SHAREHOLDERS' RIGHT TO REVIEW THE ADOPTION AND CONTINUATION OF A TAKEOVER DEFENSE PLAN: IS THE *FLEMING* DECISION DEAD ON ARRIVAL?

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In this note, the author examines the rights of shareholders to review actions of the board of directors in matters of corporate governance. Over the last few decades, the traditional duties of the board of directors to manage corporate affairs have been challenged as shareholders become more active and unified. A recent corporate governance case in Oklahoma, International Brotherhood of Teamsters v. Fleming Cos.*, finally has addressed the balance of the corporate rights and duties between the board and the activist shareholders. The decision increased the range of shareholder power in the takeover context, holding that shareholders have the right to review and force the redemption of a corporation's poison pill.*

The author contends that for Fleming *to have a serious effect on corporate law, other state courts, and more specifically, Delaware state courts, must adopt a similar analysis. The author, however, finds this occurrence unlikely and believes that the* Fleming *court failed to analyze the issues correctly.*

To comprehend the problem underlying the Fleming *decision, the author analyzes the traditional corporate model and the development of the board of directors' duties in the takeover context. Moreover, he looks to both traditional Delaware precedents and recent Delaware case law to support his contention. The author proposes that instead of adopting decisions like* Fleming*, courts should recognize the preclusive effects of multiple takeover defenses and attempt to mitigate them accordingly to deter board entrenchment.*

I. INTRODUCTION

Corporate law, especially in the takeover context, has been at a crossroads during the last few years. The rise of the institutional shareholder has created a more active and centralized shareholder base, which, in turn, has challenged the authority of the board of directors to manage the corporation in certain transactions.[1] The courts have had to adapt to this new role of the shareholder. Adapting, however, has not

1. *See infra* notes 38–39 and accompanying text.

been easy given the traditional model of corporate governance on which most state corporate statutes are based.[2] Consequently, courts have struggled in balancing corporate governance power between shareholders and the board of directors in this new corporate environment. State legislatures have not made the judiciary's task any easier, as the legislatures have been willing to adopt many protectionist schemes developed by local corporations.[3]

The anticipated shareholder challenge to the traditional role of the board of directors occurred recently when the District Court for the Western District of Oklahoma, in *International Brotherhood of Teamsters v. Fleming Cos*., held that shareholders have a right not only to review but also to deny the board of directors' adoption of a poison pill plan.[4] Furthermore, the Supreme Court of Oklahoma supported this shareholder right of review as being consistent with Oklahoma law.[5] But will the court's decision in *Fleming* change how corporations are governed or will it "die" without serious implications outside Oklahoma?

For the *Fleming* analysis to seriously alter the traditional model of corporate governance, other state courts, particularly Delaware state courts, must adopt a similar analysis. Given the well-established corporate jurisprudence in Delaware, however, Delaware courts most likely will not adopt the *Fleming* analysis or holding any time soon. Therefore, *Fleming* may not have an immediate impact on restructuring the existing corporate governance paradigm. But this lack of immediate impact does not necessarily doom *Fleming* to a life in academic casebooks—looking only to the case's immediate impact fails to address the question as to whether shareholders should have more rights to review the adoption and continuation of takeover defenses. In other words, perhaps the *Fleming* court is merely here before its time.

This note will examine the *Fleming* decision and demonstrate that, although the court's policy concerning the proper allocation of power may be compelling, the court failed to analyze the problem correctly. Illuminating the analytical problems of *Fleming* requires an understanding

2. *See infra* notes 8–12 and accompanying text.

3. Both Connecticut's and Georgia's legislatures have recently pushed antitakeover legislation based on hostile takeover attempts of corporations within their respective jurisdictions. Connecticut's bill "was drafted at the behest of New Haven area auto maker Echlin, which received a $3 billion hostile offer . . . from Michigan-based auto parts maker SPX." *CT Anti-Takeover Bill with "Dead-Hand" Clause Would Rescue Echlin*, Corp. Officers & Directors Liability Litig. Rep. (Andrews), Mar. 23, 1998, *available in* WESTLAW, 13 No. 10 ANCODLLR 3 [hereinafter *CT Anti-Takeover Bill*]. Georgia's bill "was pushed by Senator Steve Thompson, whose district includes the Marrietta base of Healthdyne Technologies, Inc." *Georgia Bill Requiring Staggered Board Stalls in Legislature*, 1997 Corp. Officers & Directors Liability Litig. Rep. (Andrews), Apr. 9, 1997, *available in* WESTLAW, 1997 ANCODLLR 21020. Healthdyne is currently in litigation over its defense against a hostile takeover by Invacare Corp. *See* Invacare Corp. v. Healthdyne Tech., Inc., 968 F. Supp. 1578, 1579 (N.D. Ga. 1997).

4. *See* International Bhd. of Teamsters v. Fleming Cos., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2980 (W.D. Okla. Jan. 27, 1997), *aff'd*, 173 F.3d 863 (10th Cir. 1999).

5. *See* International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 908 (Okla. 1999).

of the traditional corporate model and the development of the duties of the board of directors in the takeover context. Furthermore, comprehending the reasons Delaware courts will probably not follow *Fleming* requires an analysis of historical and current Delaware jurisprudence.

Part II of the note analyzes the background of the battle between boards of directors and shareholders for control over corporate management in the takeover context. Traditional corporate governance principles, especially in the takeover context, have been increasingly challenged as institutional investors have risen to prominence.[6] This rise in institutional investors, coupled with securities market factors and sophisticated takeover defenses, has created an environment in which shareholders have been forced to increase their participation in corporate governance.[7] Part II also examines both the changing face of corporate shareholders and the changing nature of hostile takeovers and takeover defenses. The purpose of this background section is to demonstrate the difficulties courts will encounter as they attempt to make current decisions on corporate governance using the traditional model of corporate governance.

Part III sets out Delaware's judicial and statutory framework that has historically drawn the line between the power of the board of directors and that of the shareholders in exercising management authority. Moreover, this part examines a recent pro-shareholder decision by the Delaware Court of Chancery that sheds light on the direction the Delaware courts are moving in the takeover context. This case should also assist other state courts in properly analyzing controversies in the adoption of takeover defenses. The aim of this section is to establish the foundation for the correct judicial analysis of the relationship between the board of directors and shareholders, especially in the takeover context.

Part IV analyzes the *Fleming* decision and demonstrates the policy considerations important to both the trial and appellate courts in holding for Fleming. Part V will introduce both the practical and the analytical implications of *Fleming*. This part also addresses the viability of a *Fleming*-type case in Delaware. The answer to these issues has major implications as shareholders increase their activism efforts in corporate governance at the same time management implements sophisticated takeover defenses. This part also introduces a judicial response to increased shareholder power, with the understanding that, given an opportunity, numerous state legislatures may decide the answer statutorily—an outlook not favorable to shareholders.

6. *See infra* notes 38–39, 43.
7. *See infra* note 44.

II. THE HISTORICAL CONTEXT: MANAGEMENT V. SHAREHOLDER

A. The Traditional Corporate Model

Traditionally, shareholders have been relegated to the role of passive investors in the corporation in which they own shares, while a fiduciary body—the board of directors—controlled the management of the shareholders' investment.[8] The sources of this passivity include a collective action problem, caused by fragmented ownership of shares of a corporation; and a rational apathy problem, caused by the high costs of participating in corporate governance and the relatively small returns from such participation.[9] This shareholder passivity is codified in most state statutes in the breakdown between management's powers and shareholders' rights.[10] More specifically, management alone is responsible for the "business and affairs" of the corporation and must either manage or direct the management of the corporation.[11] Shareholders are responsible for reviewing the actions of the board of directors in certain situations as well as approving changes to the corporation's bylaws.[12]

The traditional relationship between management and shareholders and its effect on corporate governance is perhaps best exhibited in the takeover context. Two theories explain the proper role of the shareholder in reviewing the performance of the board of directors. The first,

8. *See* CHARLES O'KELLEY, JR. & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 181, 215 (2d ed. 1996) (describing the traditional roles of shareholders and management); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 383–85 (1994); *see also* MODEL BUS. CORP. ACT. § 8.01 cmt. (Supp. 1997) (stating that management by the board of directors is the traditional form of governance).

9. The most influential treatment of the traditional roles of management and shareholders is generally attributed to Adolf Berle and Gardiner Means, whose groundbreaking work, *The Modern Corporation and Private Property*, explained the passivity of shareholders as a rational response to the fragmentation of ownership. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933); *see also* Mark R. Wingerson & Christopher H. Dorn, *Institutional Investors in the U.S. and the Repeal of Poison Pills: A Practitioner's Perspective*, 1992 COLUM. BUS. L. REV. 223, 226 (explaining the work of Berle and Means). In other words, because of fragmented ownership, no shareholder owns a sufficient number of shares in a corporation to make active monitoring of management by the shareholder a value-added pursuit. *See* Morgan N. Neuwirth, Comment, *Shareholder Franchise—No Compromise: Why the Delaware Courts Proscribe All Managerial Interference with Corporate Voting*, 145 U. PA. L. REV. 423, 428 (1996). Furthermore, the dispersed nature of the shareholders of a large, publicly held corporation creates a "collective-action" problem, where each shareholder waits for other shareholders to take on the cost of corporate monitoring. *See id.* at 428–29; *see also* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1285 & n.23 (1991) (using the collective action phenomenon to explain institutional shareholders' passivity). In the end, none of the shareholders monitor management. *See* O'KELLEY & THOMPSON, *supra* note 8, at 216–17.

10. *See* Goforth, *supra* note 8, at 385–86; *see also infra* text accompanying notes 63–65.

11. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1991); MODEL BUS. CORP. ACT § 8.01(b) (1984); ALI, PRINCIPLES OF CORPORATE GOVERNANCE § 3.02(a) (1994).

12. *See* JAMES D. COX ET AL., CORPORATIONS § 13.1, at 13.3 (Supp. 1998); *see also* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 1.13, at 1-30 & n.151 (2d ed. Supp. 1996); O'KELLY & THOMPSON, *supra* note 8, at 181; Goforth, *supra* note 8, at 434–35.

termed the political model, is "an approach in which active investors seek to change corporate policy by developing voting support from dispersed shareholders, rather than by simply purchasing voting power or control."[13] The foundation for this model is built into most state corporation statutes, which allow shareholders to change the corporation's bylaws, vote for changes in the articles of incorporation, and vote for a new board of directors.[14] The second, the "transaction-based 'market for corporate control,'"[15] also known as the takeover model, argues that the hostile takeover (or threat of a takeover) is an adequate monitor for corporate governance. If management is performing poorly, the company will be taken over by a third party believing that new management can run the company more efficiently.[16] Unlike the political theory, support for the takeover model cannot be found in most state corporate statutes; instead, limitations on the takeover model have been popular in state legislatures during the last twenty years.[17]

The takeover model's rise to prominence was manifested during the 1980s when takeovers were prevalent and shareholders were less active in corporate governance.[18] Thus, proponents of monitoring by takeover could show that because shareholders were passive, the hostile takeover was an efficient means of monitoring management, allowing shareholders to remain passive. This theory, however, assumes both that shareholders will remain passive and that hostile takeovers can occur efficiently without the prohibitive costs created by sophisticated takeover defenses.[19] A further assumption, also key to the viability of the theory, is that the acquiring party actually desires to improve the management of

13. John Pound, *The Rise of the Political Model of Corporate Governance and Control*, 68 N.Y.U. L. REV. 1003, 1007 (1993).

14. *See id*. at 1029 ("The political model thus creates a process through which shareholders can govern the corporation in an ongoing manner. . . . If pursued effectively over time, this kind of incremental oversight should in fact ensure that the corporation does not need to be taken over.").

15. *Id.* at 1008.

16. *See id*. at 1018.

17. *See id*. at 1024. State legislatures increasing deference to and protection of management decisions, especially in the takeover context, are commonly known as the race to the bottom. For a general discussion of the race to the bottom phenomenon, see William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 715 & nn.1–2 (1998), which discusses the literature about corporate chartering competition and its race to the bottom. Signs of such a competition can be seen in legislation in Kentucky, Mississippi, and North Carolina allowing "continuing-director" restrictions like the one used in Georgia. *See CT Anti-Takeover Bill*, *supra* note 3; *see also* Daniel A. Neff, *The Impact of State Statutes and Continuing Director Rights Plans*, 51 U. MIAMI L. REV. 663, 663 (1997) ("In response to a prior takeover wave, many state legislatures amended their corporate statutes. Recent court interpretations of some of these statutes have produced a number of decisions which are more protective of directors' discretion in the takeover context than . . . the *Unocal* standard.").

18. *See* Pound, *supra* note 13, at 1005 ("This [the 1990s] is a very different world of corporate governance than the one we knew at the end of the 1980s. Then, the only obvious vehicle for corporate change was the takeover. . . . [T]akeovers were an efficient means of corporate governance because it was inherent . . . that shareholders would be passive . . . ."); *see also* Goforth, *supra* note 8, at 401–08.

