Corporate Governance at the Millennium: The Decline of the Poison Pill Antitakeover Defense

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CORPORATE GOVERNANCE AT THE MILLENNIUM: THE DECLINE OF THE POISON PILL ANTITAKEOVER DEFENSE

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> "[T]he emergence of the 'poison pill' as an effective takeover device has resulted in such a remarkable transformation in the market for corporate control . . . ."[2]

> "In the ever-evolving field of corporate takeover jurisprudence, the defensive mechanism that has mutated more rapidly than others, and has prompted the most widespread debate, is the 'poison pill' rights plan. Since making its legal debut in 1985, the story of the poison pill has been work in progress . . . ."[3]

I. INTRODUCTION

As recently as twenty years ago, the ability and desire of corporate shareholders to mount a challenge over corporate governance[4] seemed unlikely. After all, shareholders were considered to be passive, impotent, and unconcerned with anything but the value of their investment.

Although shareholders of decades past were admittedly passive and powerless, today's shareholder activism is fueled largely by the institutional investor.[5] In short, a shareholder revolution has occurred, highlighted by the ascendancy of the institutional investor. Accompanying the institutional investors' growth and concentration of share ownership is their desire and ability to participate meaningfully in governance issues. "[A]n extraordinary ferment of activity in the field of corporate governance" has resulted.[6]

The primary device standing in the path of unfettered monitoring of corporate management by these institutional shareholders and the market for corporate control has been the antitakeover mechanism known as the share-

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1. S. Walter Richey Professor of Corporate Law, University of Minnesota Law School. Of Counsel, Kaplan, Strangis and Kaplan, P.A.

2. Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995).

3. Mentor Graphis Corp. v. Quickturn Design Sys., Inc., 1998 WL 839079 (Del. Ch. Dec. 3, 1998), *aff'd*, 721 A.2d 1281 (Del. 1998).

4. As used herein, "corporate governance" defines the process by which the balance of power between a corporation's shareholders and nonshareholders is allocated. Nonshareholders include the corporation's board of directors, officers, creditors, suppliers, and customers. The current framework of corporate governance is defined through state-enacted corporate codes, case law, and customized corporation-specific provisions such as articles of incorporation and bylaws.

5. Commentators have explained:

> [W]e are now witnessing the reagglomeration of ownership of the largest corporations, so that long-term shareholders are well on the way to majority ownership of America's companies. They are, of course, the institutional shareholders, who invest collections of individuals' assets through pension funds, trusts, indurance companies, and other entities.

ROBERT A. MONKS & NELL MINOW, POWER AND ACCOUNTABILITY 18 (1991).

6. Roswell B. Perkins, *The President's Letter*, 4 A.L.I. REP. 1 (1982), *quoted in* Melvin A. Eisenberg, *An Introduction to the American Law Institute's Corporate Governance Project*, 52 GEO. WASH. L. REV. 495, 496 (1984).

holder rights plan or "poison pill."[7] So significant is this device in the defensive arsenal of publicly traded corporations that thousands of companies have adopted it, including some sixty-two percent of the S&P 500.[8] In 1997 alone over 300 new shareholder rights plans were adopted.[9]

Institutional investors have gone from expressing intense criticism of this device to challenging particular aspects of its operation, in addition to seeking mandatory removal of it from the arsenal of corporate defenses. The resolution of this issue is closely tied to the evolution of the nature and role of modern institutional investors and the role of hostile takeovers in the market for corporate control[10] as a monitoring device upon management.[11] Moreover, the intense controversy surrounding this corporate governance battle appears inevitable given the far-reaching economic and social impact of the modern corporation.[12]

Although "the 1980s witnessed an unprecedented development in the law surrounding corporate governance,"[13] the 1990s have proven to be even more ground-breaking. The unveiling of the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations* (ALI Project)[14] ranks among the major governance developments of this decade. Its fifteen-year gestation yielded an impressive treatise on corporate law and governance.[15]

Part II of this Article will trace the historical development of corporate governance. Parts III, IV and V will highlight three crucial developments leading to the current governance landscape, namely, the expanded role of

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7. Poison pills or shareholder rights plans typically are stock warrants or rights that allow the holder to buy a suitor's stock ("flip-overs") or the target's stock ("flip-ins") at bargain prices while excluding the hostile purchaser from making the same bargain purchase. *See, e.g.*, P. John Kozyris, *Corporate Takeovers at the Jurisdictional Crossroads: Preserving State Authority Over Internal Affairs While Protecting the Transferability of Interstate Stock Through Federal Law*, 36 UCLA L. REV. 1109, 1156 (1989). These bargain-purchase rights are triggered if a hostile party crosses a pre-determined threshold of target company stock ownership, usually between 10 and 20 %. Adoption of a rights plan can be accomplished without shareholder approval and the rights can only be redeemed by the board of directors of the adopting company. *See id.* The Investor Responsibility Research Center, an independent non-profit research group, found that 51% of large American companies were armored with poison pills as of August, 1990. *See Majority of Large U.S. Corporations Have Adopted Poison Pills*, IRRC Finds [July-Dec.] SEC. REG. & L. REP. (BNA) No. 47, at 1659 (Nov. 30, 1990). Throughout this Article the terms "poison pill" and "shareholder rights plan" will be used interchangeably.

8. *See* IRRC, Corporate Governance Service 1998 Background Report E: Poison Pill, June 5, 1998, at 1 [hereinafter 1998 Poison Pill Report].

9. *See id.*

10. No governance issue has received more attention than the impact of takeovers and antitakeover weaponry upon shareholders and nonshareholders. For commentary on this issue, *see* Richard A. Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988); Henry N. Butler, *Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters*, 1988 WIS. L. REV. 365; John C. Coffee, Jr., *Shareholders Versus Manager: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986); John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholder, and Bustups*, 1988 WIS. L. REV. 435 [hereinafter Coffee, *Takeover Reform*]; Lyman Johnson & David Millon, *Misreading the Williams Act*, 87 MICH L. REV. 1862 (1989) [hereinafter Johnson & Millon, *Williams Act*]; Lyman Johnson & David Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846 (1989) [hereinafter Johnson & Millon, *Missing the Point*]; Donald C. Langevoort, *State Tender-Offer Legislation Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977); Johathan R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467 ; John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425 (1991) [hereinafter Matheson & Olson]; Dale Arthur Oesterle, *Revisiting the Antitakeover Fervor of the '80s*, 19 CARDOZO L. REV. 565 (1997); Roberta Roman, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987).

11. Commentators disagree on the effectiveness of hostile takeovers to discipline corporate management for varying reasons. *Compare* Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investor*, 43 STAN. L. REV. 863, 870-71 (1991) ("Given the contribution of hostile takeovers to portfolio values during the 1980s, institutional investors were quite right to target defensive tactics in their initial foray into corporate governance debate . . . . [Nevertheless, the] hostile takeover has proved to be an expensive and inexact monitoring device . . . .") *with* Martin Lipton & Steve A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 198 (1991) (asserting that "the hostile takeover is not a particularly effective or efficient means of motivating or disciplining managers").

the board of directors in hostile takeover contests, the development of the poison pill as an antitakeover device, and the rise to power of the institutional investor. Part VI will explore the altered balance of power resulting from the recent successful legal challenges to the most significant provisions of the poison pill and its resulting detoxification in many circumstances. The active battle by institutional shareholders to force redemption of poison pills in individual companies is also examined. Part VII considers the future of corporate governance in this new context.

II. CORPORATE GOVERNANCE -- THE BATTLE FOR CONTROL

The relationship between shareholders and nonshareholders in the operation of the modern public corporation appears to have a dialectical character:[16] as the power of one expands, the power of the other diminishes; the strength of the one often causes the other to react and to expand its power. Thus, commentators often view shareholder and nonshareholder interests as opposing and mutually exclusive. Modern shareholders, they argue, typically seek short-term profit while nonshareholders typically seek

12. "Today . . . the corporation is the dominant form of business organization[,] . . . account[ing] for about 89 percent of business receipts . . . . [O]verall, the business corporation is the principal form for carrying out business activities in this country." ROBERT C. CLARK, CORPORATE LAW § 1.1, 1-2 (1986). Few governance issues affect society as broadly and intensely as corporate takeovers. Thus, "[n]o current corporate issue has attracted more attention from legal and economic scholars than takeover defensive moves by corporate manager." Larry E. Ribstein, *Takeover Defense and the Corporate Contract*, 78 GEO. L.J. 71, 72 (1989).

For commentary probing major economic concerns over takeover activity and antitakeover devices, *see* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); Frank H. Easterbrook & Daniel R. Rischel, *Corporate Control Transaction*, 91 YALE L.J. 698 (1982) [hereinafter Easterbrook & Fischel, *Corporate Control Transactions*]; Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 95 HAR. L. REV. 1161 (1981) [hereinafter Easterbrook & Fischel, *The Proper Role*]; Frank H. Easterbrook & Daniel R. Fischel, Takeover Bids, *Defensive Tactics, and Shareholders' Welfare*, 36 BUS. L. 1733 (1981) [hereinafter Easterbrook & Fischel, *Takeover Bids*]; Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1981); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Years Offers*, 33 STAN. L. REV. 819 (1981) [hereinafter Gilson, *A Structual Approach*]; Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987) [hereinafter Lipton, *Corporate Governance*]; Martin Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook & Fishcel*, 55 N.Y.U. L. REV. 1231 (1980) [hereinafter Lipton, *Target's Boardroom*]; Matheson & Olson, *supra* note 10; Dale A. Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53 (1985); Alan Schwartz, *Search Theory and the Tender Offer Auction*, 2 J.L. ECON. & OR. 229 (1986). *See also* Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1434-44 (1964) (explaining how shareholders may react to tender bids, mergers, and proxy fights).

13. D. BLOCK ET. AL, THE BUSINESS JUDGEMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 1 (3d ed. 1989). The authors further note that "[t]he early 1990s will likely prove an equally active period . . . ." *Id.* at 41.

14. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994) [hereinafter ALI PROJECT].

15. In addition, commentators advanced three significant corporate governance proposals during this decade. The Lipton/Rosenblum proposal recommends extending board terms to five years. *See* Lipton & Rosenblum, *supra* note 11. The Gilson/Kraakman proposal recommends the infusion of "professional directors." *See* Gilson & Kraakman, *supra* note 11, at 883-92. The Matheson/Olson proposal advocates implementing a "longterm shareholder" regime. *See* Matheson & Olson, *supra* note 10.

16. Although this Article does not attempt to describe the dialectical development of corporate law in philosophical terms, the author recognizes that philosophical principles of the "dialectic" have fueled efforts to describe the nature and evolution of social and economic phenomenon. The proposition that certain social phenomenon evolve dialectically was forcefully articulated by the philosophers G.W.F. Hegel and Karl Marx. *See generally* Joseph McCarney, *Hegel, Marx, and Dialectic*, *in* HEGEL AND MODERN PHILOSOPHY 161 (David Lamb ed., 1987). Together, Hegel and Marx established the significance of the dialectic for social science inquiry. *See generally id.*

This Article suggests that corporate law has more or less proceeded in dialectical stages. The seeds of this dialectical progression take objective foothold in the ownership/control dichotomy intrinsic to the corporate form. As one strand of the shareholder/manager dialectic expands its power, the other reacts to further entrench its power. The development of corporate governance has mirrored this intrinsic dialectical tension. The subjective manifestation of this dialectical tension is discussed in the remainder of Part II.

longterm protection.[17] The American Law Institute Corporate Governance Project describes the nature of these tensions between shareholders and one nonshareholder group, management, as endemic to corporate governance:

> The challenge for corporate law is to facilitate the development of a corporate structure that allows management the discretion to utilize its expertise on behalf of shareholders, but at the same time establish safeguards in situations in which management might utilize that discretion to favor itself at the expense of shareholders.[18]

The best economic explanation for the dialectical nature of corporate governance is the agency cost theory,[19] which emphasizes the dichotomy between discretion and accountability. This dichotomy stems from the separation of ownership and control, as articulated by Adolf Berle and Gardiner Means in their classic work, *The Modern Corporation and Private Property*.[20] Berle and Means claimed that shareholders are merely passive owners and that managers provide the true locus of control amid pervasive shareholder passivity.[21] They predicted that the separation of ownership and control would ultimately cause the demise of the corporation as a form of private enterprise.[22] While Berle and Means accurately identified a significant governance problem in the modern publicly traded corporation, their prediction of corporate demise has not proven accurate. Instead, however, the tensions between shareholders and management inherent in corporate governance have resulted in a dialectical development of corporate governance.

