results emphasizes that a lack of anti-takeover statutes might serve as a signal of superior managerial quality. Signaling models typically allow for multiple equilibria, including pooling equilibria, in which all firms adopt the same amount of protections, and separating equilibria, in which better managers have less protection than lesser managers as a signal of the better manager's higher quality. A change in default rule or menu might change the equilibrium through one of two avenues. First, differences in transaction costs imposed by different default laws and menus lead to different sets of equilibrium outcomes in states with different types of laws. This effect, however, does not make one type of outcome more likely than another in any way that correlates with the difference in transaction costs. As a result, it cannot predict the results presented here. Second, differences in default laws may lead to different equilibria by changing investors' out-of-equilibrium beliefs about what managers will do. Opt-out laws might lead to a pooling equilibrium where investors believe that the presence or absence of anti-takeover protections have no signaling value, and therefore all firms have protection, while opt-in rules lead to a separating equilibria where the lack of protection is a signal of quality. Too much should not be made of this possibility, however, because of the notorious instability of pooling models and the difficulty of making firm statements about the relative probabilities of pooling versus separating equilibria. For a discussion of signaling models, see Patrick Bolton & Mathias Dewatripont, *Contract Theory* ch. 3 (2005).

⁶⁶See Jennifer Arlen et al., *Endowment Effects Within Corporate Agency Relationships*, 31 *J. Legal Stud.* 1 (2002).

The results strongly contradict the claim that corporate law is trivial. The presence or absence of corporate menus leads to large differences in outcomes—an empirical finding that has not been made before—as do differences in default rules. Lawmakers and judges cannot rely on bargaining between managers and investors to arrive at efficient outcomes regardless of the content of corporate law; instead, policymakers should invest the time and energy to create value-enhancing default rules and menus.

The results offer guidelines for identifying value-maximizing corporate enabling laws. Corporate enabling laws reduce transaction costs. By providing the imprimatur of the state, facilitating network effects, and reducing the cost of continually updating corporate charters to reflect changes in the law and the economy, corporate enabling laws provide a public good that allows managers and investors to enjoy provisions that might be too costly to create or negotiate from scratch.⁶⁷ Transaction costs are reduced even when the corporate enabling laws are offered as menus rather than instituted as default laws. Thus, legislatures should offer limited menus of terms that might be desirable in some corporate circumstances.

The transaction-cost-reducing effects of corporate enabling laws do not imply that default rules should be majoritarian rules, however. The previous section indicated that default rules in favor of management are more difficult to alter than default rules against management. Thus, states should often choose anti-manager default rules, even if the anti-manager rule is not the preference of the majority of corporations.

These findings support policies that combine the benefits of transaction-cost minimization and investor protection. For any given corporate law issue, states should enact one or more “optional” laws. Each optional law should implement a different corporate arrangement. One of the laws, which restricts management, but is otherwise desirable, should be chosen as the default rule. This recommendation reduces transaction costs by providing state templates, but prevents managerial opportunism by providing for anti-manager default rules. It is important, however, that the state limit the number of menu offerings. Too many menu offerings would limit the

⁶⁷Future research should examine whether this public good could be provided by nonstate actors, such as the American Law Institute. Terms from nonstate actors will always be subject to greater legal uncertainty than state-created terms, however, because they are not binding on courts. Moreover, it is not clear that nonstate bodies are subject to less pressure to deviate from efficiency than state bodies. See Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 Pa. L. Rev. 595, 607–37 (1995).

network effects created by state statutes, and hinder the ability of the state to alter the statutes in response to economic developments, thereby hindering the transaction-cost-minimizing benefits of menus.

Menu statutes also help address another concern about state statutes—their openness to manipulation by concentrated interests. Menu statutes do not bind any companies unless they choose to do so, so the costs of a menu statute that was primarily motivated by inefficient public choice concerns will be much lower than the cost of a similar default statute. In addition, the necessity of approval by investors reduces the incentive for management to lobby for menu statutes. Default statutes, by contrast, are much more likely to attract heavy management lobbying and impose significant costs as a result of public choice concerns.

The powerful impact of corporate default laws and menus found here raises many questions for other areas of law. If default laws and menus have this large an impact on the outcomes of large corporations, it is reasonable to suspect that they may have similarly large impacts in other areas, such as contract law, trust law, or even anti-discrimination law.⁶⁸ Future research should be devoted to determining the impacts of default laws and menus in other areas of law.

⁶⁸See Ayres, *Menus Matter*, *supra* note 4.