19. *See* Pound, *supra* note 13, at 1018–20 (describing the structural qualities of the takeover model).

the target company.[20] Unfortunately, none of these assumptions are always true.[21] This is not to say that the proponents of the political model are without their own problems—the model is only viable if shareholders could play an active role in the governance of the corporation and, even if they could, if they would play such a role.[22] The play between these two theories has now been on the corporate stage for almost two decades, and both continue to play major roles in corporate governance policies.

B. The Takeover Environment in the 1980s

At no time was the traditional corporate governance paradigm tested more frequently than in the 1980s with the frenzy of corporate takeovers.[23] Unfortunately, the corporate takeover "artist" of the 1980s, sometimes called a "corporate raider," did not always fit the description of an acquiror purchasing the corporation to increase the corporation's value through better management.[24] Instead, the raider often times would leverage the takeover with massive debt, break up the target, and sell the various assets of the target to pay the debt—believing the parts had greater value than the whole.[25]

In response to the corporate raider, which often employed coercive means to achieve a takeover, management initiated various takeover defenses to protect shareholders.[26] Because the courts generally viewed a would-be acquiror as a raider attempting to coerce the shareholders of the target into tendering their shares to the acquiror, courts usually deferred to management when reviewing takeover defenses.[27] Management

20. *See id*.

21. *See infra* notes 24–25, 38–39 and accompanying text.

22. *Cf.* Goforth, *supra* note 8, at 433–34.

23. *See id.* at 419.

24. *See id.* at 419–22.

25. *See, e.g*., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180–81 (Del. 1986) ("Pantry Pride [the hostile bidder] was a small, highly leveraged company bent on a 'bust-up' takeover by using 'junk bond' financing to buy Revlon cheaply, sell the acquired assets to pay the debt incurred, and retain the profit for itself."); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 653–54 (Del. Ch. 1988) (explaining that the threat to the target corporation was an acquiror financed through junk bonds that sought to cash out the target's assets).

26. *See* Neuwirth, *supra* note 9, at 430 ("Management responded to the growing number of hostile offers by putting up defenses. Poison pills (also known as shareholder rights plans), shark repellents, white knights and other colorfully named techniques were developed in an attempt to protect corporations, and their management, from the possibility of being acquired (and fired)."); *see also* Patrick J. Thompson, Note, *Shareholder Rights Plans: Shields or Gavels?*, 42 VAND. L. REV. 173, 178–79 (1989).

Two key Delaware Supreme Court decisions in the takeover area include *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949–50 (Del. 1985), where the court held that Unocal's exclusion of a shareholder from participation in Unocal's self-tender was valid because the purpose of the exclusion was to protect Unocal's shareholders from a coercive two-tiered, front-loaded cash tender offer initiated by the excluded shareholder, and *Moran v. Household International, Inc*., 500 A.2d 1346, 1348 (Del. 1985), where the court upheld the use of the "most recent defensive mechanism in the arsenal of corporate takeover weaponry—the Preferred Share Purchase Rights Plan [popularly known as a poison pill]." For more detail on the poison pill takeover device, see *infra* note 169.

27. *See infra* Part III.B.3.a.

was often viewed as the protector of the "corporate enterprise, which includes stockholders, from harm reasonably perceived."[28] Furthermore, many state legislatures aided management by imposing statutory takeover controls, the so-called second and third generations of takeover defense statutes.[29] Thus, both the courts and the legislatures viewed shareholders not only as passive participants in the corporation's activities but also as either unsophisticated investors unable to differentiate a good deal from a bad one or as sitting targets unable to effectively choose a good deal if it arose.

C. The Takeover Environment of the 1990s

The early 1990s brought a brief reprieve from the frenzy of leveraged buyouts of the 1980s.[30] This slowdown in corporate takeovers caused commentators to reassess the value of the takeover as the best means of corporate monitoring.[31] Others saw a complete shift away from the takeover model to the political model.[32] One commentator went so far as to declare: "The takeover wars are over. Management won."[33] Since this brief lull in the early 1990s, however, takeover activity has been on a record-breaking pace.[34] Thus, perhaps a clearer reflection of the state of the takeover activity prior to 1995 is that the takeover *battles* were over, and management had won those battles.[35] The war, however, between management and shareholders over the balance of power in the

28. *Unocal*, 493 A.2d at 954.

29. *See* Dale Arthur Oesterle, *Delaware's Takeover Statute of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 888–89 (1988) (noting that the first generation of takeover legislation, passed in the mid-1970s, "typically allowed state officials to rule on the fairness of tender offers for resident corporations," while the second generation, passed in the mid- to late-1980s, commonly were business combination acts or control share acts) (citing Thomas Lee Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 WAKE FOREST L. REV. 77, 78 (1988); Mark A. Sargent, *On the Validity of State Takeover Regulation: State Responses to* MITE *and* Kidwell, 42 OHIO ST. L.J. 689, 712 (1981)).

30. *See* Kenneth J. Bialkin & Robert G. Wray, *Recent Developments in Mergers & Acquisitions*, *in* CORPORATE GOVERNANCE INSTITUTE: BLUEPRINT FOR GOOD GOVERNANCE IN THE 1990S 649, 657–60 **(**PLI Corp. L. & Practice Course Handbook Series No. 1053, 1998) (describing the financial atmosphere of the early 1990s and comparing it to the atmosphere in the late 1990s).

31. *See* Neuwirth, *supra* note 9, at 430–35.

32. *See* Pound, *supra* note 13, at 1004–06.

33. Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 858 (1993), *quoted in* Neuwirth, *supra* note 9, at 432. Of course, up until 1993, management had completely dominated the shareholders in the courts and legislatures. *See* Goforth, *supra* note 8, at 394 (describing the deference given management by the courts in the form of the business judgment rule and the limited rights given shareholders by the legislatures to assume greater responsibilities in corporate governance).

34. Although takeover activity may have taken a break during the early 1990s, 1997 was a "record-breaking year for M&A lawyers." Emily Barker & Krysten Crawford, *Kindler's Calling*, AM. LAW., Apr. 1998, at 53; *see also* Theodore N. Mirvis, *Mergers and Acquisitions and Takeover Preparedness: 1997 Update*, *in* CORPORATE GOVERNANCE CURRENT AND EMERGING ISSUES 101, 105 (ALI-ABA Course of Study No. SC53, Dec. 11, 1997) (reporting that the value of the "announced domestic mergers and acquisitions reached an all-time high . . . in 1996" and that the transactional activity in the first half of 1997 was even higher than that recorded in the first half of 1996).

35. *See* Grundfest, *supra* note 33, at 858.

corporate governance paradigm and, more specifically, in adopting and perpetuating takeover defenses, still wages.

The current battle between management and shareholders has a much different look than any of those in the past. First, hostile takeovers in the mid-1990s were generally much different than the hostile takeover of the 1980s. The "corporate raider" became the "strategic corporate buyer."[36] The corporate buyer, finding its easy access to cash dissipating, had to place a premium on the synergies produced by the merger and not merely on the value produced by selling the assets of the target.[37] Second, the nature of shareholders continues to change. No longer are shareholders passive in their role as residual claimants of the company's assets;[38] they demand more of the board of directors, both economically and socially.[39] Thus, the political model and the takeover model are sharing the same stage. Third, perhaps feeling frustration at the heightened judicial scrutiny of management's discretion, management has again turned to the legislature to overcome such scrutiny.[40] Many state

36. Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet*, 19 CARDOZO L. REV. 511, 514–15 (1997) (pointing out differences in management turnover rates between the period of frequent hostile takeovers (1984–1988) and the period of infrequent turnovers (1989–1994)); *see also* Bialkin & Wray, *supra* note 30, at 654 (explaining that "'[s]trategic' corporate buyers have, to a large extent, replaced financial buyers as the prevalent hostile raiders").

37. *See* Bialkin & Wray, *supra* note 30, at 657–58 (comparing cash availability and other financial factors in the late 1990s to the environment in the early 1990s); Goforth, *supra* note 8, at 421–22 (explaining the collapse of the junk-bond market as a factor in the decrease in hostile takeovers but arguing against the synergy-seeking takeover).

38. *See* International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 909 (Okla. 1999) ("The stock market has had a long history of shareholder of passivity, but this is likely a thing of the past. The rise of the institutional investor and the increased knowledge of stockholders as a whole [are] forcing an increased accountability to shareholders for many boards of directors."); *see also* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("It may be that we are now witnessing the emergence of new institutional voices and arrangements that will make the stockholder vote a less predictable affair than it has been."); Goforth, *supra* note 8, at 402–04.

39. *See* Thomas C. Franco, *Institutional Ownership in the U.S.: An Overview*, *in* SHAREHOLDER ACTIVISM: THE EMERGING ROLE OF INSTITUTIONAL INVESTORS 285, 292 (PLI Corp. L. & Practice Course Handbook Series No. 575, 1987) (reporting that institutional shareholders have been reviewing proxy statements more closely than ever and issuing guidelines through proxy voting committees); Warren F. Grienenberger, *Institutional Investors and Corporate Governance*, *in* PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1998, at 63, 67–70 (PLI Corp. L. & Practice Course Handbook Series No. 1029, 1998) (providing examples of institutional shareholders' involvement in corporate economic and governance issues); James E. Heard & Patrick S. McGurn, *Corporate Governance Audit for 1998*, INSIGHTS, Dec. 1997, at 3, 4–6 (1997) (describing various shareholder groups with concerns ranging from economic performance to management accountability to various social issues).

The debate continues as to the proper role of the institutional investor. *See* Coffee, *supra* note 9, at 1281–82 (explaining the arguments for and against an increased monitoring role for institutional investors); Franco, *supra*, at 292–93 (arguing that the institutional investor's short-term focus would make it an undesirable corporate monitor). Additionally, debate continues as to whether institutional investor ownership activism increases the value of the corporation. *See Corporate Governance: No Bottom-Line Improvement Seen Issuing from Institutional Ownership, Activism*, Corp. Couns. Wkly. (BNA) 3, 3–4 (Aug. 14, 1996) (reporting both the results of a study that indicated that companies with a higher percentage of institutional ownership did not outperform companies with a smaller percentage of such ownership and the counterargument by CalPERS that its activism does in fact improve "bottom-line performance").

40. *See supra* note 29 and accompanying text.

legislatures have responded to management activism by promulgating pro-management legislation, especially in the takeover context.[41] As a consequence, the courts have been under pressure to balance statutory permissiveness with basic shareholder rights.[42]

This balancing effort has become more difficult as the sophistication of takeover defenses increases, leading to more authority for the board of directors to erect barriers against both acquisitions and shareholder activism, while at the same time diminishing shareholders' power to eject the boards of directors. These factors, as well as the concentration of corporate ownership in institutional investors,[43] have forced shareholders to take a more active role in corporate governance.[44] This increase in shareholder activism has pushed the courts to reexamine the already fuzzy line between the traditionally passive shareholder and the board of directors of the corporation. Delaware courts have struggled with balancing shareholder rights and management authority for the last fifteen

41. *See supra* note 3.

42. *See* Neff, *supra* note 17, at 663; *see also* Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 500 (7th Cir. 1989) ("If our views of the wisdom of state law mattered, Wisconsin's takeover statute would not survive. Like our colleagues who decided *MITE* and *CTS*, we believe that anti-takeover legislation injures shareholders."). The Seventh Circuit admitted, however, that "[u]nless a federal statute or the Constitution bars the way, Wisconsin's choice must be respected." *Id.* at 502.

43. "Institutional activity is usually defined to include banks and other fiduciaries, business corporations, employee pension and profit-sharing plans, insurance companies, foundations and other types of institutions." Franco, *supra* note 39, at 288. According to a report by the Conference Board, institutional investors' ownership in the top 1000 U.S. corporations was 58.8% in 1996. *See* Eileen J. Williams, *Shareholders: Largest Institutional Investors Adding to Market Share, Increasing Their Control over Outstanding Domestic Equity*, Corp. Couns. Wkly. (BNA) 8, 8 (Sept. 10, 1997). For more information on these groups and how they influence corporations, see Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 567–75, 596–604 (1990); Grienenberger, *supra* note 39, at 67–70, which notes that the "role of institutional investors ('II's') has continued to grow and evolve;" and Wingerson and Dorn, *supra* note 9, at 226–27, 233–35, which describes the rise of institutional investors in general and their role as corporate monitors in particular.