A. The Shareholder Primacy Norm

The traditional shareholder primacy model of the corporation derives from the concept that the shareholders are the owners of the corporation and, as such, are entitled to control it, determine its fundamental policies, and decide whether to make fundamental shifts in corporate policy and practice. This system of corporate governance developed its essential attributes when "owners managed and managers owned,"[23] which was essentially an accurate description of most corporate enterprises at the beginning of the last century. There was not a wide dispersion of share ownership, there were few institutional investors, and the shares of most corporations were owned

17. *See, e.g.*, Lipton & Rosenblum, *supra* note 11, at 214-15.
18. ALI PROJECT, *supra* note 14, at 519 (introductory note to Part VI).
19. Michael Jensen and William Meckling originated and defined the term "agency costs." *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).
20. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 301 (rev. ed. 1967).
21. *See id.* at 355-56.
22. *See id.*
23. ALFRED D. CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 9-10 (1977).

by the founders or local investors. Other potential corporate constituencies took their place after and only to the extent the shareholders determined, by contract or conscience, to be so bound.

The viability of this model derives from economic common sense. Only shareholders have strong incentives to maximize profits, thereby promoting economic efficiency.[24] In the shareholder primacy model, the shareholder vote traditionally has been seen as an important mechanism for shareholder control over corporate decisions.[25] Shareholders vote to elect and remove directors.[26] The board in turn designates officers to act as agents of the corporation. In addition, fundamental corporate transactions require shareholder approval. For example, shareholders normally must vote on mergers,[27] dissolutions,[28] or sales of substantially all of a corporation's assets.[29] Within this model, however, the board is presumed to act as a surrogate for and in the interests of the shareholders.

B. Managerial Capitalism

Whether or not theoretically sound, the reign of the economic-based shareholder primacy concept of corporate governance was short-lived.[30] Stressing separation of ownership from control as the most important factor in corporate governance, Berle and Means in 1933 questioned the reality of "shareholder primacy."[31] They claimed that shareholders were merely passive owners; managers provided the true locus of control amid pervasive shareholder passivity. Berle and Means asserted that, in an increasing number of large companies, management was not chosen by shareholders but rather was a self-perpetuating oligarchy.[32] Management controlled the director nomination process and the proxy machinery, resulting in a system of managerial capitalism.[33]

The separation of ownership and control enhances the likelihood that those controlling the corporation will lack an incentive to maximize efficiency and shareholder profitability because of pressures to diverge from the interests of shareholders. With the separation of ownership from control also

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24. *See* CLARK, *supra* note 12, § 9.5, at 389. Clark has explained:

> From an economic point of view, there is a strong argument that the power to control a business firm's activities should reside in those who have the right to the firm's residual earnings . . . . The intuition behind this argument is that giving control to the residual claimants will place the power to monitor the performance of participants in the firm and the power to control shirking, waste, and so forth in the hands of those who have the best incentive to use the power.

Id. See also Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 787-88 (1972) (explaining the nature of the control exerted by residual claimants over management).

25. *See* Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071, 1073 (1990).

26. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(k) (1991).

27. *See, e.g.*, *id.* § 251(c).

28. *See, e.g.*, *id.* § 275.

29. *See, e.g.*, *id.* § 271.

30. Of course, the shareholder primacy model still holds forth in many closely held corporations because the shareholders often wear multiple governance hats, serving also as directors, officers, and employees of the business.

31. *See* BERLE & MEANS, *supra* note 20, at 244.

32. *See id.* at 124.

33. *See id. See also* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 419-20 (1983) (stating that "shareholders' involvement in the voting process has not increased with the adoption of the proxy rules").

came the potential for managers to pursue their own self-interested agendas more aggressively within the corporate framework. When directors face claims for consideration from multiple interests or are self-interested,[34] shareholders cannot rely fully upon the directors' business judgment.

Delaware law, for example, provides that either the disinterested board members, the shareholders, or the courts may validate a transaction in which managers' interests clearly diverge from those of shareholders.[35] *Weinberger v. UOP, Inc.*[36] stated the modern formula for judicial review of transactions involving direct conflicts of interest. *Weinberger* held that "directors . . . [who] are on both sides of a transaction . . . are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."[37]

However, the types of conflicts and self-interested actions engendered by managerial capitalism typically do not call into play this strict standard of review. Rather, such conflicts are more subtle. For example, the pursuit of longterm stability, the reinvestment of earnings, and the growth and diversification of the corporate business tend to solidify the corporate enterprise and maintain managers in their positions. From this perspective, current earnings and profits may take on secondary importance.[38]

As the nature of the corporate dynamic changed, so did the nature of corporate law. Corporate codes became "enabling," thereby presumptively allowing contracting parties (i.e., managers and investors) much flexibility to determine the terms of the corporate charter and to establish corporate governance regimes free from most legal intervention.[39]

To be effective tools for efficient contracting, these enabling corporate codes presume the ability of contracting parties to make their wishes known. Despite the original conception of the corporation, in which the shareholders exercised primary control, modern corporate codes developed their essential character when "[e]ach shareholder owned few shares and lacked the means or inclination to participate actively [in corporate matters]."[40] The separation of ownership from control and the concomitant ability of managers to control the proxy process therefore left owners without traditional control or the ability to negotiate effectively with management. As mentioned earlier, the resulting loss in efficiency and the expense in designing alternative means to control management discretion have been aptly described as

34. This conflict between duty and self interest arises either when directors stand on both sides of a transaction or when they may otherwise reap some personal benefit from their actions.

35. *See* Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987); Merritt v. Colonial Foods, 505 A.2d 757, 764 (Del. Ch. 1986). *See also* DEL. CODE ANN. tit. 8, § 144(a) (1991) (noting the presumptive validity of transactions approved by disinterested directors or shareholders).

36. 457 A.2d 701 (Del. 1983).

37. *Id.* at 710.

38. As to these actions, strict judicial scrutiny does not come into play. Rather, the courts apply the hands-off business judgment rule to directors' informed decisions, erecting a presumption of good faith, thereby barring legal intervention that might substitute judicial judgment for those actions presumptively best left to managers.

39. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417 (1989).

40. George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 883.

"agency costs."[41]

C. Monitoring Management

The great challenge of corporate law in the modern era, then, is to minimize agency costs by constraining abuse of managerial discretion. Agency costs stemming from the ownership/control dichotomy may be minimized in a variety of ways. First, corporate law imposes liability for breaches of fiduciary duties. Fiduciary principles constrain managerial discretion by governing the web of agency relationships constituting the corporate structure.[42] Charged with managing the corporation,[43] directors owe a fiduciary duty to shareholders to act in their best interests.[44] This duty of care is circumscribed by the business judgment rule, the common law "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 was in the best interests of the company."[45] Consistent with the business judgment rule, liability will not attach for breach of the duty of care unless the director acted with gross negligence.[46]

Second, in addition to fiduciary duties, there has been a push by regulatory authorities and, to some extent, shareholders, to require that corporations have independent directors on their boards. The purpose for this requirement is the presumption that such directors, independent of management, will monitor management activities for the benefit of shareholders. According to this modified form of the shareholder primacy model, these monitoring mechanisms limit managerial discretion in an effort to conform managerial conduct with the interests of shareholders. Thus, corporate law provides the mechanisms to minimize agency costs by guaranteeing that management will attempt to maximize shareholder value. This discretion-constraining model of corporate governance stresses that managers, inclined to pursue their own selfish motives, have intrinsic conflicts of interests with shareholders.[47] Reconciling the shareholder primacy tenet with the Berle and Means thesis, scholars endorsing this model assert that the law

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41. *See, e.g.*, Michael C. Jensen & W.H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 293 (1988).

42. *See* Easterbrook & Fischel, *Corporate Control Transactions*, *supra* note 12, at 700. "The entire corporate structure is a web of agency relationships. Investors delegate authority to directors, who subdelegate to upper managers, and so on." *Id.*

43. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1991) ("The business [of a corporation] . . . shall be managed by or under the direction of a board of directors").

44. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch. 1938), *aff'd*, 5 A.2d. 503 (Del. Super. Ct. 1939)) ("In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders.").

45. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). The business judgment rule is a creation of common law. *See generally id.* at 812. There are no statutory formulations of the business judgment rule. *See generally id.* By invoking the business judgment rule, courts seek to avoid second-guessing the merits of a business decision provided there is no evidence of bad faith or self-dealing. *See generally id.*

46. *Aronson*, 473 A.2d at 812 n.6. Gross negligence is the Delaware standard, governing many publicly traded corporations. Other jurisdictions theoretically apply an ordinary negligence standard, but the application of that standard together with the presumption of the business judgment rule operates to approximate the Delaware gross negligence standard.

47. *See* Easterbrook & Fischel, *The Proper Role*, *supra* note 12, at 1169-70 (stating that discipline serves to check management's tendency "to shirk responsibilities, consume perquisites, or otherwise take more than the corporation promised to give them"); Gilson, *A Structural Approach*, *supra* note 12, at 836 (unless checked, management will seek "to maximize their own welfare rather than the shareholders").

must impose controls on management to ensure it is responsible to shareholders and the public.[48]

Managers and directors, however, are not inalterably self-interested--after all, most managers and directors diligently attempt to maximize shareholder value.[49] Furthermore, numerous corporations provide managers with financial incentives to maximize corporate profitability, thereby tending to align shareholder and nonshareholder interests.[50] The combined effects of these factors, together with the monitoring provided by shareholders, supply the strongest support for the claim that monitoring mechanisms effectively minimize agency costs.

In addition, market forces, like the market for corporate control, may also constrain managerial abuses. At one extreme, this monitoring model views shareholders as owners of the corporation and posits that stock ownership is like ownership of any other property.[51] Unhappy shareholders can simply sell their shares to others. At the least, such conduct should evidence their displeasure with management. If sold to a bidder in a tender offer, such a sale might result in the ouster of management. Throughout the 1970s and much of the 1980s, this market in corporate control acted as an important mechanism for monitoring corporate behavior.[52]

Consistent with the market-monitoring model, corporate law should merely seek to facilitate the operation of the market and reduce transaction costs. Thus, the corporation simply substitutes for costly, multiple contractual arrangements to increase efficiency and maximize profits. Supporters of the market model tend to ally themselves with the efficient capital market hypothesis which decrees that, even when a change of control is not threatened, stock prices accurately reflect all available information about the corporation, including the extent of agency costs because of management-protecting behavior.[53] The market-monitoring model places substantial emphasis on the invisible hand of the marketplace.[54] It stresses that the optimal governance structure must derive from experience rather than theory. Corporations persuading shareholders that they offer the highest return will garner the largest investments. Thus, only firms and managers making choices that investors would ordinarily prefer will prosper relative to other companies.[55] Discretion-constraining rules are thus thought unnecessary to the extent that market forces sufficiently curb managerial discre-

48. *See* Elliott Goldstein, *The Relationship Between the Model Corporation Act and the Principles of Corporate Governance: Analysis and Recommendations*, 52 GEO. WASH. L. REV. 501, 501 (1984).

49. *See* JAY W. LORSCH, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 30 (1989).

50. Consider, for example, incentive/merit compensation tied to stock value appreciation, earnings, or profit increases. *See* Lipton & Rosenblum, *supra* note 11, at 196-97.

51. *See, e.g.*, Easterbrook & Fischel, *The Proper Role*, *supra* note 12, at 1191, 1201.

52. *See, e.g.*, Matheson & Olson, *supra* note 10, at 1435-38.

53. For a general overview of materials relevant to the efficient capital market hypothesis, *see* ROBERT W. HAMILTON, CORPORATION FINANCE 252-95 (2d ed. 1989); Easterbrook & Fischel, *Takeover Bids*, *supra* note 12, at 1734.

54. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1419 ("Managers may do their best to take advantage of their investors, but they find that the dynamics of the market drive them to act as if they had investors' interests at heart. It is almost as if there was an invisible hand.").

55. *See id.* at 1421.

tion.

The strength of this combined legal and economic-based modified shareholder primacy model of corporate governance is uncertain. As discussed below, shareholders' ability to dislodge entrenched management during ongoing control transactions in the 1970s and 1980s proved intolerable to nonshareholder forces, particularly corporate management. Nonshareholders responded by devising ways to stultify shareholder input while expanding management discretion. This has resulted in the "insulated managerialism" norm of corporate governance.

D. Insulated Managerialism

While there is debate over the efficacy of internal and market-monitoring mechanisms, including the hostile takeover, there is no doubt that corporate management, the courts, and state legislatures responded to the perception, if not the reality, of the monitoring concept. Beginning in the middle to late 1980s and carrying through the 1990s, most of the response came in decisions and statutes limiting the ability of potential acquirers to go directly to shareholders to gain control of a target corporation. Statutes limiting or eliminating potential officer and director liability also provided insulation. Since management already controlled the proxy machinery, giving management substantially more control over the prospect and process of control transactions brought forth an era of insulated managerialism.

Most public corporations are shielded by now-ubiquitous, state-imposed antitakeover legislation,[56] which typically endows management with the power to reject unwelcome takeover overtures.[57] These antitakeover provisions come in all shapes and sizes, including fair price statutes,[58] disclosure statutes,[59] share rights plan endorsement statutes,[60] anti-greenmail statutes,[61] and cashout/redemption rights statutes.[62] Two antitakeover statutes -- the business combination statute and the control share acquisition statute -- overshadow the others. They demonstrate how far legislatures have gone toward bolstering the pro-management antitakeover

56. *See, e.g.*, Matheson & Olson, *supra* note 10, at 1439 ("By January 1, 1991, at least forty-nine states had adopted antitakeover statutes of some kind.").

57. *See, e.g.*, Jonathon R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467, 468-69 (noting that all state statutes "share the common feature of serving to consolidate the ability to respond to tender offers in the hands of the incumbent managers of [target firms]").

Maine and Pennsylvania have enacted statutes granting "appraisal rights" to nontendering shareholders, entitling them to receive "fair value" when the suitor acquires a threshold percentage of the target's shares. ME. REV. STAT. ANN. tit. 13A, § 910 (West 1990); PA. STAT. ANN. tit. 15, §§ 2546, 2547 (West Supp. 1991). Since the appraisal remedy may require payment of a judicially determined "fair" price, it introduces into the bidding process costly risks--the judge's determination of "fair value" will surely generate much litigation; as risks increase, bids will be deterred. Although cashout statutes grant shareholders the same protection as Maryland-type fair price statutes, cashout statutes effectively require the bidder to acquire 100% of the firm: their mandatory redemption procedures guarantee all shareholders a fair price. *See* Matheson & Olson, *supra* note 10, at 1451-52.

58. Aimed at front-end loaded two-tiered offers, fair price statutes seek to ensure that all target shareholders are offered and receive a "fair price" for all shares -- whether tendered during the "first tier" or "second tier" -- unless the offer is approved by a super-majority of noninterested shareholders. *See* Matheson & Olson, *supra* note 10, at 1445. Most fair price statutes are based on Maryland's two-tier offer cash-out merger model. This model requires an "interested shareholder" to satisfy the statute's fairness requirement by offering to the remaining minority the highest price paid any other shareholder before the merger announcement. Failure to satisfy the fairness requirement triggers a prohibitive super-majority statutory requirement: 80% of all the shareholders and two-thirds of all disinterested shareholders (i.e., shareholders other than the bidder) must vote to approve a cash-out merger. *See* MD. CODE ANN., CORPS & ASS'NS §§ 3-602, 3-603 (1985).

landscape.

A majority of states have enacted business combination statutes. These statutes prohibit most business combinations, such as mergers or asset sales,[63] between a target corporation and an "interested" shareholder absent prior board approval.[64] Allowing a board to decide unilaterally whether business combination legislation is applicable grants the board ultimate power to determine whether to accept a tender offer. Most of these statutes render shareholders wholly powerless to accept tender offers by guaranteeing that no such offer will be brought to fruition without target company board approval.

For example, New York's law prohibits business combinations between resident domestic corporations and a twenty percent shareholder for five years absent prior board approval.[65] Delaware modified New York's statute[66] by establishing a three-year prohibition on any business combination between a Delaware corporation and an "interested" stockholder[67] acquiring fifteen percent or more of the company unless the board of directors gives prior approval.[68] Since the Delaware law covers more corporations than any other,[69] the business combination statute is currently the most pervasive form of antitakeover legislation.

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59. Paralleling the disclosure requirements of the Williams Act, these statutes typically require disclosure of the suitor's source of funds, the restructuring plans involving the target corporation, and the number of shares the suitor owns directly (or as a beneficiary). As to the overall benefits to shareholders of state-level disclosure statutes, the United States Supreme Court in *Edgar v. MITE Corp.*, 457 U.S. 624, 644 (1982), was unconvinced that the Illinois Act substantially enhanced the shareholders' position. The Illinois Act sought to protect shareholders of a company subject to a tender offer by requiring disclosures regarding the offer, assuring that shareholders have adequate time to decide whether to tender their shares, and according shareholders withdrawal, proration, and equal consideration rights. However, the Williams Act provides these same substantive protections. "[T]he disclosures required by the Illinois Act which go beyond those mandated by the Williams Act . . . may not substantially enhance the shareholders' ability to make informed decisions . . . . [We] conclude that the protections the Illinois Act affords resident security holders are, for the most part, speculative." *Id.* at 644-45. For a discussion of the Williams Act, *see infra* notes 99-102 and accompanying text.

60. These statutes explicitly authorize directors to implement discriminatory poison pills. Most Shareholder Rights Plan Endorsement Statutes (SRPES) allow directors to design poison pills that may include restrictions or conditions that preclude or limit the exercise, transfer, or receipt of such rights by any suitor, or invalidate such rights held by a suitor. *See, e.g.*, IND. CODE ANN. §§ 23-1-35-1, 23-1-26-5 (Michie 1989); OHIO REV. CODE ANN. §§ 1701.06, 1701.13(f)(7) (Banks-Baldwin 1989).

61. Anti-greenmail statutes attempt to eliminate abuses associated with a target's payment of "greenmail," i.e., where the target repurchases, at a price above its fair market value, its own stock held by an unwanted suitor. *See, e.g.*, MINN. STAT. § 302A.553 (1990). These statutes generally prohibit a target from purchasing, for more than fair market value, three percent or more of its own stock from any shareholder who has held the shares for less than two years. Most statutes provide that the restrictions do not apply if both the board and a majority of shareholders approve the repurchase. *See id.*

62. Maine and Pennsylvania have enacted statutes that grant "appraisal rights" to nontendering shareholders, entitling them to receive "fair value" when the suitor acquires a threshold percentage of the target's shares. *See* ME. REV. STAT. ANN. tit. 13A, § 910 (West Supp. 1990); PA. STAT. ANN. tit. 15, §§ 2546, 2547 (West Supp. 1991). Since the appraisal remedy may require payment of a judicially determined "fair" price, it introduces into the bidding process costly risks–the judge's determination of "fair value" will surely generate much litigation; as risks increase, bids will be deterred. Although cashout statutes grant shareholders the same protection as Maryland-type fair price statutes, cashout statutes effectively require the bidder to acquire 100% of the firm: their mandatory redemption procedures guarantee all shareholders a fair price. *See* Matheson & Olson, *supra* note 10, at 1451-52.

63. "Business combination" is a comprehensive term including virtually every conceivable type of fundamental change. *See, e.g.*, DEL. CODE ANN. tit. 8, § 203(c)(3) (1991); N.Y. BUS. CORP. LAW § 912(a)(5) (McKinney 1986).

64. *See* Matheson & Olson, *supra* note 10, at 1521-29 (identifying twenty-eight states).

65. *See* N.Y. BUS. CORP. LAW § 912 (McKinney 1986). The New York statute prohibits both two-step bids and coercive two-tier bids. With two-tier bids, the bidder announces in advance that, once control passes, the remaining shareholders will be cashed out at a lower price than those who initially tendered in the first tier, coercing some shareholders to tender for less than they otherwise would. The New York statute essentially prohibits hostile takeovers if the suitor plans to change the target's business significantly.

66. Delaware's statute is manifestly less restrictive than New York's -- indeed, the Delaware statute is one of the mildest in the nation: it applies only to suitors who acquire between 15 and 85 %of a target's shares. *See* DEL. CODE ANN. tit. 8, § 203(a)(2), (c)(5) (1991).

67. "Interested Stockholders" are shareholders that possess fifteen percent or more of a corporation's voting stock. *Id.* § 203(c)(5).

In addition, a majority of states have enacted control share statutes[70] that, following Indiana's lead, afford shareholders the right to determine collectively whether a bidder's "control shares" accrue voting rights.[71] Despite this pro-shareholder appearance, the essential purpose of control share acquisition statutes may be to endow the target board with the power to dispose of, or at least delay, hostile tender offers. The powers granted directors under these statutes are vast. They include the power to opt into or out of statutory protection;[72] the power to control the timing of the shareholder meeting;[73] the power to approve a merger unilaterally, thereby bypassing the statute;[74] the power to issue stock to a "white knight" without triggering the statute's provisions;[75] and the power to engage in friendly control transactions.[76] In addition, the requirement that a meeting and vote be held causes significant delay and attendant costs for the potential acquirer. More fundamentally, however, control share statutes dramatically alter the corporate control terrain. Instead of making an investment decision, that is, whether to sell their shares, shareholders are asked to vote on the acquirer's voting rights. Thus, although control share statutes in theory grant shareholders a much-needed voice in control transactions,[77] their ultimate effect is to grant directors one more means of minimizing shareholder input.