44. *See* Pound, *supra* note 13, at 1008 (citing both the difficulties in successfully ousting management through a takeover and the concentration of corporate ownership in the institutional investor as the reasons for the rise in investor activism). For arguments that investor activism and the political model did not vanish in the 1980s, see *Corporate Governance: De-Mythifying Union Activism in 1997: It's Not New, It's Here to Stay, Shareholder Proposals Can Be Negotiated*, Corp. Couns. Wkly. (BNA) 8 (Jan. 29, 1997) [hereinafter *De-Mythifying Union Activism*] (reporting Patrick S. McGurn's statement that union activism is not a new phenomenon but "predates corporate activism by public pension funds," which have been engaging in activism since the 1980s); *see also* PAUL R. BERGIN, INVESTOR RESPONSIBILITY RESEARCH CTR., VOTING BY INSTITUTIONAL INVESTORS ON CORPORATE GOVERNANCE ISSUES IN THE 1988 PROXY SEASON 1 (1988) (reporting on the increasing activism by institutional shareholders in the proxy process).

Another factor forcing shareholders, especially institutional investors, into taking a more active role in corporate governance is their inability to follow the "Wall Street Rule." The Wall Street Rule describes the relative ease by which shareholders have been able to sell their ownership interest in the corporation coupled with the traditional role of the shareholder as a passive owner and the consequent incentives for shareholders to sell their shares in an underperforming company rather than to take an active role in improving the company. *See* O'KELLY & THOMPSON, *supra* note 8, at 217; Coffee, *supra* note 9, at 1288 & n.29. This "rule" has become increasingly unavailable to institutional shareholders due to market problems associated with selling large blocks of a company's stock. *See* Grienenberger, *supra* note 39, at 68; Neuwirth, *supra* note 9, at 433 & n.50. Thus, institutional investors have been compelled to improve the corporations in which they invest. *See* Coffee, *supra* note 9, at 1288–89 & n.33.

years and have recently attempted to clarify the limits of managerial authority.

III. DELAWARE'S JUDICIAL AND STATUTORY FRAMEWORK

By most accounts, Delaware law is the preeminent authority in corporate law principles.[45] In fact, "[a] majority of the publicly traded Fortune 500 companies are Delaware corporations. More than 80 percent of the companies that have reincorporated during the past quarter century have migrated to Delaware."[46] In addition, state and federal courts interpreting state corporate law often look to Delaware jurisprudence absent relevant precedent in their own jurisdictions.[47] The reasons for Delaware's preeminence in corporate law are many, but two factors of particular applicability to this note are (1) the broad discretion extended to the board of directors, and (2) the predictability of Delaware's judicial determinations.[48] Although the second of these reasons remains a stable principle and one that elicits little controversy, the first is constantly challenged and continues to evolve as the corporate environment changes— especially in the takeover context.[49]

A. Shareholder Resolutions Under Delaware Law

The shareholders' main tool to affect change in corporate policies is the shareholder resolution. When shareholders desire to suggest various courses of action to the board of directors of the corporation, the shareholders may, under limited circumstances, force the corporation to mail

45. *See, e.g.*, ERNEST L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW at xii (1972); Leo Herzel & Laura D. Richman, *Foreword*, *Delaware's Preeminence by Design*, *in* THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS F1, F-1 to F-10 (2d. ed. Supp. 1991 & 1992).

46. Herzel & Richman, *supra* note 45, at F-1; *see also* Oesterle, *supra* note 29, at 883–84 ("Because Delaware is the corporate home of 56% of the Fortune 500 firms and 45% of the firms listed on the New York stock exchange, any change in the Delaware corporate code affects a substantial number of shareholders.").

47. *See* O'KELLEY & THOMPSON, *supra* note 8, at 176; Dennis J. Block, *Role of the Board of Directors When Faced with Unsolicited Takeover Attempts*, *in* CORPORATE GOVERNANCE INSTITUTE: BLUEPRINT FOR GOOD GOVERNANCE IN THE 1990S, *supra* note 30, at 743, 747.

48. *See* DALE A. OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 19–20 (1999).

49. Although Delaware's broad grant of power to the board of directors and its judicial deference to the board of directors' decisions have received much criticism, some argue that an analysis of the history of Delaware's jurisprudence in the takeover context paints a different story: a slow but steady awareness of shareholder rights and increasing protection of those rights. *See* Herzel & Richman, *supra* note 45, at F-1 to F-10. Although Delaware courts remain quite deferential to the board of directors' business decisions, the state's corporate law has developed, and is currently developing, limits to the board of directors' decisions in the takeover context. *See infra* Parts III.B.3 & III.C; *see also supra* note 17 (explaining the race to the bottom theory and the belief by some that a few state corporate codes have been interpreted as more favorable to management than the Delaware code). Moreover, Delaware adopted relatively moderate takeover defense statutes in the late 1980s and has lagged behind the current move to protect management from takeovers. *See* Herzel & Richman, *supra* note 45, at F-1 to F-10.

their resolution with the corporation's own proxy materials.[50] Under federal securities regulations, however, a board of directors may refuse to include a shareholder proposal in the corporation's proxy solicitation if the proposal is inappropriate as a matter of state law.[51]

Initially, whether a shareholder proposal is contrary to a state's law is often determined by the Securities and Exchange Commission (SEC) in a no-action letter.[52] "Under certain states' laws, a proposal that mandates certain action by the registrant's board of directors may not be a proper subject matter for shareholder action, while a proposal recommending or requesting such action of the board may be proper under such law."[53] This limitation on binding resolutions has been applied in recent no-action letters issued to Delaware corporations.[54] Notwithstanding the shareholders' recasting the proposal in precatory language, the corporation may still exclude the resolution "where state law either expressly and exclusively reserves a particular issue to the board, or is otherwise dispositive on the subject matter of a particular proposal."[55] Because a no-action letter is not binding, the ultimate decision as to whether a proposal is contrary to a state's law is made by the courts and the legislatures of that state.[56]

Questions regarding the validity of a shareholder resolution in the takeover context thus present two issues for Delaware courts: first, whether shareholders may require the board of directors to act in certain instances; and second, whether a shareholder resolution, binding or

50. *See* 17 C.F.R. § 240.14a-8 (1999); *see also* COX, *supra* note 12, §§ 13.26–13.28, at 13.61–13.70; LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1998–2003 (3d ed. 1990).

51. *See* 17 C.F.R. § 240.14a-8(i)(1). "Depending on the subject matter some proposals are not considered proper under state law if they would be binding on the company if approved by shareholders." *Id.* at note to paragraph (i)(1); s*ee also* LOSS & SELIGMAN, *supra* note 50, at 2005–06.

52. *See* JAMES D. COX ET AL., SECURITIES REGULATION 832 (2d ed. 1997); *see also* RANDALL S. THOMAS & CATHERINE T. DIXON, ARANOW & EINHORN ON PROXY CONTESTS FOR CORPORATE CONTROL § 16.04[A], at 16-32 to 16-33 (3d ed. 1998).

53. Rule 14a-8(c)(1), note, *cited in* LOSS & SELIGMAN, *supra* note 50, at 2006. The shareholders may present a valid binding resolution if the relevant state law commits the matter to the shareholders. *See* THOMAS & DIXON, *supra* note 52, § 16.04[A], at 16-30 & n.142. In addition, "[t]he Securities and Exchange Commission Division of Corporate Finance has stated in no-action letters that the appropriateness of binding shareholder resolutions [related to transactions for corporate control] under state law is 'unsettled,' and that the Commission will not permit the exclusion of such shareholder resolutions from proxy statements." DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 1195 (5th ed. 1998).

54. *See, e.g.*, D&N Fin. Corp., 1999 SEC No-Act. LEXIS 184, at *7 (Feb. 9, 1999) ("The Commission has long recognized that shareholder proposals which would mandate action on matters which are within the discretion of a company's board of directors may be omitted under Rule 14a-8."); First Bell Bancorp, Inc., 1999 SEC No-Act. LEXIS 91, at *17–*18 (Jan. 28, 1999) (same); CVS Corp., 1998 SEC No-Act. LEXIS 1066, at *5 (Dec. 15, 1998) (same). Each of the SEC's responses state that "this defect [the mandatory nature of the proposal] could be cured if the proposal were recast as a recommendation or a request to the board of directors." First Bell Bancorp, Inc., 1999 SEC No-Act. LEXIS, at *1; CVS Corp., 1998 SEC No-Act. LEXIS, at *1; *see also* THOMAS & DIXON, *supra* note 52, at 16-30.

55. THOMAS & DIXON, *supra* note 52, at 16-30.

56. *See* Amalgamated Clothing & Textile Workers Union v. SEC, 15 F.3d 254, 257 (2d Cir. 1994).

precatory, may limit the board of directors' discretion in adopting takeover defense plans.

Delaware law provides that shareholders have the right to propose resolutions that adopt, amend, or repeal corporate bylaws.[57] The bylaws may "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers, or employees."[58] The right to alter the bylaws through a resolution is limited, therefore, to proposals that are not inconsistent with Delaware law or the corporation's certificate of incorporation and are related to the corporation's business. Courts are left to decide whether a resolution is contrary to Delaware law because it impermissibly interferes with the board of directors' authority. To resolve this issue, the courts should look both to the statutory powers given to the board of directors to implement takeover defenses and to the limitations placed on such powers.

B. Traditional Board Discretion Under Delaware Corporate Law

The Delaware General Corporation Law was created as a "modern, flexible corporation statute" able to quickly adapt to various changes in the corporate law environment.[59] One consequence of this flexibility has been the added reliance the Delaware legislature has had to place in Delaware courts to fashion appropriate limits on many corporate transactions and activities.[60] The role of the Delaware courts in applying various rules and limits to the board of directors in corporate transactions, especially in the takeover context, has created a legal environment where the judge-made obligations and limitations receive as much or more attention than does the statute upon which these obligations and limitations are derived.[61] Thus, when looking to apply Delaware law to corporate transactions based on another state's law (presumably due to the absence of applicable precedent in the immediate jurisdiction), courts outside of Delaware should first ensure that the two state statutes are substantially identical before analyzing the rules that the Delaware courts have fashioned.[62] The continuing viability of this judicial analysis

57. *See* DEL. CODE ANN. tit. 8, § 109(a) (1991).
58. *Id*. § 109(b).
59. Herzel & Richman, *supra* note 45, at F-3.
60. *See id.*
61. *See id.* at F-1 to F-10.
62. *See* BLOCK ET AL., *supra* note 53, at 3 & n.14; *see also, e.g.*, Robert A. Wachsler, Inc. v. Florafax Int'l Inc., 778 F.2d 547, 549 (10th Cir. 1985) (stating that the relevant Oklahoma statutes are "substantially identical" to those in the Delaware General Corporation Law), *cited in* International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 911 (Okla. 1999); Hilton Hotels Corp. v. ITT Corp., 978 F. Supp. 1342, 1346–47 (D. Nev. 1997) (applying Delaware case law to establish the rights of shareholders in a corporate takeover).

puts a premium on the non-Delaware court's correctly applying the principles the Delaware courts have fashioned.

1. The Foundation of Delaware's Jurisprudence on the Power of the Board of Directors

Delaware corporate governance law, like that in many other jurisdictions, is based on the premise that shareholders are essentially passive owners of the corporation, and the board of directors has the power to manage the business affairs of the corporation.[63] This premise is codified in Delaware under title 8, section 141 of the Delaware Code, which provides that the board of directors is to manage the business of the corporations—unless an exception is provided in Delaware corporate law or in the corporation's articles of incorporation.[64] "The reference to the 'business and affairs' of the corporation in Section 141(a) has been interpreted to be an extremely broad grant of power to the directors . . . [and has been] recognized . . . as being an independent source of board authority, especially in the area of responding to takeover threats."[65]

This broad interpretation of the board's statutory duty to manage the corporation has given rise to judicial deference to the board's business decisions and to judicial permissiveness in its exercise of corporate authority.[66] The shareholders' power, on the other hand, is limited both by statute and by court decree.[67] The authority granted to the board of directors, however, is not unlimited. Instead, Delaware courts have fashioned various fiduciary duties to limit the board's power to act.

To ascertain the proper balance of power between the shareholders and the board of directors in the takeover context, Delaware courts generally look first to specific statutory provisions granting power to the board of directors—generally section 141(a) coupled with another code section related to the specific transaction under examination.[68] Unless the

63. *See supra* notes 8–12 and accompanying text.

64. *See* DEL. CODE ANN. tit. 8, § 141(a) (1991). Most state codes have language identical or similar to the language in section 141. *See, e.g.*, CAL. CORP. CODE § 300(a) (West 1990) ("Subject to the provisions of this division and any limitations in the articles . . . the business and affairs of the corporation shall be managed *and all corporate powers* shall be exercised by or under the direction of the board . . . ." (emphasis added)); MOD. BUS. CORP. ACT. ANN. § 8.01, at 8-10 to 8-11 (3d ed. Supp. 1997) (listing of state laws with comparisons of statutory language).

65. BALLOTI & FINKELSTEIN, *supra* note 12, § 4.1, at 4-4.

66. *See* Paramount Comm. Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994) ("Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors.").

67. *See* BALOTTI & FINKELSTEIN, *supra* note 12, § 4.1, at 4-6.