The popularity of these statutes likely stems from the fact that they are the only variety of protectionist legislation upheld by the United States Supreme Court.[78] As an antitakeover weapon, armed with disinterested shareholder approval requirements and redemption and dissenters' rights,

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68. *See id.* § 203(a)(1). In addition to this prior board approval, the Delaware statute provides two additional pathways for a suitor to circumvent the three-year freeze. First, the suitor may override the freeze if the qualifying transaction results in a suitor's owning at least eighty-five percent of the target stock. *See id.* § 203(a)(2). Second, the suitor may override the freeze if the business combination is approved by both the board and by two-thirds of the outstanding disinterested shares. *See* DEL. CODE ANN. tit. 8, § 203(a)(3) (1991). The Delaware statute has withstood constitutional challenges. *See, e.g.*, BNS, Inc. v. Koppers, 683 F. Supp. 458 (D. Del. 1988).

69. One point in time calculation showed that 56% of the Fortune 500 firms are incorporated in Delaware. *See* Dale A. Oesterle, *Delaware's Takeovers Statute: Of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 883-84 (1988). Forty-five percent of the firms listed with the New York Stock Exchange have Delaware as their corporate home. *See id.*

70. *See* Matheson & Olson, *supra* note 10, at 1533-37 (table identifying and discussing statutes in twenty-seven states).

71. *See* IND. CODE ANN. § 23-1-42 (Michie 1989). Indiana based its passive law on the more restrictive Ohio Control Share Acquisition Statute. *See* OHIO REV. CODE ANN. § 1701.831 (Banks-Baldwin 1989). Ohio's control share law differs from Indiana's law in one important way: the Ohio Act requires advance shareholder approval for the bidder to purchase shares that lift its ownership over the relevant thresholds (20%, 33%, and 50%). *See* Booth, *supra* note 10, at 1678 n.157. Also, the Ohio statute focuses on the stock itself (rather than the voting rights of the stock) in requiring the approval of disinterested shareholders. *See* OHIO REV. CODE ANN. § 1701.831(a), (E) (Banks-Baldwin 1989).

Indiana's law prohibits the acquiror of twenty percent or more of the target's shares from voting those shares unless a majority of noninterested shareholders grant the acquiror voting rights. *See* IND. CODE ANN. § 23-1-42-9 (Michie 1989). Indiana's law requires additional noninterested shareholder votes when the acquiror attains over one-third and one-half, respectively, of the total target's voting power. Upon filing an "acquiring person statement" with the target, the acquiror may request that a vote be held within fifty days. Upon failing to garner adequate shareholder votes, the target may redeem the acquiror's shares at fair market value; if acquirors prevail in the vote and subsequently acquire a majority of the shares, dissenting shareholders may elect to be cashed out at the highest price per share paid by the acquiror in her control share acquisition. *See id.*

72. *See, e.g., id.* § 23-1-42-5 (directors may unilaterally amend bylaws, thereupon controlling election to opt in/out).

73. *See, e.g., id.* § 23-1-42-7(b).

74. *See* IND. CODE ANN. § 23-1-42-2(d)(5) (Michie 1989) (acquisition of shares not deemed a control share acquisition if pursuant to a plan of merger or plan share exchange).

75. *See, e.g.*, MINN. STAT. § 302A.011 (38)(e) (1990) (exempting shares issued directly by the target corporation from the statute's coverage); MINN. STAT. ANN. § 302A.671 reporter's notes (West 1985).

76. MASS. GEN. LAWS. ch. 110 D, § 1(c)(2)(vi) (1990); VA. CODE ANN. § 13-1-728.1(6) (Michie 1988).

77. *Cf.* Allen Boyer, *When it Comes to Hostile Tender Offers, Just Say No: Commerce Clause and Corporation Law in CTS Corp. v. Dynamics Corp. of America*, 57 U. CIN. L. REV. 539 (1988). Boyer hails control share statutes as empowering shareholders to defeat or accept hostile offers, arguing that the ultimate effect of control share statutes is to give shareholders a voice, provide a mechanism for making this voice heard, and expand shareholders' role in corporate governance. *See id.*

control share acquisition statutes impose significant delays that may prove lethal to would-be suitors by increasing risks.[79] As a result, potential acquirers will be "extremely reluctant to acquire stock above any of the [statutory] thresholds" lest they become permanently disenfranchised.[80]

Legislatures often enact these and other types of antitakeover statutes hastily.[81] As suggested by the character and pervasiveness of the recent waves of antitakeover legislation,[82] legislators do not consider shareholders a favored constituency. Since shareholders are rarely concentrated locally, their interests are systematically under-represented.[83] Further, since the expected gains of local nonshareholder antitakeover forces generally exceed those of resident shareholders, nonshareholders have far more incentive to direct resources toward supporting antitakeover legislation.[84]

What motivates states to enact antitakeover legislation? Wary of raiders' tendencies to liquidate companies, close plants, and lay off workers, state legislators seek to protect home-based businesses.[85] More specifically, the impetus likely derives from two sources: the enacting state's desire to protect nonshareholder constituencies,[86] including managers who are unable

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78. These statutes were believed to be pro-shareholder to the extent that they allow shareholders to vote collectively, thereby mitigating coercion:

> If, for example, shareholders believe that a successful tender offer will be followed by a purchase of non-tendering shares at a depressed price, individual shareholders may tender their shares - even if they doubt the tender offer is in the corporation's best interest - to protect themselves from being forced to sell their shares at a depressed price .... [Thus], the shareholders as a group, acting in the corporation's best interest, could reject the offer, although individual shareholders might be inclined to accept it.

CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 83 (1987) (citation omitted).

79. "Delay has been characterized as 'the most potent weapon in a tender-offer fight.'" *Edgar*, 457 U.S. at 637 n.12 (citing Langervoort, *State Tender Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213, 238 (1977); Herbert M. Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433, 1437-42 (1977); Diane Wilner & Craig A. Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 FORDHAM L. REV. 1, 9-10 (1976)).

80. Thomas J. Andre, *A Preliminary Inquiry Into the Utility of Vote Buying in the Market for Corporate Control*, 63 S. CAL. L. REV. 533, 554 (1990). *Cf. CTS Corp.*, 481 U.S. at 95, 97 (Scalia, J., concurring) ("Whether the control shares statute 'protects shareholders of Indiana corporations' or protects incumbent management seems to me a highly debatable question .... But a law can be both economic folly and constitutional."). Indeed, Judge Posner considered these ex ante deterrences so powerful as to decry Indiana's statute as a "lethal dose" for hostile takeovers. *See* Dynamics Corp. v. CTS Corp., 794 F.2d 250, 262-63 (7th Cir. 1986), *rev'd. in part*, 481 U.S. 69 (1987).

81. *See* P. John Kozyris, *The Federal Role in Corporate Takeovers: a Framework for a Limited Second Congressional Intervention to Protect the Free Market*, 51 OHIO ST. L.J. 263, 263 (1990) (arguing that despite the "unprecedented" transfer of power from the shareholders to management, antitakeover legislation is "enacted without any substantive debate").

82. I have previously stated:

> [A]ntitakeover statutes have been enacted in three waves. First-generation statutes were enacted in response to the spell of takeover activity in the late 1960s, and often paralleled the requirements of the Williams Act. Second-generation statutes were passed in response to the Supreme Court's rejection of first-generation statutes announced in *Edgar v. MITE Corp.* Third-generation statutes are those that have been passed since *CTS Corp. v. Dynamics Corp. of America*, where the Supreme Court upheld Indiana's second- generation statute.

Matheson & Olson, *supra* note 10 at 1438-49 (footnotes omitted).

83. *See* Macey, *supra* note 57, at 488-89.

84. *See* Kenneth B. Davis, Jr., *Epilogue: The Role of the Hostile Takeover and the Role of the States*, 1988 WIS. L. REV. 491, 501. Professor Davis notes that "because the activities of the antitakeover interests tend to be more local, these interests are more likely to be well-organized at the state level. Labor unions and municipalities typically have statewide associations; institutional investors do not." *Id.*

85. *See* Alan E. Garfield, *Evaluating State Anti-takeover Legislation: A Broadminded New Approach to Corporation Law or "A Race to the Bottom?,"* 1990 COLUM. BUS. L. REV. 119, 126. *Cf.* Macey, *supra* note 57, at 476 ("Managerial self-interest remains the sole explanation for state anti-takeover legislation."). Garfield explains:

> [a] study of takeover statutes suggests that these statutes are not employee protective but management protective. By attempting to stop takeovers, the statutes serve only one purpose: to entrench current management in power. Nothing in the legislation ties the hands of current managers from engaging in the same dislocative conduct attributed to acquirors. The legislators are simply hoping that by protecting current managers, they will perpetuate current management policies, including the current deployment of corporate assets and jobs.

Garfield, *supra*, at 126.

or unwilling to persuade shareholders of the value of internal defensive measures,[87] and financial protectionism, where states desire to retain and maximize tax-generating resources.[88]

E. The Post-Insulation Dynamic

A series of four significant developments, each separately addressed in Parts III through VI, have either solidified corporate governance or are leading it out of the insulated managerialism era. The first is the protection given to boards of directors in control transactions and the empowerment of target company boards to deal with hostile tender offers. Empowerment may be meaningless without the tools appropriate to the successful exercise of the new-found power. Thus, the second development in the transition to the current stage of corporate governance is the creation and perfection of the ultimate antitakeover device, the poison pill. These two developments nearly served to give the board of directors of publicly traded companies a strangle hold on corporate governance.

However, as reviewed previously, at least in the corporate context, the enhancement of power usually begets a powerful response. That is, because of the extreme power that was reposed in boards of directors of publicly traded companies, a dialectical response was inevitable. In this context the response had two parts. First, the growth and aggressiveness of the institutional investor served notice on incumbent management that a battle was brewing. Second, fueled by institutional shareholder activism, a series of significant court decisions limited the effectiveness of the poison pill and thereby opened the way for a new era of corporate governance.

III. THE ROLE OF THE BOARD OF DIRECTORS IN CONTROL TRANSACTIONS

A. The Board's Role as Gatekeeper in Traditional Control Transactions

The most salient legal and economic characteristic of corporate governance is the concentration of decision-making authority in the board. The corporate board is the focal point of the corporation: management's role is derivative of the board's -- the shareholders' role is reactive.[89] By centraliz-

86. More than half of the states have adopted provisions that expressly allow directors to consider nonshareholder interests in responding to takeover bids. *See* Matheson & Olson, *supra* note 10, at 1500-01, 1538 (identifying twenty-nine states that have enacted some form of these statutes).

87. State antitakeover legislation is often adopted at the request of potential target corporations reluctant to propose the defenses embodied in the statutes. *See id.* at 1501.

88. Justice Powell has stated:

> The corporate headquarters of the great national and multinational corporations tend to be located in the large cities of a few States. When corporate headquarters are transferred out of a city and State into one of these metropolitan centers, the State and locality from which the transfer is made inevitably suffer significantly. Management personnel-many of whom have provided community leadership-may move to the new corporate headquarters. Contributions to cultural, charitable, and educational life-both in terms of leadership and financial support-also tend to diminish when there is a move of corporate headquarters.

Edgar, 457 U.S. at 646 (Powell, J., concurring in part).

ing corporate authority and information processing in the board while granting shareholders merely a passive, reactive role, corporate law seeks to minimize the costs of corporate decision making.

The corporate board has historically played, and still plays today, a primary role in most corporate events. Significant corporate transactions, such as a merger or sale of assets, typically require board recommendation before being considered by the shareholders, so that the board has the ability to short-circuit such fundamental changes. Or, from a different perspective, the shareholders are not burdened with such important decisions unless their duly-elected representatives have first carefully considered the matter and decided it is in the interests of the corporation and the shareholders. Similarly, changes in the corporate charter are typically initiated by the directors. Even when statutes require shareholder approval of certain board actions, such as amendments to the articles of incorporation or fundamental corporate reorganizations, usually the board must first approve the proposal.[90] Shareholders may only vote when directors present them with matters; they may not amend board proposals.