68. *See* Lawrence A. Hamermesh, *The Shareholder Rights By-Law: Doubts from Delaware*, CORPORATE GOVERNANCE ADVISOR, Jan.–Feb. 1997, at 9. This statutory issue is often overlooked in favor of courts' emphasis on judicially created standards of scrutiny because the number of statutory exceptions granting power other than to the board of directors is few, especially in the takeover context. *See infra* notes 90–94 and accompanying text. Courts, nevertheless, generally use the statutory foundation as a springboard to reach the issue of scrutiny. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) (starting with title 8, section 141 of the Delaware Code

relevant statute limits the powers of the board of directors to act, the court assumes the board of directors has the authority, limited by certain fiduciary duties.[69] Only after the court finds that the board of directors has acted within its statutory authority does the court analyze the board of directors' fiduciary obligations.[70]

2. *Statutory Authority of the Board of Directors in the Takeover Context*

The board of directors has broad statutory authority to implement a wide variety of defensive measures.[71] The board of directors' authority is derived from its inherent powers to manage the corporation under title 8, section 141(a) of the Delaware Code, specific grants of power in the Delaware Code, and its fundamental duty to protect the corporate enterprise.[72] The board's statutory authority to adopt a shareholder rights plan is provided in title 8, section 157 of the Delaware Code.[73]

In *Moran v. Household International Inc.*,[74] the Supreme Court of Delaware held that title 8, section 157 of the Delaware Code confers the power to issue stock rights to the board of directors, subject to any provisions in the corporation's articles of incorporation.[75] Although the provision vests this power in the "corporation," the court noted that "the inherent powers of the Board conferred by title 8, section 141(a) of the Delaware Code, which provides that the board of directors has the authority to manage the corporation's 'business and affairs,' provides the board of directors additional authority upon which to enact the Rights Plan."[76] Thus, the court seems to interpret the statutory power given to the corporation as authority given to the board of directors. Such a broad grant of power to the board of directors should negate the shareholders' right to require certain actions of the board of directors in the takeover context.[77]

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and moving to title 8, section 251 of the Delaware Code before finally analyzing the appropriate level of scrutiny); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (starting with the general grant of power to the board of directors embodied in title 8, section 141 of the Delaware Code and with the specific authority given the corporation under title 8, section 160 of the Delaware Code before moving to the "standard by which director action is to be measured").

69. *See* Hamermesh, *supra* note 68, at 9–10.

70. *See supra* note 68.

71. *See Unocal*, 493 A.2d at 953 ("The board has a large reservoir of authority upon which to draw.").

72. *See id*. at 953–54.

73. DEL. CODE ANN. tit. 8, § 157 (1991).

74. 500 A.2d 1346, 1353 (1985).

75. *See id.* at 1353.

76. *Id.* at 1353 (emphasis added).

77. *Compare* Hamermesh, *supra* note 68, at 10 (arguing that the broad powers given the board of directors limits the shareholders' right to enact bylaws mandating certain actions), *with* Leonard Chazen, *The Shareholder Rights By-Law: Giving Shareholders a Decisive Voice*, CORPORATE GOVERNANCE ADVISOR, Jan.–Feb. 1997, at 17 (arguing that the right of the shareholders to enact

3. Judicially Created Scrutiny of the Board of Directors

Statutory authority does not give the board of directors carte blanche power to engage in any desirable action. Rather, the board of directors "owe[s] fiduciary duties of care and loyalty to the corporation and its shareholders" when discharging its statutory duty to manage the corporation.[78] As long as the board of directors acts reasonably and in good faith, the courts will grant its decisions great deference.[79]

a. The Business Judgment Rule

The judicial deference to the board of directors is embodied in the business judgment rule, which applies to most business decisions the board makes.[80] The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[81] The business judgment rule is the court's way of staying out of the corporate management business.[82] The rule applies when a disinterested and independent board of directors makes a business decision within the scope of its fiduciary duty of due care.[83]

The application of the business judgment rule, however, is not appropriate if the corporate transaction or decision is not "within the power or authority of the Board."[84] In other words, the action of the board of directors must be a legitimate exercise of a valid managerial power.[85] In addition, the judicial deference narrows in the takeover context because of the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[86] The degree of deference the court gives to the board of directors depends both on the underlying transaction and the development of the transaction. An enhanced standard of judicial scrutiny to the actions of the board of directors will generally apply in at least three situations—

bylaws that limit the board of directors pursuant to title 8, section 109 of the Delaware Code is permitted under title 8, section 141 of the Delaware Code).

78. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986).

79. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).

80. *See* Ross W. Wooten, Comment, *Restructurings During a Hostile Takeover: Directors' Discretion or Shareholders' Choice?*, 35 HOUS. L. REV. 505, 508–09 (1998). For a detailed discussion of the business judgment rule, see BALOTTI & FINKELSTEIN, *supra* note 12, § 4.6, at 4-39 to 4-178.

81. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

82. *See In re* Unitrin, Inc., Nos. C.A. 13656, 13699, 1994 Del. Ch. LEXIS 187, at *15 (Del. Ch. 1994), *rev'd on other grounds*, 651 A.2d 1361, 1391 (Del. 1995). For more on the purposes behind the business judgment rule, see BALOTTI & FINKELSTEIN, *supra* note 12, § 4.6, at 4-40 to 4-42; O'KELLY & THOMPSON, *supra* note 8, at 185–86.

83. *See* Block, *supra* note 47, at 747.

84. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985).

85. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985).

86. *Id*. at 954.

when the board adopts a takeover defense, decides to break up the company, and interferes with the shareholder vote.[87]

b. The *Unocal* Standard of Deference

An "enhanced scrutiny" standard, not the business judgement rule, will apply when the board of directors initiates a takeover defense "in response to an alleged threat to corporate control or policy."[88] The enhanced scrutiny standard applicable in such a situation is the *Unocal* standard, which requires that the board of directors' actions be "reasonable in relation to the threat that the board rationally and reasonably believed was posed by [the would-be acquiror's] offer."[89]

Similar to its inquiry under the business judgment rule, the court must first establish the statutory authority for the board of directors to act before analyzing any fiduciary limitations on the board of directors' actions.[90] In *Unocal*, the Delaware Supreme Court examined the statutory foundation for the board of directors' authority to adopt takeover defenses in general—"[a]bsent such authority, all other questions are moot."[91] The Supreme Court first looked to the statute, holding that the statute conferred "inherent powers" to the board in the management of the corporation and, more specifically, on the corporation's power to "deal in its own stock."[92] Because the statute, including the duties inherent in the statute,[93] did not except the board's power to deal in its own stock, the court "was satisfied that in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality."[94]

Once the statutory grounds for the board's action were established, the court ascertained whether the business decision was made "in reaction to a perceived threat to corporate policy and effectiveness which

87. Although the last of these, interference with the shareholder vote, is not considered a level of scrutiny in the takeover context (i.e., although a company might be in either "*Unocal* mode," *see infra* Part III.A.2.b, or "*Revlon* mode," *see infra* Part III.A.2.c, there is no "*Blasius* mode"), the "substantial justification" requirement is an enhanced standard of scrutiny that is increasingly finding its way into traditional takeover cases. *See* Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1193 (Del. Ch. 1998).

88. Mirvis, *supra* note 34, at 110.

89. *Unocal*, 493 A.2d at 958.

90. *See id.* at 953. Two issues were presented in *Unocal*: first, whether the Unocal board had "the power and the duty to oppose a takeover threat it reasonably perceived to be harmful to the corporate enterprise;" and second, if the board does have the power, is its exercise of such power "entitled to the protection of the business judgement rule?" *Id.*

91. *Id.*

92. *Id.* The court started with title 8, section 141(a) of the Delaware Code and then analyzed the relevant section dealing with stock transactions (section 160(a)). *See id.* Because the court seemed to treat the corporation and the board of directors as one and the same in this case, the Teamsters might have a difficult time succeeding with a *Fleming*-type case in Delaware. *See infra* Part IV.

93. Responsibilities include the duty of the directors not to "[act] out of a sole or primary purpose to entrench themselves in office." *Unocal*, 493 A.2d at 954.

94. *Id.* at 954. The court listed the "traditional areas of fundamental corporate change" as charter amendments, mergers, sale of assets, and dissolution. *Id.* at 954 & n.8. The court noted that "director action [was] a prerequisite to the ultimate dispositions of such matters." *Id.* at 954.

touches upon issues of control."[95] Delaware courts have held that the adoption of a "defensive mechanism . . . to ward off possible future advances and not a mechanism adopted in reaction to a specific threat"[96] should be analyzed under the *Unocal* standard and not the business judgment rule.[97] If the board of directors demonstrates that a threat to corporate control existed and the defensive measure undertaken was reasonable in relation to such threat, thereby satisfying the heightened standard, the court will apply the business judgment rule to the board of directors' actions.[98]

Generally, "the Board has no more discretion in refusing to redeem the Rights than it does in enacting any defensive measure."[99] Consequently, Delaware courts have used *Unocal*'s enhanced scrutiny to force a board of directors to redeem the company's poison pill.[100] In requiring redemption of the poison pill, the courts have reasoned that the purpose of the poison pill had terminated[101] or that the continuance of the poison pill was not reasonable in relation to the threat posed to the company.[102] The deference extended to the board in continuing a poison pill provision when the company is not faced with a direct takeover threat, however, is greater than the deference extended when the company is in "*Unocal* mode."[103] Generally, courts will not force the board of directors to redeem a poison pill under the business judgment rule.[104]

c. The *Revlon* Standard of Deference

The *Unocal* standard of deference in adopting takeover defenses extends only so far. Once the board of directors has moved from defending against a hostile takeover to selling the company, its duty changes "from one of preservation . . . to the maximization of the company's value at a sale for the stockholders' benefit."[105] Thus, when a break-up becomes inevitable, the board of directors enters "*Revlon*" mode and is no longer the "defender[] of the corporate bastion [but is the] auctioneer."[106]

95. Stroud v. Grace, 606 A.2d 75, 82 (Del. 1992).

96. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985). For commentary by subsequent Delaware courts on the discretion given the board of directors to implement poison pills, see *Mills Acquisition Co. v. Macmillan, Inc*., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, at 91,024 (Del. Ch. Oct. 17, 1988), *rev'd on other grounds*, 559 A.2d 1261 (Del. 1989).

97. *See* BLOCK ET AL., *supra* note 53, at 639–40.

98. *See Unocal*, 493 A.2d at 955.

99. *Moran*, 500 A.2d at 1354.

100. *See* City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); Grand Metropolitan PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); *Macmillan*, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071. For an explanation of poison pills, see *infra* note 169.

101. *Macmillan*, [1988–89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, at 91,024.

102. *See City Capital*, 551 A.2d at 803–04; *Grand Metropolitan*, 558 A.2d at 1060.

103. *See Unocal*, 493 A.2d at 954–56; Block, *supra* note 47, at 750–51.

104. *See* Moore Corp. v. Wallace Computer Serv., Inc., 907 F. Supp. 1545 (D. Del. 1995).

105. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986). The duty is called the *Revlon* duty or standard and a company subject to the standard is in "*Revlon* mode."

106. *Id.*

The *Revlon* standard, however, does not affect the board's statutory authority to implement takeover defenses generally but only affects the board's authority at a certain stage of the transaction.[107] In fact, the court in *Revlon* stated that "lock-ups[108] and related agreements were permitted under Delaware law where their adoption was untainted by director interest or other breaches of fiduciary duty."[109] The court extended both the board of directors' authority to manage the corporation under title 8, section 141(a) of the Delaware Code and the board's duties of care and loyalty to support the court's view of the board's broad authority in corporate takeover issues.[110] The court treated Revlon's ability to adopt defensive measures as a non-issue, emphasizing that the board of directors "clearly had the power to adopt the measure [in this case, a poison pill provision]."[111] "Thus, the focus becomes one of reasonableness and purpose,"[112] and the court must analyze the defensive mechanism under the appropriate standard of deference.

d. The *Blasius* Standard of Deference

Independent from but often intertwined with the *Unocal* and the *Revlon* analyses,[113] the *Blasius* standard applies to board actions that interfere with shareholders' rights to exercise their voting powers.[114] "Strict scrutiny" under *Blasius* requires that the board marshals a "compelling justification"[115] for any action that has the principal purpose of interfering with the shareholder franchise, regardless of the board's good faith.[116] Delaware courts have established a strong precedent in favor of protecting the shareholder franchise — especially the unfettered right to elect the board of directors.[117]

The adoption and continuation of a poison pill, however, should meet the standard under a *Blasius* claim because the *Moran* court found

107. *See id.* at 185.

108. A lock-up is a contractual arrangement in which one potential acquiror is given an option to "purchase valuable company assets, to protect the favored bid from competition." BALOTTI & FINKELSTEIN, *supra* note 12, at F-6. For more on the use of lock-ups and related merger tools, see ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE § 15.05[B], at 15-46 to 15-50 (5th ed. Supp. 1997).

109. *Revlon*, 506 A.2d at 176.

110. *See id*. at 179.

111. *Id.* at 180 (citing Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985)).

112. *Id.* at 180.

113. *See* Stroud v. Grace, 606 A.2d 75, 91–92 & n.3 (Del. 1992) (finding that the *Unocal* and *Blasius* analyses are "not mutually exclusive, because both recognize the inherent conflicts of interest that arise when shareholders are not permitted free exercise of their franchise"). Although the court in *Stroud* claims not to have rendered the *Blasius* analysis meaningless, *see id.* at 91–92, an argument has been made that the heightened scrutiny under *Blasius* may be unavailing outside a *Unocal* transaction, *see* THOMAS & DIXON, *supra* note 52, § 20.01[B], at 20-12 to 20-13.

114. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988).

115. *Id.*

116. *See id.* at 658–59.

117. *See id*. at 659–60 (citing the many cases and policies supporting the idea that the legitimacy of corporate governance rests on shareholders' abilities to vote without interference).

that the poison pill would not preclude the company's shareholders from removing the board of directors.[118] Thus, "the Rights Plan will not have a severe impact upon proxy contests and it will not preclude all hostile acquisitions of [the corporation]."[119] Defensive measures that tend to entrench management or impermissibly weaken the shareholder franchise, however, may be defeated under *Blasius*— as the Delaware courts have recently shown.

C. Recent Analysis of Delaware Takeover Law

Carmody v. Toll Brothers, Inc.,[120] a case recently decided by the Delaware Court of Chancery, highlights the Delaware courts' opinion on the use of certain types of aggressive takeover defenses that effectively, and now impermissibly (at least in Delaware), take certain powers away from new directors. These defenses, popularly called "dead-hand,"[121] "no-hand,"[122] "continuing-director,"[123] or "delayed-redemption"[124] provisions, operate in conjunction with a poison pill and limit the ability of the directors to remove the poison pill by allowing only those directors who enacted the poison pill or their "approved successors" to remove the pill.[125] The court's holding is important not only because of the new limitation placed on the adoption of dead-hand provisions by Delaware corporations but also because of the court's analysis of the balance of power between the board of directors and the shareholders in corporate governance— an analysis that should have implications outside of Delaware.

1. Background

In *Carmody*, the court denied Toll Brothers, Inc.'s (Toll Brothers) motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), stating that Carmody's legal attack on the Toll Brothers' dead-hand pro-

118. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985). The language in *Moran* suggests that the Supreme Court of Delaware does not view the poison pill as impermissibly interfering with the shareholder franchise. *See id.* at 1355–56.

119. *Id.* at 1356.

120. 723 A.2d 1180 (Del. Ch. 1998).

121. *Id*. at 1182.

122. Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 27 (Del. Ch. 1998), *aff'd*, 721 A.2d 1281, 1293 (Del. 1998).

123. Recent Case, 111 HARV. L. REV. 1626, 1626 (1998).

124. *Mentor Graphics*, 728 A.2d at 28.

125. Recent Case, *supra* note 123, at 1626. Although no-hand, dead-hand, and continuing-director provisions may come in a variety of forms and operate in a variety of ways, their general purpose is to create an additional barrier to an acquiring company's ability to defeat a poison pill and take over the target company. *See* Shawn C. Lese, Note, *Preventing Control from the Grave: A Proposal for Judicial Treatment of Dead Hand Provisions in Poison Pills*, 96 COLUM. L. REV. 2175, 2190–91 (1996). For convenience, this note will refer to all variations as dead-hand provisions. The delayed-redemption provision is essentially a dead-hand provision that expires after a certain time. *See Carmody*, 723 A.2d at 1195 n.52.

vision had both a statutory and a fiduciary cognizable claim for relief.[126] Toll Brothers, a publicly held Delaware corporation based in Pennsylvania, adopted a poison pill provision with flip-in and flip-out features (the Rights Plan) in June 1997.[127] Tolls Brothers' management[128] adopted the Rights Plan against a backdrop of major consolidations in the company's industry.[129] Furthermore, Toll Brothers' stock was trading at the low end of its established price range, which, the company's management concluded, made the company a "potential target for an acquisition."[130]

James Carmody, a shareholder of Toll Brothers, individually and on behalf of other shareholders of Toll Brothers, filed a complaint in the Delaware Court of Chancery alleging that the purpose of the Rights Plan, or poison pill, had the purpose and effect of making "any hostile acquisition of Toll Brothers prohibitively expensive, and thereby [deterring] such acquisitions unless the target company's Board of Directors first approves the acquisition proposal."[131] Because the Supreme Court of Delaware had previously upheld the legality of poison pill provisions,[132] the complaint did not attack the poison pill itself, choosing instead to specifically address the deleterious effects of the dead-hand provision in Toll Brothers' poison pill. First, the complaint alleged that the dead-hand provision had the practical effects of making an unsolicited offer for the company unlikely "because even if the acquiror wins the [proxy] contest, its newly-elected director representatives could not redeem the Rights."[133] The second allegation was that the dead-hand provision disenfranchised the shareholders because a shareholder cannot elect a board of directors with the power to redeem the Rights Plan, leaving shareholders with no other "practical choice except to vote for the incumbent directors."[134]

Toll Brothers made a motion to dismiss the complaint for failing to state a legal claim upon which relief could be granted.[135] Toll Brothers based its motion on three issues: (1) the plaintiffs' claims were not ripe;[136] (2) even if ripe, the plaintiffs' claims were derivative and subject to the

126. *See Carmody*, 723 A.2d at 1195.

127. For the features of the Rights Plan, see *id.* at 1184. For a discussion of poison pills in general, see *infra* note 169.

128. At the time the Rights Plan was adopted, Toll Brothers' management consisted of Bruce and Robert Toll, chief executive officer and chief operating officer, respectively, and owners of 37.5% of Toll Brothers' stock, and of the nine-member Board of Directors, five of whom were outside directors. *See Carmody*, 723 A.2d at 1182.

129. *See id.* at 1182–83 (describing the consolidation activity in the home building industry).

130. *Id.* at 1183.

131. *Id.* at 1184.

132. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351 (Del. 1985); *supra* notes 74–76 and accompanying text.

133. *Carmody*, 723 A.2d at 1184.

134. *Id.*

135. *See* FED. R. CIV. P. 12(b)(6). "Thus on this motion the focus of the inquiry is not whether the Rights Plan is invalid, but rather, is only whether the complaint states one or more cognizable claims of legal invalidity." *Carmody*, 723 A.2d at 1185.

136. *See Carmody*, 723 A.2d at 1187.

demand requirement;[137] and (3) the adoption of a dead-hand provision was valid under Delaware law.[138]

2. The Decision

Before reaching the merits of the Toll Brothers' motion to dismiss, the Delaware Chancery Court first set forth the factual findings that the *Moran* court held were key to upholding the poison pill.[139] First, the poison pill "would not erode fundamental shareholder rights, because the target Board of Directors would not have unfettered discretion to . . . refuse to redeem the pill. Rather the board's judgment . . . would be subject to judicially enforceable fiduciary standards."[140] Second, a board refusing to redeem a pill could be defeated by an acquiror soliciting proxies "for consents to remove the Board and redeem the Rights."[141] Third, the target company's shareholders could "wage a proxy contest to remove the board."[142] In other words, shareholders were free to attempt and redeem undesired poison pills through a tender offer even if the courts were unwilling to force the redemption of poison pills based on fiduciary grounds.[143] After quickly dismissing Toll Brothers' first two defenses,[144] the court then evaluated the legality of the dead-hand provision of the Rights Plan in accordance with the *Moran* principles.

137. *See id.*

138. *See id*.

139. *See id.* at 1185–86.

140. *Id.* at 1185.

141. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1354 (Del. 1985), *quoted in Carmody*, 723 A.2d at 1185.

142. *Carmody*, 723 A.2d at 1185.

143. *See id.* To counteract this weakness in the poison pill, however, management began initiating various defenses in response to the tender offers—only the dead-hand provision, like that adopted by Toll Brothers, proved to be a "show stopper." *Id*. at 1187. Other defensive tactics included implementing a staggered board and delaying the annual meeting, but these mechanisms only postponed a hostile takeover. *See id*. at 1186.

A corporation may stagger its board of directors by dividing the directors into three classes each serving staggered terms. *See* O'KELLEY & THOMPSON, *supra* note 8, at 875–76. A staggered board, also called a "classified board," is a takeover defense that precludes a hostile party from voting out the entire board of directors at one election. *See* Neuwirth, *supra* note 9, at 438. Staggered boards are valid under Delaware law. *See* DEL. CODE ANN. tit. 8, § 141(d) (1991). For more on the general history of poison pill defenses, offenses, and countermeasures, see *infra* note 169.

144. The "ripeness" defense was dismissed because the alleged "depressing and deterrent effects upon the shareholders' interest" were present with or without a present takeover threat; therefore, the shareholders' claims were ripe for adjudication. *See Carmody*, 723 A.2d at 1188. As for the derivative defense, the court held both that the plaintiff's claims were individual, not derivative, and that "even if the claims were derivative, the complaint satisfies the requirements for demand excusal." *Id.* at 1189. Demand excusal would have been satisfied because the complaint alleged in "a particularized way" that management was acting for entrenchment purposes. *Id*.

a. Statutory Grounds

The dead-hand provision of the Rights Plan was attacked "on both statutory and fiduciary duty grounds."[145] The plaintiffs based their statutory argument on title 8, subsections 141(a) and 141(d) of the Delaware Code.[146] These subsections are the basis for the management power of the board of directors[147] and also limit the board's ability to allocate management powers to some directors and not others.[148] Title 8, section 141(d) of the Delaware Code provides that the special allocation of voting powers among the board of directors is "reserved to the stockholders;" a dead-hand provision thus violates the statute because it takes powers reserved to the shareholders and vests them in the board of directors.[149] The court explained that the right to extend special voting powers to certain members of the board must be provided by the articles of incorporation and not by "unilateral board action."[150] The court also found that the dead-hand provision violated title 8, section 141(a) of the Delaware Code because the provision impermissibly restricted the board of directors' power without also including the restriction in the articles of incorporation.[151]

145. *Id.*

146. *See id*.

147. *See supra* notes 63–65 and accompanying text.

148. Title 8, section 141(a) of the Delaware Code requires that the "business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." DEL. CODE ANN. tit. 8, § 141(a) (1991). Title 8, section 141(d) of the Delaware Code provides that if voting rights are given to some directors and not others, that allotment must be stated in the company's articles of incorporation. *See* DEL. CODE ANN. tit. 8, § 141(d).

149. *Carmody*, 723 A.2d at 1191.

150. *Id.*

151. *See id*. The court cites approvingly *Bank of New York Co. v. Irving Bank Corp.*, 528 N.Y.S.2d 482 (1988), which held that a continuing-director provision violated a New York statute because the resulting restriction on the power of a future board was not authorized by the articles of incorporation. *See Carmody*, 723 A.2d at 1191–92. "Although the relevant language of the Delaware and New York statutes is not identical, their underlying intent is the same: both statutes require that limitations upon the directors' power be expressed in the corporation's charter." *Id.* at 1192. The court refused to follow *Invacare Corp. v. Healthdyne Technologies, Inc*., 968 F. Supp. 1578 (N.D. Ga. 1997), which upheld the use of a continuing-director provision by a Georgia company; the Georgia statute was materially different than Delaware's in that it gave unlimited power to the board to set the terms and conditions of a rights plan. *See Carmody*, 723 A.2d at 1192 n.38.