The board of directors, then, acts as a gatekeeper with respect to significant corporate transactions. No proposal gets through the gate to the shareholders unless the board approves it first. Indeed, the only significant source of shareholder power over the board is the right to replace board members. Even as to that prerogative, the current members of the board of directors, through a nominating committee or in response to management's proposals, almost always choose whether to continue in office or else decide who will replace them. At least historically, shareholders rarely have had the inclination or ability to exercise the option of changing the composition of the board of directors.

B. The Hostile Tender Offer as a Non-Corporate Transaction

However, one significant transaction, the tender offer,[91] need not

89. This board-centered corporate governance system accords well with Kenneth Arrow's "authority" model. *See* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION (1974). Arrow's model has twin foci: individuals' incentives and individuals' control over information. *See id.* at 69-70. Given identical information and incentives, each member of an organization will reach decisions by "consensus" because each member voting in her own self-interest will be motivated to select the outcome preferred by others. *See id.* at 69. Given divergent information and incentives, it is infeasible for all members to partake actively in the decision-making process; individual members lack both the information and incentives to arrive at optimal group decisions. *See id.* at 70. It is thus cheaper and more efficient to process information centrally. *See* ARROW, *supra,* at 70.

90. *See, e.g.,* MODEL BUS. CORP. ACT §§ 10.03(b) (1991) (prior board approval for amendments to the articles of incorporation); § 11.03(b) (same for mergers); § 12.02(b) (same for sale of substantially all corporate assets); § 14.02(b) (same for voluntary dissolution of corporation) (1997).

91. No consensus exists as to the definition of a tender offer. Courts consider eight factors proposed by the SEC in determining the existence of a tender offer:

> (1) Active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased; (6) offer open only for a limited period of time; (7) offeree subjected to pressure to sell his stock; [and (8)] public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of a large amount of target company's securities.

S.E.C. v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 950 (9th Cir. 1985) (quoting Wellman v. Dickinson, 475 F. Supp.783, 823-24 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir.1982), *cert. denied*, 460 U.S. 1069 (1983)).

involve the current management or the board of directors. In a tender offer, shareholders are given the opportunity to sell their shares directly to an offeror and thereby to relinquish their interest in the corporation. No board approval is necessary.[92] No shareholder vote is taken. The tender offer transaction is fundamentally financial, not corporate. Yet, if the offer is for a controlling number of shares, ultimate corporate control may shift.[93] Therefore, the ease by which a tender offer may shift the fundamental ownership of a company embodies the whole concept of the market for corporate control.[94]

Prior to the 1968 enactment of the Williams Act, tender offers typically followed this scenario:

> The prospective buyer offers a price far enough above the market to obtain the desired number of shares -- usually an amount sufficient to gain operating control of the corporation. As an aid in carrying out his objective the buyer generally hires a brokerage house to manage the offer, arranges a loan to pay for the purchase, buys a few newspaper ads and issues press releases to shareholders of the "target" company. If the number of shares tendered by shareholders falls below the number desired, then all the shares are returned and the acquisition plan is canceled. If the tender offer brings in more stock than the specified number . . . bid for, the offeror may at his option buy only the number of shares for which he has bid or may buy all of the stock tendered. [95]

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92. *See* Rule 14d-9, 17 C.F.R. § 240.14d-9 (1997). While Rule 14d-9 applies to recommendations made by the target company, Rule 14e-2 provides that the target company *must*, within ten business days from the dissemination of the tender offer, make a statement to its shareholders declaring that it (1) recommends acceptance of the offer; (2) recommends rejection of the offer; (3) is remaining neutral; or (4) is unable to take a position. *See id.* § 240.14e-2. Thus, Rule 14e-2 requires the target's board of directors to consider and respond to all tender offers, although its response may be noncommittal.

93. In enacting antitakeover legislation effective October 31, 1989, Ohio's General Assembly stressed its concern for the role of tender offers in transfers of control of Ohio corporations:

> (1) Existing Ohio corporate law was designed to deal with traditional methods of transfer of control of Ohio corporations. The tender offer has evolved as an alternative device to acquire control of a public corporation that has been in widespread use in the past several decades.... Numerous Ohio corporations have been the subject of tender offers and accumulations of significant blocks of securities.
>
> (2) The accumulation of a large block of a corporation's voting shares . . . has not been subject to the normal corporate approval mechanisms involved in other typical types [sic] of acquisition transactions such as mergers, consolidations, combinations, and majority share acquisitions. Such accumulations, however, can result in shifts of effective corporate control and hence, from a business and financial perspective, directly or indirectly, can result in significant changes in a variety of basic corporate circumstances identical or substantially similar to those arising as a result of the above-mentioned transactions. For instance, a change in corporate control accompanying a large accumulation of shares will very often result in a fundamental change in the ongoing business of the corporation and a concomitant fundamental change in the nature of the shareholders' investment in it. Thus the potential that such changes in corporate circumstances will occur gives rise to basic issues concerning the internal affairs of the corporation typical of those arising in mergers, consolidations, combinations, and majority share acquisitions. The form of the transaction in which such issues arise should not alter the basic corporate mechanisms by which such issues are presented and resolved.
>
> (3) Tender offers almost always involve a change in corporate control and, therefore, give rise to these same basic issues concerning internal corporate affairs....

OHIO REV. CODE ANN. § 1701.832 (Banks-BAldwin 1989) (legislative findings and statement of purposes; tender offers).

94. *See generally* John H. Matheson & Jon R. Norberg, *Hostile Share Acquisitions and Corporate Governance: a Framework for Evaluating Antitakeover Activities*, 47 U. PITT. L. REV. 407 (1987). "It is impossible to overstate how deeply the market for corporate control has changed the attitudes and practices of U.S. managers .... [That market] represents the most effective check on management autonomy ever devised." Alfred Rappaport, *The Staying Power of the Public Corporation*, HARV. BUS. REV., Jan.-Feb. 1990, at 96, 100.

95. 113 CONG. REC. 855 (daily ed. 1967) (statement of Sen. Williams).

Historically, the unregulated cash tender offer possessed at least three advantages over other modes of corporate control acquisition. While proxy contests and stock-for-stock exchanges required disclosure of certain pertinent information to the SEC and target company shareholders,[96] cash tender offers could be made in secrecy.[97] Cash tender offers also took less time to complete. In addition, because of the lack of regulations, cash tender offers were administratively less expensive. Finally, the advantages that tender offers provided to takeover strategists were offset, it was argued, by disadvantages to the shareholders of target companies. The lack of disclosure requirements forced shareholders to make hasty decisions, often with a dearth of information, about whether to tender their shares or wait out the offer.[98]

Congress passed the Williams Act in response to its recognition that, as a control mechanism, the end results of cash tender offers often paralleled the results of regulated proxy contests, and to counteract the perceived inequities of unregulated cash tender offers.[99] The Act was designed to protect investors from sudden shifts in control brought on by an acquirer's swift accumulation of shares. It requires, in the context of tender offers, full disclosure and equal treatment towards target company shareholders similar to that required in proxy contests and stock for stock exchanges.[100] The Act ensures that investors are furnished with more time to make informed and rational decisions without undue pressure. The drafters of the Act, however, sought to avoid tipping the balance of power in favor of either the offeror or target company management.[101]

The passage of the Williams Act did little to prevent hostile takeovers. The Act interposed a period of delay and some expense, but did not otherwise limit the offeror's ability to proceed. Management continued to be bypassed in the process of transfer of shares in the market for corporate control. Despite the Williams Act, by the middle of the 1970s the takeover boom had begun an extended expansion that would carry through the mega-mergers of the late 1980s.[102]

Corporate management, however, did not remain passive. Various defensive mechanisms were employed or adopted. From crude beginnings, such as asset sales or defensive acquisitions, to charter amendments to the mid-1980s development of the poison pill, management resisted unfriendly

96. Section 14(a) of the Securities Exchange Act of 1934 governs proxy solicitation and requires the solicitor to disclose information to the target company shareholders and the Commission. *See* 15 U.S.C. § 78n(a) (1998). A stock for stock exchange is a "sale" subject to the registration and prospectus delivery requirements of the Securities Act of 1933. *See* 15 U.S.C §§ 77(b)(3) (1994).

97. Prior to the enactment of the Williams Act, the only regulation addressing securities purchases was the Holding Company and Investment Company Acts. *See* Holding Co. Act §§ 9.10; Inv. Co. Act §23(c).

98. *See generally* D. Roger Glenn, *Rethinking the Regulation of Open Market and Privately Negotiated Stock Transactions Under the Securities Exchange Act of 1934*, 8 J. CORP. L. 41 (1982).

99. *See* The Williams Act, PUB. L. NO. 90-439, 82 Stat. 454 (1968) (codified as amended in scattered sections of 15 U.S.C.).

100. *See* H.R. REP. NO. 90-1711, at 2811 (1968).

101. *See id.*

102. *See generally* J. MADRICK, TAKING AMERICA: HOW WE GOT FROM THE FIRST HOSTILE TAKEOVER TO MEGA-MERGERS, CORPORATE RAIDING AND SCANDAL (1987).

overtures. The short term goal of such defensive tactics was often to defeat a particular bid. Many early bids were seen not only as threatening to management, but also as harmful to shareholders. Bids were purportedly made at inadequate prices, were designed to result in a bust-up of the operating entity, or sought to pay a premium for minimal control shares and then squeeze out the remaining shareholders at a much lower price. The fundamental objective of antitakeover measures has always been to reassert the board's position as primary decision maker in relation to fundamental corporate transactions.[103] The transfer of shares in a tender offer always threatens the continuity of management's control. Management seeks to manage the process of these share transfers so as to determine, if not defeat, the transfer of corporate control.

While boards responded to hostile overtures with whatever defensive tactics were available, two questions lingered. First, did the board of a target company have the right to insert itself into what was otherwise a non-corporate transaction, namely, a hostile tender offer? That is, does the board perform the same gatekeeper function with respect to tender offers that it performs in connection with mergers, sales of assets, article amendments, and other fundamental corporate transactions? Second, even if the board had a role in these transactions, how could a board justify attempting to defeat an offer that would give shareholders a significant premium on their investment, if indeed the fundamental goal of the board is to run the company so as to make the most money possible for the shareholders?

C. Empowering the Board of Directors to Deal with Hostile Tender Offers

1. The Power and Obligation to Respond

The board of directors is accepted as the policy-making organ of the corporation.[104] The directors' presumed expertise and familiarity with the corporation's business affairs best enables them to make business decisions that maximize the shareholders' welfare.[105] From this starting point, a judicially created rule has developed that the majority of directors should have the right to determine the business policy of the corporation, free from judicial second-guessing, so long as they act in good faith and without conflict

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103. *See* Gregg H. Kanter, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the "Unocal" Test*, 138 U. PENN. L. R. 225, 226 (1989) ("The ability to enact an antitakeover device, or redeem an existing one, has granted to the target board a virtual veto power over tender offerors."). Kanter further notes that antitakeover devices enable targets "in effect to defeat any unsolicited tender offer not approved by its board." *Id.* at 230. *See also Conflicting Claims Remain an Issue in Delaware Cases*, NAT'L L. J., Feb. 20, 1989, at S14.