The Chancery Court's statutory analysis has been recently approved by the Supreme Court of Delaware in *Quickturn Design Sys., Inc. v. Mentor Graphics Corp*., 721 A.2d 1281, 1291 (Del. 1998). The Supreme Court of Delaware stated that one reason the poison pill was sustained in *Moran* was because the board of directors was still under a fiduciary duty to the shareholders and the corporation, and a future board of directors still had the power to redeem the poison pill. *See id.* at 1291–92; *see also Carmody*, 723 A.2d at 1185–86. A dead-hand pill would remove the shareholders' ability to ever redeem the poison pill. Furthermore, the court clarified that a significant factor for invalidating the dead-hand pill was its limitation on a new board of directors' ability to manage the corporation—a statutory power granted in full unless restricted by the articles of incorporation. *See Quickturn Design*, 721 A.2d at 1291–92.

b. Fiduciary Duty Grounds

The court's reasoning for invalidating the dead-hand provision on fiduciary grounds merits discussion because the court employed both the *Unocal* and *Blasius* standards of scrutiny to the same transaction. Furthermore, rather than finding either standard paramount, the court found the dead-hand provision invalid under both.[152] "The validity of antitakeover measures is normally evaluated under the *Unocal*/*Unitrin* standard. But where the defensive measures purposefully disenfranchise shareholders, the board will be required to satisfy the more exacting *Blasius* standard . . . ."[153]

A purposeful disenfranchisement can be created by the adoption of a defensive measure that renders the shareholder vote either "impotent or self defeating."[154] The court found that the dead-hand provision in this case constituted a purposeful disenfranchisement because the provision precluded an acquiror from waging a proxy contest or, if a proxy contest were initiated, that it coerced shareholders into voting for the existing board of directors.[155] In other words, the dead-hand provision of Toll Brothers' poison pill negated the factors the Delaware Supreme Court used to uphold "traditional" poison pills in *Moran*. Because the dead-hand provision impermissibly blocked shareholder access to redeem the poison pill by voting the board out of office, as required in *Moran*, the court invalidated the provision.[156]

In a relatively short discussion, the court also held that the dead-hand provision violated the *Unocal* standard because it was "disproportionate and unreasonable."[157] The court, however, failed to fully explain its rationale. First, the court used the same arguments that it used to invalidate the dead-hand provision under the *Blasius* standard, namely, the coercive effect on shareholders and the prevention of future proxy contests.[158] Second, the court failed not only to analyze the threat that faced the company but never even identified a threat.[159] Thus, the court created

152. *See Carmody*, 723 A.2d at 1193.

153. *Id*. The foundation for applying *Blasius* to antitakeover defenses was set in *Stroud v. Grace*, 606 A.2d 75 (Del. 1992), which held that a takeover defense "that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.'" *Carmody*, 723 A.2d at 1193.

154. *Carmody*, 723 A.2d at 1193.

155. *See id.* at 1194.

156. *See id*.

157. *Id*. at 1195.

158. *See id.*

159. Presumably the threat in this case was the consolidating nature of Toll Brothers' industry. *See id.* at 1182–83. The lack of an immediate threat shows one potential weakness in applying *Unocal* to defensive measures adopted absent a hostile takeover. If *Unocal* is applied in these situations, the defensive measure seemingly always will be invalid because one of the elements for the court to balance, the immediate threat component, is missing. The business judgment rule, however, applies regardless of an immediate threat and ensures the board of directors is acting in the best interests of the shareholders and not merely for entrenchment purposes. *See supra* notes 80–86.

little precedent when attacking a defensive measure under *Unocal* absent an immediate threat to the corporation.

3. Deferred Redemption Provisions

Although the Chancery Court's opinion in *Carmody* was merely denying the defendant's motion to dismiss and is not a binding precedent of the legality of the dead-hand provision in Delaware, the court's negative attitude toward dead-hand provisions on all fronts should force Delaware boards of directors to think twice before adopting a similar provision of unlimited duration.[160] The court did, however, leave the door open for dead-hand provisions of limited duration, "diluted" or "deferred redemption" provisions.[161]

The importance of *Carmody* as well as subsequent Delaware court decisions concerning the dead-hand provision of a poison pill lies in the analysis that the court used to both limit and expand the board of directors' power to implement defensive tactics. The *Carmody* court reaffirmed the board's power to implement defensive mechanisms unless the action fails the *Unocal* test and, where the defensive measure purposefully disenfranchises the shareholders, the heightened standard of *Blasius*.[162] Because the dead-hand provision of the poison pill implemented by the Toll Brothers' board of directors effectively restricted the statutory power of the company's future boards of directors, the court held that the current board's action was impermissible under either standard.[163]

Much of the same argument can be made against a binding shareholder proposal that requires a board of directors to redeem a defensive mechanism. Such a bylaw proposal would restrict both the current and future boards from exercising the full extent of their statutory powers.[164] Such an encroachment on the board of directors' authority is arguably contrary to the restrictive language of title 8, section 109 of the Delaware Code and the broad language of section 141. Without a breach of fiduciary duty, Delaware courts should disallow such an encroachment on the

160. Boards of directors will think more than twice about implementing dead-hand provisions after the Delaware Supreme Court approved the chancery court's opinion in a case decided on December 31, 1998. *See* Quickturn Design Sys., Inc. v. Mentor Graphics Corp., 721 A.2d 1281, 1293 (Del. 1998) (agreeing that a delayed-redemption provision, like a dead-hand provision, "impermissibly circumscribes the board's statutory power under Section 141(a) and the directors' ability to fulfill their concomitant fiduciary duties").

161. The *Carmody* court emphasized that its opinion does "not involve the validity of a 'dead hand' provision of limited duration, and nothing in this Opinion should be read as expressing a view or pronouncement on that subject." *Carmody*, 723 A.2d at 1195 n.52. The Delaware Supreme Court did, however, express its view on delayed-redemption provisions and dead-hand features when it held that they were invalid as a matter of Delaware law. *See Quickturn Design*, 721 A.2d at 1293.

162. *See Carmody*, 723 A.2d at 1185–87, 1193–95.

163. *See id*. at 1193–95.

164. *See id.* at 1191–92.

board's clear and long-standing authority to adopt and redeem poison pills.

IV. THE *FLEMING* CASE

Carmody as well as *Fleming* raise the question whether management will continue its winning ways in controlling corporate governance generally and takeover defenses specifically.[165] The shift away from management discretion and toward shareholder participation and protection evident in these cases demonstrates the effect that institutional investors and shareholder activists have had on the traditional corporate paradigm. Courts now must struggle with balancing the board's duty to manage the corporation against the rights of a concentrated and active shareholder base. Although Delaware courts have taken reasonable steps in protecting shareholders from takeover defenses such as dead-hand provisions, other courts, including the *Fleming* court, as shown below, have facilitated a change in the corporate governance paradigm without establishing an adequate and reasonable basis for their actions.

A. The Fleming *Decision*

The *Fleming* decision is perhaps the most novel corporate governance case to be decided recently. In *Fleming*, the United States District Court for the Western District of Oklahoma held that shareholders could propose binding bylaw resolutions to effectively limit the board of directors' authority to implement takeover defenses.[166]

1. The Litigation

The *Fleming* litigation was initiated by the International Brotherhood of Teamsters General Fund (the Teamsters), a large union as well as shareholder activist group[167] and owner of Fleming Companies, Inc. (Fleming) stock.[168] At Fleming's 1996 annual shareholder meeting, the Teamsters submitted a nonbinding shareholder proposal "recommending

165. *See supra* notes 27–29, 33 and accompanying text.

166. *See* International Bhd. of Teamsters v. Fleming Cos., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2980 (W.D. Okla. Jan. 27, 1997).

167. *See De-Mythifying Union Activism*, *supra* note 44, at 8 (describing the Teamsters' current activist program, which includes addressing such issues as executive compensation, director accountability, and declassification of boards of directors). For a brief list of activist programs taken on by labor unions in general, see Richard H. Koppes, *Shareholder Activist Ranks Grow: Current Trends and Perspectives*, *in* CORPORATE GOVERNANCE CURRENT AND EMERGING ISSUES, *supra* note 34, at 475, 478.

168. According to the brief submitted by Fleming, the Teamsters owned only 65 shares of Fleming stock. *See* Appellant's Brief on Certified Question of Law at 2, *Fleming* (No. 90,185) [hereinafter Appellant's Brief].

that the company amend its bylaws to redeem Fleming's poison pill,[169] and to prevent [Fleming] from adopting future poison pills unless shareholders approved them."[170] Although Fleming's shareholders passed the Teamsters' resolution,[171] "the Board considered the nonbinding resolution and determined that the 1986 rights plan should not be redeemed. The Board also affirmed its earlier decision to implement the new Rights Plan . . . ."[172]

Round two started shortly after the 1996 annual meeting, when the Teamsters submitted a binding shareholder proposal (with the same language as the 1996 proposal) for inclusion in Fleming's 1997 proxy statement.[173] Fleming refused to include the binding resolution in its statement, declaring that the proposal was not a proper subject for shareholder action under Oklahoma corporate law.[174]

The Teamsters filed suit against Fleming in the United States District Court for the Western District of Oklahoma seeking a preliminary injunction and a declaratory judgment to require Fleming to include the Teamsters' 1997 shareholder proposal in Fleming's proxy materials un-

169. Fleming adopted its shareholder rights plan in 1986 with a 10-year term limit. In February 1996, with the rights plan close to expiration, Fleming adopted a new rights plan. The Teamsters' resolution asked Fleming's board of directors to redeem the current poison pill and refrain from implementing the new rights plan. *See id*. at 1–2; Appellee's Brief in Chief on Certified Question at 2–3, *Fleming* (No. 90,185) [hereinafter Appellee's Brief].

A shareholder rights plan, popularly called a poison pill, is a plan whereby stock rights or warrants are issued to the shareholders (other than the acquiring party) of a corporation that is the target of a hostile takeover. *See* O'KELLY & THOMPSON, *supra* note 8, at 874. When triggered, usually by the acquiring company purchasing a certain percentage of the target's stock, the shareholders of the target have the right either to purchase shares of the target corporation at a price substantially below the then-current market price (a flip-in poison pill provision) or to purchase shares in the acquiring company at a price substantially below the then-current market price (a flip-over poison pill provision). *See id.* at 895–96; Wingerson & Dorn, *supra* note 9, at 235.

The purpose of a poison pill is to prevent hostile takeovers by making the takeover prohibitively expensive for the acquiring company. *See* Wingerson & Dorn, *supra* note 9, at 237. This expense encourages the acquiring company to negotiate with the management of the target company. *See* Meredith M. Brown & William D. Regner, *Shareholder Rights Plans: Recent Toxopharmacological Developments*, 11 INSIGHTS 2, 2 (1997). Whether the poison pill is the best means to protect against unwanted takeover bids, is merely a management entrenchment devise, or is a defense mechanism that actually adds a "premium" to shares of a target company are matters of much debate. *See* Thompson, *supra* note 26, at 188–92; Wingerson & Dorn, *supra* note 9, at 237–42.

For the development of poison pills and other takeover defenses in the 1980s, see FLEISCHER & SUSSMAN, *supra* note 108, § 5.01[A], at 5-5 to 5-6, and O'KELLEY & THOMPSON, *supra* note 8, at 895.

170. *De-Mythifying Union Activism*, *supra* note 44, at 8; *see also* Appellant's Brief, *supra* note 168, at 2 n.3 (quoting the Teamsters' bylaw proposal).

171. The resolution passed with 65% of the shareholders (not counting abstentions) voting in favor of the proposal. *See* Appellee's Brief, *supra* note 169, at 3. That such a large majority of Fleming's shareholders voted in favor of the resolution was a factor Judge Alley considered in denying Fleming's motion for summary judgment. *See* Reporter's Transcript of Oral Arguments on Motions for Summary Judgment at 4, International Bhd. of Teamsters v. Fleming Cos., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2980 (W.D. Okla. Jan. 27, 1997) [hereinafter Oral Arguments for Summary Judgment].

172. Appellant's Brief, *supra* note 168, at 2. The poison pill originally adopted by Fleming was near the end of its 10-year life the original stock rights instrument imposed. Thus, the shareholder resolution proposed redeeming the original poison pill and not adopting the new one. *See id.*

173. *See id*. at 2–3; Appellee's Brief, *supra* note 169, at 3–4.

174. *See* Appellee's Brief, *supra* note 169, at 4; Appellant's Brief, *supra* note 168, at 3.

der section 14(a) of the Securities Exchange Act of 1934[175] and SEC Rule 14a-8.[176] Fleming responded with a motion for summary judgment asking the judge to find that the Teamsters' resolution was not a proper subject for shareholder action.[177] The Teamsters filed a cross-motion for summary judgment.[178]

The district court granted the Teamsters' cross-motion for summary judgment and denied Fleming's motion for summary judgment.[179] In his brief written order, Judge Wayne E. Alley held that Fleming could not refuse to include the Teamsters' resolution in Fleming's proxy materials and that the resolution was a proper subject for shareholder action under Oklahoma law.[180] Both the district court and the U.S. Court of Appeals for the Tenth Circuit denied Fleming's subsequent motion to stay the injunction pending appeal.[181] The Teamsters' resolution was submitted to Fleming's shareholders at Fleming's 1997 annual meeting, and the resolution again received a majority of the shareholders' votes.[182]

2. The Appeal and Certified Question

Fleming appealed the district court's order to the Tenth Circuit, which certified a question to the Supreme Court of Oklahoma asking whether Oklahoma law provides that the board of directors has exclusive authority to implement poison pills or whether shareholders may submit resolutions requiring that proposed poison pills be submitted to shareholder vote.[183]

The Supreme Court of Oklahoma recently issued its response to the Tenth Circuit's certified question, holding that Oklahoma law does not vest the authority to create and implement poison pills exclusively in the board of directors and that shareholders may propose resolutions re-

175. 15 U.S.C. § 78n(a).

176. 17 C.F.R. § 240.14a-8; *see* Appellee's Brief, *supra* note 169, at 5; Appellant's Brief, *supra* note 168, at 3.