104. *See, e.g.*, MODEL BUS. CORP. ACT ANN. § 8.01 (3d ed. 1985) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation.").

105. *See* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917) ("Courts interfere seldom to control such discretion intra vires the corporation"); Miller v. American Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974) ("[T]he sound business judgment rule . . . expresses the unanimous decision of American courts to eschew intervention in corporate decision-making"); Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981) ("[T]he 'business judgment' rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power"); Selheimer v. Manganese Corp., 224 A.2d 634, 644 (Penn. 1966) ("[C]ourts are reluctant to interfere in the internal management of a corporation, since that is a matter for the discretion and judgment of the directors and shareholders").

of interest or breach of trust.[106]

It is not surprising that, early on, courts charged with reviewing antitakeover activities began their inquiry from this same perspective.[107] *Panter v. Marshall Field & Co.*[108] exemplifies the solidification of the business judgment rule in cases involving management responses to perceived takeover threats. In *Panter*, Marshall Field was approached, as it had been in the past, concerning its interest in a merger. Marshall Field was publicly traded and its management previously had pursued a course that avoided combination with other entities. When Carter Hawley Hale (CHH) made a tender offer, Marshall Field once again was determined to remain independent. To carry out its objective, Field first made acquisitions that were designed to cause antitrust problems for CHH and then sued to enjoin the tender offer because it would result in violations of the antitrust laws.

The court's focus in *Panter* was on the initial decision of the board to fight the offer. The means used, the purchase of additional retail outlets, and the initiation of legal proceedings were actions that generally are recognized as being safely within the discretion of a company's board of directors.[109] The plaintiff, however, attacked the use of these otherwise accepted powers in the context of a control struggle. The Seventh Circuit predictably held that the "desire to build value within the company, and the belief that such value might be diminished by a given offer is a rational business purpose."[110]

A significant shift in antitakeover activities, however, occurred after *Panter*. The means adopted by a board of directors to retain its control of a target corporation became increasingly potent and discriminatory in effect, causing disparities in treatment of otherwise similarly situated shareholders. In addition, the means employed by target management to prevent or resist takeover consideration focused more on limiting shareholder discretion, whereby a board attempts to create a regime of corporate barriers and board prerogatives so that incumbent management has plenary power to approve all changes in corporate ownership and control.

The fundamental issue of the board's role in hostile transactions still

106. *See, e.g.*, Regenstein v. J. Regenstein Co., 97 S.E.2d 693, 695 (Ga. 1957) ("No principle of law is more firmly fixed in our jurisprudence than the one which declares that the courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs."); Neidert v. Neidert, 637 S.W.2d 296, 301 (Mo. Ct. App. 1982) ("[W]here the matter under consideration is one that calls for the business judgment of a board of directors or of the majority shareholders and if this judgment is exercised fairly and honestly courts will not interfere.").

107. An early federal appellate court decision highlights the strength of this premise. *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981), involved a battle for control of a closely held corporation where a challenge was made to the proposed sale of new shares to someone loyal to the majority owners. The analysis of the Third Circuit in upholding the sale was predictable and correct. With the issue framed as one of motivation, the court relied on the well-worn and clearly applicable proposition that "directors of a corporation are presumed to exercise their business judgment in the best interest of the corporation." *Trueblood*, 629 F.2d at 292. Further, the court rejected as unworkable and ill-advised plaintiffs' claim that any motivation to retain control served to rebut this presumption. "Yet by the very nature of corporate life a director has a certain amount of self-interest in everything he does. The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so that they will not oust him." *Id.* In short, unless a challenger demonstrates "that the sole or primary motive of the defendant was to retain control," the presumption of proper motivation afforded by the business judgment rule applies. *Id.* at 292-93. *See also* Franz fg. Co. v. EAC Indus. Inc., [current] F. Sec. L. Rep. (CCH) ¶ 92,405 (Del. Dec. 5, 1985) (purchase of authorized but unissued shares by target board-created employee stock ownership plan after insurgents had gained majority control held ineffective when opposed by new majority).

108. 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981).

109. *See id.* at 297-98.

110. *Id.* at 296.

remained. Does the board act as a gatekeeper with respect to hostile tender offers, or is this a form of a non-corporate transaction with respect to which the board should remain passive and watch from the sidelines while the market determines the fate of the enterprise? If any doubt existed over whether the target company board had a proper role in attempting to defeat a presumptively non-corporate transaction, a hostile tender offer, that issue was put to rest by the Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.*[111] In *Unocal* the court addressed the defensive maneuvers taken by Unocal in response to a tender offer by Mesa. Mesa sought fifty-one percent of Unocal's shares and was willing to pay fifty-four dollars per share. Unocal responded by making its own tender at seventy-two dollars per share. By its terms, however, this self-tender excluded Mesa and all of its affiliates from participation.

Initially, the Delaware Chancery Court granted a temporary restraining order against Unocal's self-tender offer.[112] As Mesa presented the case, the propriety of Unocal's decision to fight Mesa was properly separated from the validity of the means employed to wage the battle. "Mesa does not dispute the bona fides of Unocal's decision to oppose its tender offer. However, Mesa contends that the business judgment rule has no application in deciding the validity of the defensive technique chosen by Unocal."[113] Rather, Mesa contended, and the chancery court found, that discrimination among shareholders must be justified by a showing that the exclusion was fair to all concerned. As determined by the chancery court, such discrimination could not be upheld solely because it involved a battle for control. "In other words, legally or equitably impermissible conduct cannot be justified by the fact that it was motivated by a proper purpose."[114] The end sought by Unocal did not necessarily justify the means it used to achieve that end.

The Delaware Supreme Court approached the case differently, however. Initially, the court highlighted the fundamental issue of whether a target company board has the authority to inject itself between the shareholders and a party willing to purchase shares from those shareholders in a tender offer:

> We begin with the basic issue of the power of a board of directors of a Delaware corporation to adopt a defensive measure of this type. Absent such authority, all other questions are moot. Neither issues of fairness nor business judgment are pertinent without the underpinning of a board's legal power to act.[115]

At this point the court spoke about the general, broad scope of board

111. 493 A.2d 946 (Del. 1985). *Unocal* is most often cited for its statement of the two-prong test for determining the validity of antitakeover measures. As discussed in the text, two other issues addressed by Unocal were even more significant to the fundamental corporate governance landscape.

112. *See* Mesa Petroleum Co. v. Unocal Corp., No. 7997, slip op. at 6 (Del. Ch. Apr. 29, 1985), *rev'd*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

113. *Unocal*, 493 A.2d at 953.

114. *Mesa Petroleum*, No. 7997, slip op. at 7.

115. *Unocal*, 493 A.2d at 953.

authority and the specific power of the board to authorize a repurchase of company shares, even in a discriminatory manner. However, finally addressing the issue directly and citing the explicit statutory role of the board as gatekeeper in other fundamental corporate transactions, the Delaware Supreme Court predictably found authority for the board to act:

> [T]he board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source . . . . Thus, we are satisfied that in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality.
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> . . .
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> When a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders. In that respect a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment.[116]

With this single passage, the general issue of target board authority to act to defeat a hostile tender offer was resolved. Indeed, in the manner phrased by the Delaware Supreme Court, target directors not only had the "authority" to review the tender offer and act appropriately, but moreover it was their "duty" to do so. If this duty was not met, the directors presumptively could be held liable. Still, with most tenders coming to the shareholders at a substantial premium over current market price, and with the target company board charged with determining if such a premium offer is in the best interests of the company and its shareholders, how could the board justify preventing the shareholders from accepting the tender offer?

2. *Consideration of Stakeholder Interests*

If the board is charged with consideration of "the best interests of the corporation,"[117] a phrase common to corporate statutes and decisions defin-

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116. *Id.* at 954.

117. For example, the Delaware Chancery court in *TW Services, Inc. v. SWT Acquisition*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,147 (Del. Ch. Mar. 2, 1989), equated "shareholder longterm interests" with "multi-constituency interests:"

> The knowledgeable reader will recognize that this particular phrase masks the most fundamental issue: to what interest does the board look in resolving conflicts between interests in the corporation that may be characterized as "shareholder longterm interests" or "corporate entity interests" or "multi-constituency interests" on the one hand, and interests that may be characterized as "shareholder short term interests" or "current share value interests" on the other?

Id.

ing a director's duty of care, what factors are properly a part of that calculus? Some commentators argued that a corporation has an "independent interest in its own longterm business success."[118] In *Unocal Corp. v. Mesa Petroleum Co.*,[119] however, the Delaware Supreme Court first directly endorsed directors' consideration of nonshareholder constituencies:

If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, *the impact on "constitutencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)*, the risk of nonconsummation, and the quality of securities being offered in the exchange.[120]

Since the 1985 decision, at least twenty-nine states have enacted legislation allowing directors to consider nonshareholder constituencies.[121] Typically, these multi-constituency statutes explicitly allow directors to consider nonshareholder interests. One such statute, passed in Minnesota, provides in pertinent part:

> [A] director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.[122]

To their credit, the multiple constituency statutes are consistent with a theory of corporate law positing that a corporation is essentially a "nexus of contracts" in which numerous constituencies contract with the corporation for protection and gain. Corporate control is shared among numerous corporate constituencies; shareholders thus comprise only one component of this nexus. This theory is based on the assumption that the firm is but a legal fic-

118. Lipton & Rosenblum, *supra* note 11, at 202. Lipton and Rosenblum explain:

> The greater the amount of goods or services the enterprise can sell, and the greater the difference between what the consumer is willing to pay and what the goods or services cost to produce, the greater the profit that inures to the enterprise. Viewed in this light, the corporate enterprise has an independent interest of its own in the successful operation of its business, with success measured in terms of present and expected profit.

Id. at 203.

119. 493 A.2d 946 (Del. 1985).

120. *Id.* at 955 (emphasis in original). *Unocal* illustrates the degree to which the business judgment rule may be wielded to expand the already broad scope of a director's discretion to bypass shareholder input. Thus, the business judgment rule in the takeover context may allow stakeholder interests to be furthered at the expense of shareholders. *See* Matheson & Olson, *supra* note 10, at 1455-66 (analyzing protectionist case law).

121. *See* Matheson & Olson, *supra* note 10, at 1540-45.

122. MINN. STAT. § 302A.251 (5) (1990). The effect of such legislation is to help shield directors from liability by expanding the criteria that directors may consider in reaching decisions on behalf of the corporation.

tion in which parties freely consummate contracts articulating the nature of their relationships, and management takes on the character of a central contracting agent.[123]

This shareholder contract derives from three sources: legislation as interpreted by the courts,[124] articles of incorporation, and fiduciary duties.[125] Unlike statutory standard terms, fiduciary duties embody ex post evaluation of decisions rather than defining the scope of directors' powers beforehand. As such, fiduciary duties fill gaps left by standard contract terms. State statutes provide that most contractual terms may be amended -- typically by majority shareholder vote.[126] Shareholders initially investing in a corporation implicitly agree to abide by majority-approved provisions. A threshold inquiry into the province of corporate law thus involves examining the extent to which governance terms should be determined contractually.

Shareholder primacy advocates argue that board consideration of nonshareholder interests breeds inefficiency by distorting the free-flowing market allocation of resources and by promoting arbitrary management decision-making.[127] However, the shareholder primacy model is not unassailable. Shareholders' ownership of stock may not be the equivalent to ownership of private property: unlike typical private property,[128] the corporation is a central productive element of our economy upon which our nation depends for its vitality.[129] Further, shareholder stock ownership frequently appears to be merely a residual financial investment -- quite unlike the "use and enjoyment" interest of the owner of personal property.[130]

Nevertheless, there are problems in the application of the multiple constituency concept. How are directors to consider these constituencies in conjunction with the fiduciary duty they owe shareholders?[131] Even during a takeover, if directors focus primarily on shareholders' best interests, both shareholders and stakeholders simultaneously benefit,[132] but numerous prob-

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123. *See* Jenson & Meckling, *supra* note 19, at 310.

124. In this sense, corporate statutes provide standard form contractual terms. *See, e.g.*, DEL. CODE ANN. tit. 8, § 394 (1991) ("This chapter and all amendments thereof shall be part of the charter or certificate of incorporation of every corporation.").

125. These duties may derive from either statute or case law. *See, e.g., id.* § 144 (implied presumption that a transaction is voidable where director is financially interested).

126. *See, e.g., id.* § 242(b)(1).

127. *See* Matheson & Olson, *supra* note 10, at 1482-91 (citing authorities and noting that consideration of nonshareholder interests aggravates conflicts of interest that inhere in control change contexts).

128. Lipton and Rosenblum have explained: "To the extent there is an intrinsic nature to the corporation, it is more akin to that of a citizen, with responsibilities as well as rights, than to that of a piece of private property." Lipton & Rosenblum, *supra* note 11, at 193.

129. *See id.* at 192.

130. *See id.* at 193-94 ("Stockholder's intrinsic ownership interest is a financial interest").

131. Until a takeover becomes imminent, directors may consider nonshareholder constituencies in deploying takeover defenses as long as they also benefit the shareholders. *See* Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (citation omitted) (stating that a board may consider nonshareholder constituencies "provided there are rationally related benefits accruing to stockholders . . . . However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress [such that the sole duty is] . . . to sell it to the highest bidder."). *See also* TW Servs., Inc. v. SWT Acquisition [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,147 (Del. Ch. Mar. 2, 1989) (noting that "[w]hen a corporation is in a 'Revlon mode,' legitimate concerns relating to the claims of other constituencies are absent and, indeed, concerns about the corporation as a distinct entity become attenuated."); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1282 n.29 (Del. 1989) (holding that a board may consider "the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests"); ABA Comm. on Corporate Laws, *Other Constituencies Statutes: Potential For Confusion*, 45 BUS. LAW. 2253 (1990) [hereinafter *Other Constituencies*].

lems emerge from a stakeholder model in which directors are allowed to consider stakeholder interests.[133]

First, since a corporation would harm itself by discarding valuable employees or suppliers,[134] the extra protection assists primarily suboptimal employees, suppliers, or creditors who would be affected by a "shareholder primacy" approach.[135] Since most nonshareholders are already protected by other laws,[136] stakeholder problems resulting from board action under a shareholder primacy perspective would be short term.[137]

Second, requiring accountability to holders of conflicting interests may ultimately harm both groups.[138] Directors who are free to consider nonshareholder interests would be less accountable to shareholders.[139] In addition, the "standard" by which courts articulate a director's duty to stakeholders defies precise definition.[140] The undefined parameters of this "standard" fuels directors' uncertainty regarding their allegiance to shareholders.[141]

3. Legislation Limiting Director Accountability

Unocal was actually the second watershed case from the Delaware

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132. *See* Easterbrook & Fischel, *The Proper Role; supra* note 12, at 1190-92. *Cf. Other Constituencies, supra* note 131, at 2269 (suggesting that a better interpretation of directors' duties statutes and related case law allows directors to take into account nonshareholder constituencies, but only "to the extent that the directors are acting in the best interests, long as well as short term, of the shareholders and the corporation").

133. For an analysis of directors' duty legislation, *see Other Constituencies, supra* note 131, at 2263-70.

134. *See* Easterbrook & Fischel, *The Proper Role, supra* note 12, at 1170-71.

135. *See id.*

136. *See Other Constituencies, supra* note 131, at 2268 (discussing how creditors, management, employees, and unions have other means of protection). *See also* Gregory R. Andre, *Tender Offers for Corporate Control: A Critical Analysis and Proposals for Reform*, 12 DEL. J. CORP. L. 865, 884 (1987) (noting that employees are protected by labor laws and stating that legislation "governing hostile takeovers should not attempt to minimize noninvestors' risks at the expense of our free market system").

137. In addition, employees or suppliers are usually only temporarily displaced -- that is, many constituencies have the capacity to find a replacement for their reliance on the acquired company.

138. *See* Easterbrook & Fischel, *The Proper Role, supra* note 12, at 1192. *See also* Andre, *supra* note 136, at 884-85 ("[M]anagement should not be asked or allowed to attempt to carry out the impossible task of acting as fiduciaries for groups with competing interests."); Ronald J. Gilson, *Just Say No to Whom?*, 25 WAKE FOREST L. REV. 121, 126 (1990).

139. In the narrowest sense, when directors are free to consider nonshareholder interests in takeover scenarios rather than focus on the sole objective of maximizing shareholder wealth, their accountability is diminished inasmuch as shareholders can less easily monitor a manager's performance.

Former SEC chairman Davis S. Ruder has explained that director accountability to a clearly defined group (i.e., shareholders) is a cornerstone of the corporate system: "If management duties to others are declared, the process of corporate accountability will be thrown into disarray." David S. Ruder, Speech to the American Bar Association committee responsible for the Revised Model Business Corporation Act (Aug. 6, 1990), *in ABA Model Act Panel Rejects Other- Constituencies Measures*, 22 SEC. REG. & L. REP. (BNA) No. 33, ¶ 1217 (Aug. 17, 1990).

140. Directors' duty legislation affords no guidance on how directors should consider nonshareholder constituencies. *See* Dennis J. Block & Yvette Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44, 69 (1983); Matheson & Olson, *supra* note 10, at 1538-45.

141.

> The issue thus becomes whether director duties statutes constitute an efficient and desirable way to provide protections for nonshareholder groups. The Committee has concluded that permitting -- much less requiring -- directors to consider these interests without relating such consideration in an appropriate fashion to shareholder welfare (as the Delaware courts have done) would conflict with directors' responsibility to shareholders and could undermine the effectiveness of the system that has made the corporation an efficient device for the creation of jobs and wealth.
>
> The Committee believes that the better interpretation of these statutes, and one that avoids such consequences, is that they confirm what the common law has been: directors may take into account the interests of other constituencies but only as and to the extent that the directors are acting in the best interests, long as well as short term, of the shareholders and the corporation ....
>
> The confusion of directors in trying to comply with such statutes, if interpreted to require directors to balance the interests of various constituencies without according primacy to shareholder interests, would be profoundly troubling .... When directors must not only decide what their duty of loyalty mandates, but also to whom their duty of loyalty runs (and in what proportions), poorer decisions can be expected.

Other Constituencies, supra note 131, at 2268-69.

Supreme Court in 1985. The first was *Smith v. Van Gorkom*,[142] in which the board of directors of a publicly traded corporation was found liable for breach of the duty of care in approving an acquisition transaction at a substantial premium above market price. In direct response to the holding in *Van Gorkom*, the Delaware legislature enacted section 102(b)(7) of the Delaware Corporate Code, which allows firms to opt out of the duty of care standard.[143] That section permits companies to amend their articles of incorporation to eliminate monetary liability of directors to the corporation and its shareholders,[144] essentially allowing each firm to adopt its own standard of fiduciary responsibility. Many other states have enacted similar statutes and many corporations have included them in, or adopted them as part of, their articles of incorporation.

In addition, all jurisdictions recognize the power of a corporation, within specified limits, to indemnify its directors and officers against expenses and liabilities incurred while carrying out their duties.[145] These expenses include litigation costs directly resulting from service to the corporation.[146] Most of these statutes provide for mandatory and permissive indemnification, depending on the circumstances. Delaware law, for example, mandates corporate indemnification for expenses incurred in any proceeding to the extent the director has been successful.[147] If the director loses, Delaware law permits indemnification.[148] Corporations may provide for broader indemnification in their bylaws or articles.

The statutes in every state except Vermont expressly permit corporations to purchase insurance protecting officers and directors against liability. For example, the Delaware statute grants corporations the right to purchase insurance on behalf of any director, officer, employee, or agent of the corporation for liability arising out of such capacity.[149] Thus, the insurance coverage may be broader than indemnity coverage.[150]

IV. THE ULTIMATE DEFENSIVE MECHANISM: THE POISON PILL

A. Design and Effect of the Poison Pill

A third watershed Delaware case, *Moran v. Household International, Inc.*,[151] was decided in 1985. *Moran* involved a defensive device known as a

142. 488 A.2d 858 (Del. 1985). In *Van Gorkom*, the Delaware Supreme Court held that the business judgment rule did not protect the directors of a company who breached their duty of care in approving a proposed cash merger. *See id.* at 893.

143. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1991); Note, Craig W. Hammond, *Limiting Directors' Duty of Care Liability: An Analysis of Delaware's Charter Amendment Approach*, 20 U. MICH. J.L. REF. 543, 548 (1987).

144. *See* DEL. CODE ANN. tit. 8, § 102 (b)(7) (1991).

145. *See* ALI PROJECT, *supra* note 14, pt. VII, § 7.20 cmt. a, at 905.

146. *See, e.g.*, ALA. CODE § 10-2A-21 (1987 & Supp. 1989).

147. *See* DEL. CODE ANN. tit. 8, § 145(c) (1991). *See also* Merrett-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138, 141 (Del. Super. Ct. 1974).

148. *See* DEL. CODE ANN. tit. 8, § 145 (a) (1991).

149. *See id.* § 145(g).

150. *See id.* § 145(b) (insurance could encompass liability associated with shareholder derivative action even though otherwise limited under Delaware law).

151. 500 A.2d 1346 (Del. 1985).

Preferred Share Purchase Rights Plan,[152] or "poison pill." Under the terms of the Plan, Household shareholders were entitled to one "Right" for every common share held, with each Right giving the holder the option to purchase a portion of a share of a new preferred class of stock for a set price. The Rights were not exercisable, however, until either (1) the announcement of a tender offer for thirty percent or more of Household's shares; or (2) the acquisition of twenty percent or more of Household's shares by any single entity or group, that is, a hostile share acquisition.[153] The Rights were generally redeemable by Household's board of directors for fifty cents per right, but they became nonredeemable if anyone actually acquired twenty percent or more of Household's shares.[154]

All of this was basically window dressing, however. The Rights were not intended to be exercised and the purchase price for the preferred stock was out of the money. Most importantly, though, the rights contained antidilution provisions which provided that, if a merger or consolidation occurred between the company and another party in circumstances not approved by the incumbent board of directors, each holder could exercise the Right and purchase two hundred dollars of the common stock of the tender offer or other acquiring entity for one hundred dollars.[155] This antidilution provision was made effective by providing that the company could not enter into any merger agreement unless this bargain-purchase benefit was provided to shareholders. The resulting dilution of the financial interests of the hostile party would be so great that to cross the pre-determined share acquisition threshold and ultimately engage in a merger or other acquisition transaction without target board approval would be financial suicide. Hence, the moniker "poison pill."

Moran is unusual in several respects. First, the Rights Plan was prophylactic in nature, since it was not adopted during a battle for corporate control. Second, in an unprecedented move, the SEC filed an amicus curiae brief supporting the challenge to the Plan.[156] Finally, unlike the selective self-tender offer at issue in *Unocal*, in *Moran* the Delaware Supreme Court was presented with a defensive mechanism which, although adopted by the board of directors, had fundamental effects on the structure of the corporation and the separation of functions between the shareholders and the board.