177. *See* Appellee's Brief, *supra* note 169, at 5.

178. *See id.*

179. *See* International Bhd. of Teamsters v. Fleming Cos., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2980, at *1 (W.D. Okla. Jan. 27, 1997) (order granting plaintiff's cross-motion for summary judgment and denying defendant's motion for summary judgment), *aff'd*, 173 F.3d 863 (10th Cir. 1999).

180. The judge cited title 18, section 1013(A) of the Oklahoma Statutes, which provides the authority for the shareholders to create and approve changes to the corporate bylaws. *See id.* The judge also cited title 18, section 1038 of the Oklahoma Statutes, which the court stated "vests initiative in the Board of Directors [to set the terms of stock rights created by the corporation], but does not foreclose shareholder action in this matter." *Id.*

181. *See* Appellee's Brief, *supra* note 169, at 6.

182. *See id.* (reporting that 60.5% of the shares voted were cast in favor of the Teamsters' resolution, 37.3% voted against, and 2.2% abstained).

183. *See* Appellant's Brief, *supra* note 168, at 1, 3–4. The certified question reads as follows:

> Does Oklahoma law restrict the authority to create and implement shareholder rights plans exclusively to the board of directors, or may shareholders propose resolutions requiring that shareholder rights plans be submitted to the shareholders for vote at the succeeding annual meeting?

Id.

quiring poison pills to be submitted for shareholder vote if the company's "certificate of incorporation does not provide otherwise."[184] The Oklahoma Supreme Court based its holding on two arguments. First, the court interpreted the term "corporation" in Oklahoma law as not being synonymous with the definition of board of directors. Thus, the statute providing that "every corporation may create and issue . . . rights or options . . . to purchase from the corporation any shares of its capital stock"[185] did not vest the authority in the board but rather in the corporation.[186] Second, the court applied judicial precedents that allowed shareholders to approve or to ratify stock option plans.[187]

Upon closer inspection, however, these arguments prove unconvincing. The Supreme Court of Oklahoma realized that "[t]he 10th Circuit's question is ultimately one of corporate governance and what degree of control shareholders can exact upon the corporations in which they own stock."[188] Oklahoma law provides that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided for in the Oklahoma General Corporation Act or in the Corporation's certificate of incorporation."[189] Thus, unless section 1038 of the Oklahoma General Business Corporation Act provides an exception to the general grant of authority to the board of directors, the board has the authority to create and issue stock rights and options. The court found a statutory exception to the general rule in section 1038 by holding that because "a corporation may create and issue rights and options within the grant of authority given it[,] . . . it does not automatically translate that the board of directors of that corporation has in itself the same breadth of authority."[190] Instead, the court held that while the board of directors has authority to implement poison pill provisions, it does not have an exclusive right to do so.[191] The court also drew a parallel to shareholder ratification of stock option plans to support the court's premise that shareholders have the right to approve shareholder rights plans.[192]

184. International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 908 (Okla. 1999).

185. OKLA. STAT. ANN. tit. 18, § 1038 (West 1999).

186. *See Fleming*, 975 P.2d at 911 ("The statutes indicate our legislature has an understanding of the distinct definitions it assigns to [the terms "corporation" and "board of directors"], and we find it unlikely the legislature would interchange them as Fleming contends.").

187. *See id.* at 911.

188. *Id.* at 911–12.

189. OKLA. STAT. ANN. tit. 18, § 1027(A).

190. *Fleming*, 975 P.2d at 911.

191. *See id.* at 908.

192. *See id*. at 911.

V. THE IMPLICATIONS AND FUTURE OF *FLEMING*

A. The Implications of Fleming

The implications of the judicial reasoning behind *Fleming*'s holding are interesting when viewed from both the district court's and the Oklahoma Supreme Court's opinions. Both opinions demonstrate the difficult task a court has when balancing the duties of management with the rights of an activist shareholder. In addition, although both courts realized the importance and the novelty of the questions raised, neither court provided a satisfactory base on which future opinions may rely.

1. The District Court's Analysis

Although Judge Alley's order granting the Teamsters' cross-motion for summary judgment was brief, the case has generated a lot of interest from shareholders and management alike because the decision "opens up the possibility that shareholders can introduce binding bylaw resolutions."[193] Another factor in this case has also generated some attention—the shifting corporate governance paradigm.

a. The Binding Bylaw Resolution

The shareholder's ability to actively participate in both day-to-day management of the company and even some rather nonroutine corporate decisions has traditionally been very limited.[194] The statutory powers given the board of directors have been interpreted expansively because of the inherent limitations on the traditional disinterested, widely dispersed shareholder.[195] Consequently, bylaw proposals or shareholder resolutions have generally been restricted to suggestions or proposals to the board of directors—resolutions or bylaws that require or mandate some type of board action are generally found to be contrary to state law.[196] In addition, bylaw proposals or shareholder resolutions that interfere with or encroach on management's day-to-day business are generally held invalid.[197] Furthermore, many state statutes provide specific instances when a board of directors lacks the power to act unilaterally, and absent such statute or limitation in the bylaws, the board—not the shareholders—has full power to act.[198] The *Fleming* case is a marked de-

193. *De-Mythifying Union Activism*, *supra* note 44, at 8; *see also* Gordon, *supra* note 36, at 545. Although this decision, based on Oklahoma corporate law, would not directly affect companies incorporated under other state charters, the Teamsters have expressed a firm desire to find an appropriate case to bring under Delaware law. *See Delaware's Corporate Governance Paradigm Could Be Challenged in Binding Bylaw Suit*, 66 U.S.L.W. 2422 (Jan. 20, 1998).

194. *See supra* notes 10–12, 63–67 and accompanying text.

195. *See supra* note 9 and accompanying text.

196. *See supra* note 53 and accompanying text.

197. *See* 17 C.F.R. § 240.14a-8(i)(7) (1999).

198. *See supra* notes 10–12, 57–58 and accompanying text; *see also infra* notes 220, 222.

parture from these traditional limitations on the shareholder resolution process.

A primary weakness of the district court's analysis is its failure to remain within the boundaries of the statute.[199] The Oklahoma statute relevant to stock rights, substantially similar to the analogous Delaware statute,[200] provides that stock rights and stock options of the corporation are to be created by the corporation and evidenced by instruments approved by the board of directors.[201] Furthermore, the terms and conditions of the stock rights and options are determined by a board resolution.[202] Although the district court was correct in noting that the "corporation" and not the "board of directors" was responsible for creating stock rights and options of the corporation, the district court in its argument reversed the order of corporate statutory analysis. Instead of holding that the lack of statutory limitations in title 18, section 1038 of the Oklahoma Code indicated to the board full power to act,[203] the district court held that the lack of exclusive power extended to the board of directors indicated that the statute did, in fact, limit the board's power to adopt stock rights and options.[204] Thus, the opinion creates a subtle change in the board's general power to manage the corporation. Under the district court's analysis, the board of directors has the authority to manage the corporation unless the statute either limits the power in the language of the statute or fails to make that extension of power exclusive by an omission of specific language in the statute. Such an argument will presumably allow all powers given to the "corporation" to be carried out by either the board or the shareholders.

Another weakness is the lack of limitations or definable boundaries of shareholder review. The policy underlying the district court's opinion is that without some form of shareholder review, the board of directors has exclusive power to implement poison pills (and presumably other types of takeover defenses), that it would have final say on the matter, and that it is likely to act in its self-interest.[205] Thus, because any effect on the marketability of the company's shares is borne principally by the shareholders, the shareholders should have a right to review. Another factor the district court considered was the wide margin by which the resolution won.[206] These policy arguments then lead to the result that any action not exclusively reserved to the board that may affect the market-

199. Judge Alley admitted that he was influenced by considerations that "go beyond the face of the statute." Oral Arguments for Summary Judgment, *supra* note 171, at 3.

200. *See* International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 910 (Okla. 1999).

201. *See* OKLA. STAT. ANN. tit. 18, § 1038 (West 1999).

202. *See id.*

203. Like Delaware law, Oklahoma law provides that all corporations are to be managed by the board of directors unless otherwise provided in the statute or in the company's articles of incorporation. *Compare* OKLA. STAT. ANN. tit. 18, § 1027(A), *with* DEL. CODE ANN. tit. 8, § 141(a) (1991).

204. *See* Oral Arguments for Summary Judgment, *supra* note 171, at 2–3.

205. *See id*. at 3.

206. *See id.* at 4.

ability of the shares of the corporation and is approved by a majority of the shareholders is a valid exercise of shareholder voting power. The failure to limit the argument to poison pills, or at minimum to takeover defenses, may create problems as courts now decide where to draw the line between management's duties and shareholders' rights to review the performance of management. These "new" shareholder rights create a shift in the basic corporate governance structure.

b. The Corporate Governance Paradigm

Chancellor William B. Chandler of the Delaware Court of Chancery suggested that the question raised by a case like *Fleming* is whether the decision would establish "a different corporate governance paradigm" than the current one (or ones).[207] The district court, in the oral arguments on the motions for summary judgment, made a case for shareholder review of management in issues concerning corporate governance.[208] On the shareholders' role in corporate governance issues, Judge Alley stated:

> Now, I have to say I am influenced in reviewing [sections 1013 and 1038 of the Oklahoma General Corporation Act] by two considerations that would go beyond the face of the statutes; that taking [Fleming's] proposition that there is an exclusive nature to 1038 would mean that without any effective shareholder review, the power in question is granted to directors, it's granted with finality, and it's thereby vested in that constituency in corporate governance that is likely to be viewing the situation in light of self-interest, and I have reservations about that.[209]

The district court's second consideration is that the effect on the marketability of the shares caused by the poison pill should be reviewed by shareholders, "the people who really care about the marketability of shares."[210] These considerations show the tension between activist shareholders and the board of directors. The district court's holding creates incentives for the shareholders to take a more active role in the governance of the corporation—seemingly in ways that previously have been beyond shareholders' traditional realm of power.

2. The Oklahoma Supreme Court's Analysis

In answering the question certified to it by the Tenth Circuit, the Supreme Court of Oklahoma supported the district court's analysis of Oklahoma law. The court also attempted to bolster its holding—that

207. *Delaware's Corporate Governance Paradigm Could Be Challenged in Binding Bylaw Suit*, *supra* note 193, at 2422.

208. *See* Oral Arguments for Summary Judgment, *supra* note 171, at 3.

209. *Id.* at 3.

210. *Id.* at 3–4.

shareholders have the right to review poison pills implemented by the board of directors—by invoking Oklahoma statutes and also by drawing parallels to other instances of shareholder review.

The Oklahoma Supreme court took the same direction of analysis in its statutory interpretation as the district court and, therefore, its opinion has the same weaknesses as the district court's analysis. The court reversed the general corporate statutory interpretation line of reasoning by holding that a statute not foreclosing shareholder action implies that the board of directors does not have exclusive authority to act as provided by the statute.[211] The court also stated that absent limitations in the company's articles of incorporation, Oklahoma law allows shareholder bylaws to limit the board's ability to adopt a poison pill.[212] Besides the weakness pointed out above, the court's analysis has another problem: the Oklahoma statute gives the board of directors power to manage the corporation unless that power is limited by the statute or the articles of incorporation—not limitations in the bylaws.[213]

A curious step the court took was comparing shareholder review of poison pills both with shareholder ratification of stock option plans and shareholder approval of tax qualified stock option plans.[214] Such comparisons, however, fail to correctly make the relevant connection between the ratification or approval and the shareholder right of review. First, a comparison to the ratification process is irrelevant. As stated by the court, the ratification process is used by the board of directors to "cure the invalidity of an otherwise voidable act of the company's board."[215] The importance of the ratification process is not the act being ratified but the result of a voidable act being validated by the shareholders. Because the adoption and continuation of a takeover defense is not a voidable act, the board of directors need not seek such ratification or approval by the shareholders. Second, the requirement of shareholder approval for federal tax qualified stock option plans is wholly independent of the shareholder rights to review poison pills. The fact that stock option plans are not exempt from shareholder approval or ratification, however, does not automatically translate into a right of shareholder review over the adoption and continuation of a shareholder rights plan.

B. The Future of the Fleming *Decision*

The Supreme Court of Oklahoma correctly recognized the impending collision between the duties of management in adopting corporate strategy and the rights of shareholders to participate in corporate ac-

211. *See* International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 911 (Okla. 1999).
212. *See id*. at 912.
213. *See* OKLA. STAT. ANN. tit. 18, § 1027(A) (West 1999).
214. *See Fleming*, 975 P.2d at 911.
215. *Id.*

tivities.[216] The court pointed to the deleterious effects produced by the adoption of a poison pill, which include entrenchment of management and prevention of mergers and the increased accountability institutional shareholders require of the board.[217] The court noted that as a result of these competing interests, "the demands of the Teamsters in its case against Fleming is something courts may encounter with increasing frequency in the years to come."[218] Unfortunately, the *Fleming* court provided inadequate judicial principles for future courts to follow and, for that reason, should not be followed by a majority of courts.

1. Mandatory Proposal for Shareholder Review

Although attempting to force management to redeem the poison pill through a shareholder resolution may work in Oklahoma, activist shareholders of a Delaware corporation run into a long line of Delaware cases giving management wide discretion in management decisions.[219] Delaware courts are frequently reluctant to submit the board of directors to nonfiduciary limitations or review without authority in the Delaware statute or limitations provided in the company's articles of incorporation.[220] Thus, power given to the board under Delaware law is generally given subject only to the board of directors' fiduciary duties and, with few exceptions, not subject to shareholder review.

These statutory limitations on the powers of the board of directors and the authority of the shareholders to review the board's actions are clearly expressed in Delaware law. Most statutory provisions limiting the board of directors' exclusive power to act deal with transactions creating fundamental corporate change.[221] Each of these areas of corporate change provides a process generally requiring action by both the board of directors and the shareholders.[222] The board's power to approve stock rights and stock options, including poison pill provisions, is not consid-

216. *See id.* at 909.

217. *See id.*

218. *Id.*

219. *See supra* Part III.B.2.

220. *See* Paramount Comm. Inc. v. QVC Network, Inc., 637 A.2d 34, 42 (Del. 1994) ("Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors. . . . Nevertheless, there are rare situations which mandate a court take a more direct and active role in overseeing the decisions made and actions taken by the directors."); Quickturn Design Sys., Inc. v. Mentor Graphics Corp., 721 A.2d 1281, 1291 (Del. 1998) ("Section 141(a) requires that any limitation on the board's authority be set out in the certificate of incorporation.").

221. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 & n.8 (Del. 1985).

222. *See* DEL. CODE ANN. tit. 8, § 242(b) (1991) (requiring a board resolution passed by a majority of the voting shareholders of the corporation for the certificate of incorporation to be amended); *id*. § 251(c) (requiring a board resolution passed by the voting shareholders for the company to merge into or consolidate with another company); *id.* § 271(a) (requiring a resolution by the shareholders of a corporation allowing the board of directors to sell, lease, or exchange substantially all of the property or assets of the corporation); *id*. § 275(a) (requiring resolution by the shareholders prior to a dissolution of the corporation proposed by the board of directors).

ered an area of fundamental corporate change[223] and should not be subject to a resolution or a review by the company's shareholders.[224] Therefore, barring legislative intervention, the Delaware courts are not likely to allow mandatory shareholder review of poison pills, and any resolution mandating the board of directors to redeem a poison pill should be invalidated as contrary to Delaware state law.

2. A Fleming *Case in Delaware*

Even if the opponents of a poison pill were to recharacterize a proposal as a suggestion to the board of directors, Delaware courts are not likely to require the board of directors to redeem a poison pill in most circumstances. In *Fleming*, the Supreme Court of Oklahoma recognized that Oklahoma and Delaware corporate laws were "substantially similar," but the court could find no precedent on which to base its opinion.[225] Although a similar case has not been decided by a Delaware court, Delaware jurisprudence is not lacking for cases balancing the power between the board of directors and the shareholders. In fact, Delaware courts have addressed issues very similar to the *Fleming* district court's concerns of board self-interest in the takeover context. In *Revlon*, for example, the Supreme Court of Delaware stated that "when a board implements anti-takeover measures there arises 'the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.'"[226] The Delaware courts often distinguish between good-faith attempts by the board of directors to delay proxy contests using "non-preclusive defensive measures" so the board may "explore transactional alternatives" and attempts to "erect defenses that would either preclude a proxy contest altogether or improperly bend the rules to favor the board's continued incumbency."[227] The former attempts are generally allowed, while the latter are not.

Once a takeover defense such as a poison pill is adopted, however, the board does not have unfettered discretion to leave the defense in

223. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1355 (Del. 1985) (explaining that the rights plan adopted by Household did not result in any more structural change to the corporation than any other defensive measures).

224. *See* DEL. CODE ANN. tit. 8, § 157 (1991) (providing that the board of directors is to approve the instruments evidencing stock rights or options and is to set the terms of such rights and options); s*ee also Moran*, 500 A.2d at 1351–53 (addressing five statutory arguments against the defendant's rights plan and the counterarguments used to uphold the rights plan).

225. International Bhd. of Teamsters v. Fleming Cos., 975 P.2d 907, 910 (Okla. 1999).

226. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986) (quoting *Unocal*, 493 A.2d at 954).

227. Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1186–87 (Del. Ch. 1998). The court cites two types of cases. In the first type, the courts allowed the board of directors to delay shareholder meetings and annual meetings "so that the board and management would be able to explore alternatives to the hostile offer (but not entrench themselves)." *Id.* at 1186 & n.16. In the second type, the courts did not permit the board of directors to delay meetings so the board could "solicit revocations of proxies to defeat the apparently victorious dissident group" or change the composition of the board of directors so as to make the outcome of the proxy contest irrelevant. *Id.* at 1186 & n.17.

place.[228] For example, when a company is in "*Revlon* mode," the board of directors will generally be forced to redeem the poison pill because the board's duties have changed from protectors to auctioneers.[229] Additionally, if the poison pill, or a variation of a poison pill, purposefully interferes with the shareholder franchise or impermissibly coerces the shareholders to vote for the incumbent board, the courts will require the board of directors to redeem the poison pill.[230]

Outside of these situations requiring enhanced scrutiny of the takeover defense and assuming the board's decision to continue the defense is reasonable in relation to the perceived threat, the courts will generally apply the business judgment rule.[231] Thus, in a case like *Fleming* where the corporation is not the target of a hostile takeover and is not on the auction block, the opponents of the takeover defense would be forced to argue that the board's failure to redeem the poison pill is a breach of its fiduciary duties under the business judgment rule or under *Blasius*. Under most circumstances, however, these approaches would generally not be satisfactory to the opponents of the poison pill. First, Delaware recognizes the board of directors' legal ability to adopt a poison pill.[232] Second, to show breach of duty under the business judgment rule requires evidence that the board was acting in bad faith, without an informed basis, and not in the best interests of the corporation.[233] Thus, the opponent of the poison pill would have to show that the board of directors was acting primarily out of an entrenchment motive or that it was uninformed. Consequently, in a *Fleming* case in Delaware, the Teamsters would have to show that the board of directors was acting to entrench itself and not reacting to perceived threats in the market place.[234] Otherwise, the Teamsters would have to show evidence of gross negligence—the standard required when claiming the board of directors did not act on an informed basis.[235]

Because of the deference given the board under the business judgment rule, the opponents of a poison pill would rather proceed under the

228. *See Moran*, 500 A.2d at 1354 ("The Board does not now have unfettered discretion in refusing to redeem the Rights. The Board has no more discretion in refusing to redeem the Rights than it does in enacting any defensive mechanism.").

229. *See supra* notes 105–06 and accompanying text.

230. *See supra* notes 114–17, 155 and accompanying text.

231. *See supra* notes 100–02 and accompanying text; *see also supra* notes 80–87 and accompanying text.

232. *See, e.g.*, *Moran*, 500 A.2d at 1352.

233. *See id.* at 1356; s*ee also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

234. *See Moran*, 500 A.2d at 1356 (finding that "the threat in the market place of coercive two-tier tender offers" was the reason the board of directors adopted the poison pill provision). Presumably, the court would have to analyze the market of the corporation—an analysis that favors the corporation, however, because most companies can point to some takeover threats or conditions creating such threats in their industries. *See, e.g.*, Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1182–83 (Del. Ch. 1998).

235. *See* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

Blasius compelling justification standard.[236] Unfortunately, a "traditional" poison pill alone will probably not be in violation of *Blasius* because the poison pill does not totally preclude a proxy contest or hostile takeover.[237] Thus, the poison pill opponents would have to show that the poison pill in question had terms or conditions more onerous than a traditional poison pill.[238]

Given the difficulties in the shareholders' ability to meet the *Blasius* standard and the ease with which the board of directors may meet the business judgment rule, the opponent of a poison pill faces an uphill battle when attempting to force the board to redeem a poison pill absent a hostile takeover threat. As long as the board considers a shareholder proposal urging management to redeem the poison pill and makes a good-faith, informed decision not to redeem the poison pill, the decision should generally withstand judicial scrutiny.

3. Cumulative Preclusive Effect Test

Shareholders' difficulty to force a redemption under any of the fiduciary standards established by Delaware law creates a situation in which the continuance of a poison pill, coupled with other defensive mechanisms, substantially precludes shareholders from voting for new directors or any potential acquirors from seeking to acquire the target. Moreover, the courts will defer to management's continuance of a poison pill if there is even a slight chance that a hostile acquiror could defeat the poison pill in a proxy contest.[239] The foundation for this view is the court's holding in *Moran*.[240] Unfortunately, *Moran* dealt with only the preclusive effects of the poison pill alone. Most companies today have multifaceted takeover defenses employing poison pills, staggered boards, supermajority voting provisions, and flexible election dates.[241]

A few courts have recognized the preclusive effects of multiple takeover defenses and have mitigated such effects by voiding either part of the takeover plan or the entire defense.[242] Although treating all of a

236. A judicial decision is greatly influenced by the applicable standard of review. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988) ("Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of [the] derivative litigation.") (citing AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986)).

237. *See Moran*, 500 A.2d at 1354.

238. A poison pill with a dead-hand provision is one example of a poison pill variant that impermissibly interferes with the shareholder franchise. *See Carmody*, 723 A.2d at 1193.

239. *See Moran*, 500 A.2d at 1353–54 (minimizing the potential effects of the poison pill on the proxy process).

240. *See id.*

241. *See* Neuwirth, *supra* note 9, at 437–44.

242. *See In re* Gaylord Container Corp., C.A. No. 14616, 1996 Del. Ch. LEXIS 149, at *8 (Del. Ch. Dec. 19, 1996), *reprinted in* 22 DEL. J. CORP. L. 1207, 1213 (1997) ("The court must scrutinize the board's defensive actions collectively to determine whether they are within the range of reasonableness."); Hilton Hotels Corp. v. ITT Corp., 978 F. Supp. 1342, 1350 (D. Nev. 1997) ("The different pro-

company's defensive mechanisms, whether implemented at one time or over a period of time, together does not go so far as to give the shareholders a right of review, it does make a *Unocal* or a *Blasius* standard easier to apply. To alleviate the entrenchment results stemming from a combination of takeover defenses, the courts should not only look at the implications of the takeover defenses together but also realistically analyze the ability of the shareholders to exercise their fundamental corporate right to oust management. Such an analysis may well prove the undoing of complex and integrated takeover defense schemes; the courts may find that the overall preclusive affects of the defense mechanisms negate the factors established by the *Moran* court in upholding the validity of the poison pill.

VI. CONCLUSION

The traditional duties of the board of directors to manage the affairs of the corporation have been on a collision course with the activist institutional shareholders for almost two decades. The collision of these two competing parties has been facilitated by the *Fleming* decision, which held that shareholders have the right to review and force redemption of a poison pill. The holding opens the door for an increased level of shareholder activism in corporate governance—blurring the already fuzzy line between the power of the board of directors and the rights of shareholders.

Although the holding in *Fleming* may not create a wholesale change in the traditional corporate governance model, it does serve notice that shareholders are no longer passive investors willing to let the board of directors exclusively chart the course of the corporation. Instead of opening the board's ordinary business decisions to shareholder review through bylaw proposals, however, the courts should enable shareholders to freely exercise their voting rights and deter board of director entrenchment. This is most easily done by scrutinizing the board of directors' failure to redeem a poison pill when suggested by the shareholders under the *Blasius* standard. Moreover, when analyzing the possible preclusive affect of the poison pill, the courts should consider all of the cor-

visions of the Comprehensive Plan are inextricably related, and this Court has already concluded that the staggered board provision is preclusive and was enacted for the primary purpose of entrenching the current board. Therefore, the entire Comprehensive Plan must be enjoined."). The comprehensive plan in *Hilton Hotels* was adopted by ITT's board of directors in response to Hilton Hotels' hostile takeover attempt. The court, following Delaware judicial precedent, found the staggered board component preclusive because the "ITT shareholders will be absolutely precluded from electing a majority of the directors [of ITT] nominated under Hilton's proxy contest at the 1997 annual meeting." *Id.* at 1349. The timing of the initiation of the staggered board without "credible justification" for seeking shareholder approval was a factor the court used in holding that the staggered board was "designed to entrench the incumbent board." *Id.* Although the court mentioned some problems with the "tax poison pill" component of the comprehensive plan, it did not rule on the poison pill's validity because another component had already been found preclusive. *See id.* at 1350.

poration's takeover defenses together and realistically appraise the ability of the shareholders to vote for a new slate of directors.