Rejecting arguments to the contrary, the Delaware Supreme Court upheld the Rights Plan in *Moran*. Preliminarily, the court turned aside the claim that the Household board of directors did not have statutory authority to adopt the Plan.[157] The court then focused on the substantive effect of the Plan. As phrased by the SEC, "the Rights Plan will deter not only two-tier offers, but virtually all hostile tender offers."[158] In sum, it was argued that

152. *See id.* at 1348.
153. *See id.*
154. *See id.* at 1349.
155. *See Moran*, 500 A.2d at 1346.
156. *See id.* at 1348.

this poison pill made any unapproved merger or consolidation prohibitively expensive, thus changing Household's fundamental structure by deterring any substantial hostile share acquisition not approved by the company's board. The Delaware Supreme Court refuted the claim that no hostile tender offers would be attempted after the adoption of this Plan by pointing to Sir James Goldsmith's takeover of Crown Zellerbach Corporation, since Crown Zellerbach had a poison pill provision similar to the one at issue in *Moran.*[159]

More importantly, however, the court did not view the Rights Plan as preclusive of all takeovers even if nearly all share acquisitions above the pre-determined threshold would be deterred:

> The evidence at trial also evidenced many methods around the Plan ranging from tendering with a condition that the Board redeem the Rights, tendering with a high minimum condition of shares and Rights, tendering and soliciting consents to remove the Board and redeem the Rights, to acquiring 50% of the shares and causing [the company] to self-tender for the Rights. *One could also form a group of up to 19.9% and solicit proxies for consents to remove the Board and redeem the Rights.* [160]

As the Delaware Supreme Court well knew, however, each of these hypothetical "methods around" the Rights Plan were impractical for a variety of reasons, including the fact that no hostile party would make a significant investment in a target company without being guaranteed that the Rights would be extinguished. That is, tender offers with high minimum or with a condition of redemption would typically be useless gestures either because enough shares would be in friendly or sympathetic hands to defeat the high minimum or the Board would, as discussed below, follow the "just say no" defense and refuse to redeem the Rights.[161] The last "method around" the Rights Plan identified in *Moran*, the proxy contest, while still mostly impracticable in the mid-1980s, would, as discussed in Part V below, become a realistic option in the mid-1990s.

After *Moran*, rights plans were refined. *Moran* involved a flip-over provision, which would cause suicidal dilution to the hostile party upon engaging in a second-stage transaction, such as a merger or sale of assets. Today, almost all rights plans contain a flip-in provision, which dilutes the hostile acquiring party's interest immediately upon crossing the predeter-

157. Statutory authority for creation of the Plan came from sections 151(g) and 157 of the Delaware General Corporation Law. *See* DEL. CODE ANN. tit. 8, §§ 151(g), 157 (1983). The court had some trouble with the fact that the "Rights" were not operative to purchase Household's shares, but rather to purchase the shares of some as yet unidentified hostile suitor. The court analogized the "Rights" to "anti-destruction" or "anti-dilution" provisions that sometimes accompany corporate securities, finding the Household "Rights" to be sufficiently like these latter devices to be valid against a hostile suitor. *See Moran*, 500 A.2d at 1352.

158. *Id.* at 1354.

159. *See id.*

160. *Id.* (emphasis added).

161. *See Moran*, 500 A.2d at 1356-57.

mined share acquisition threshold, often fifteen percent. Moreover, redemption of the rights by the incumbent board provides the only realistic means to avoid the disastrous effects of the flip-in provision, which squarely places the board in the position of "gatekeeper" to hostile overtures. Not surprisingly, then, no hostile party has ever triggered a flip-in provision.

B. The "Just Say No" Defense and the Issue of Poison Pill Redemption

Since *Moran*[162] corporate adoptions of shareholder rights plans, or poison pills, have become routine matters that easily survive judicial scrutiny. *Moran* opened the door for corporate boards to inject themselves preemptively into the tender offer or control transaction process, thereby presumptively requiring incumbent management and director approval as a necessary step in the change of corporate control. Directors have implemented numerous defensive measures to resist hostile takeover bids,[163] including second-generation poison pills,[164] stock repurchases, golden parachutes,[165] lock-up agreements,[166] and no-shop provisions.[167]

Once a poison pill or other mechanism is in place that allows the corporate board to preempt a direct takeover bid, the exercise by a corporate board of this power crystallizes the fiduciary issue. The initial analysis of this issue derives from the fourth watershed case coming from the Delaware Supreme Court in 1985: *Revlon, Inc. v. MacAndrew & Forbes Holdings, Inc.*[168] *Revlon* involved defensive actions of a corporation during a bidding war between hostile and friendly parties. Under these circumstances, that is, where a change of control or a break up of the company is inevitable, the directors' duty is to maximize the economic value to the shareholders result-

162. In *Moran* the Delaware Supreme Court upheld a board's adoption of a shareholder rights plan. The court stated: "[P]re-planning for the contingency of a hostile takeover might reduce the risk that, under the pressure of a takeover bid, management will fail to exercise reasonable judgment. Therefore, in reviewing a pre-planned defensive mechanism, it seems even more appropriate to apply the business judgment rule." *Id.* at 1350. The *Moran* Chancery Court allowed directors to justify their actions based on the interests of one or more corporate constituencies. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1079 (Del. Ch. 1985). The Chancery Court stated that poison pills, if implemented "to protect all corporate constituencies and not simply to retain control, have been consistently approved under the business judgment rule." *Id.*

163. Consistent with the wide latitude the business judgment rule grants directors, courts have upheld a variety of defensive measures. *See, e.g.*, Gearhart Indus. v. Smith Int'l, Inc., 741 F.2d 707, 724 (5th Cir. 1984) (deploying "springing warrants"); Enterra Corp. v. SGS Assocs., 600 F. Supp. 678, 688 (E.D. Pa. 1985) (entering into "standstill agreements" whereupon potential offerors agree not to proceed with offer).

164. A second-generation rights plan contains a flip-in provision whereby any acquisition above a pre-determined threshold will trigger a bargain purchase of target company shares by every holder except the party crossing the threshold. *See* Ronald A. Brown, Jr., Note, *An Examination of a Board of Directors' Duty to Redeem the Rights Issued Pursuant to a Stockholder Rights Plan*, 14 DEL. J. CORP. L. 537 (1989); Patrick J. Thompson, Note, *Shareholder Rights Plans: Shields or Gavels?*, 42 VAND. L. REV. 173 (1989).

165. These executive termination agreements are "contracts between corporations and their executive personnel guaranteeing generous severance benefits in the event of a corporate takeover." Drew H. Campbell, Note, *Golden Parachutes: Common Sense from the Common Law*, 51 OHIO ST. L.J. 279, 280 (1990).

166. Lock-up options and bust-up fees involve the right to purchase target stock or assets on favorable terms. Without these favorable terms, white knights would not likely assist a target. A target corporation board may grant a white knight the option to purchase key corporate assets, a strategy known as the "crown jewel" defense. *See* Matheson & Olson, *supra* note 10, at 1457-58 n.221.

167. White knights often require no-shop covenants by the target preventing the target from soliciting or encouraging anyone to make a competing bid or otherwise assist would-be acquirors. In *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261 (Del. 1989), the Delaware Supreme Court invalidated a no-shop provision, asserting that "[a]bsent a material advantage to the stockholders from the terms or structure of a bid that is contingent on a no-shop clause, a successful bidder imposing such a condition must be prepared to survive the careful scrutiny which that concession demands." *Id.* at 1286. *See also* Barkan v. Amstad Indus., 567 A.2d 1279, 1288 (Del. 1989) ("Where a board has no reasonable basis upon which to judge the adequacy of a contemplated transaction, a no-shop restriction gives rise to the inference that the board seeks to forestall competing bids.").

168. 506 A.2d 173 (Del. 1986).

ing from the transaction. This may mean that the duty of the directors is to auction off the corporation and act as neutral auctioneers. Either of two prerequisites must be met before *Revlon's* enhanced responsibilities[169] engage: (1) the corporation must initiate a bidding process (e.g., it must be for sale or there must be a bidding contest) or, in response to an offer, the target must abandon its long term strategy;[170] or (2) the breakup of the target corporation must be "inevitable."[171]

Revlon resulted in an uproar in corporate boardrooms. Most important was the issue of when the duty to auction attaches and, conversely, when the board can stand fast behind its various board-adopted and state-imposed defensive mechanisms. Although *Revlon's* potentially clear guidelines have proven most malleable,[172] the basic teaching of *Revlon* (and, indeed, of *Unocal* and *Moran*) is "simply that [directors] must act in accordance with their fundamental duties of care and loyalty."[173]

The "just say no" defense[174] is therefore a post-*Revlon* concept that has been used as a corporate battle-cry and serves to generalize, distill, and clarify otherwise fact-specific holdings into an ostensibly coherent category of cases, ultimately decreeing that a board need not abandon its antitakeover weaponry (e.g., redeem its poison pill or the equivalent) when such surrender defeats shareholders' long term interests. The proponents of this theory have advanced this proposition: a board of directors may "just say no" to a hopeful suitor when doing so advances the corporation's -- and thus shareholders'-- best interests. To the extent directors must know under what general circumstances they may "just say no," this concept may serve as a convenient acid test. Although much litigation has focused on target directors' duties to redeem rights plans, numerous (and various) cases grapple with a board's ability to consummate corporate restructuring in an effort to "just say no" to would-be raiders.

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169. In *Macmillan* the Delaware Supreme Court distinguished directors' enhanced "duties" under *Unocal* and their increased "responsibilities" under *Revlon*:

> As we held in *Revlon*, when management of a target company determines that the company is for sale, the board's *responsibilities* under the enhanced *Unocal* standards are significantly altered. Although the board's *responsibilities* under *Unocal* are far different, the enhanced *duties* of the directors in responding to a potential shift in control, recognized in *Unocal*, remain unchanged. This principle pervades *Revlon*, and when directors conclude that an auction is appropriate, the standard by which their ensuing actions will be judged continues to be the enhanced duty imposed by this Court in *Unocal*.

Macmillan, 559 A.2d at 1287 (emphasis in original) (citations omitted).

170. *See* Ivanhoe Partners L.P v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del.1987) (the only bidder for corporation was T.Boone Pickens' Ivanhoe Partnership, therefore Newmont was not for sale). In *Revlon* directors had authorized management to "sell" the corporation. *Cf.* Vlahakis, *"Just Say No" Made Easier; Lessons in "Just Saying Yes," in* SECURITIES REGULATION (Practising Law Institute) No. 713, 331, 333 (1990). Today, directors trigger *Revlon* duties only where "the board makes a conscious determination to initiate a sale or abandon its long-term strategy." *Id.*

171. *Revlon*, 506 A.2d at 182.

172. *See generally* Ronald J. Gilson & Reinier Kraakman, *What Triggers Revlon?*, 25 WAKE FOREST L. REV. 37 (1990). The authors suggest that the seeds of *Revlon's* malleability derive from *Revlon's* focus on that discrete point at which a sale of target becomes "inevitable." *Id.* at 38. The authors note that "management cannot restrict shareholder choice by erecting defensive tactics or lockups without intermediate level judicial review then substituting for shareholder choice as a check on the fairness of management's action." *Id.* at 59.

173. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) (citation omitted).

174. For a definition and comprehensive analysis of the "just say no" defense, *see* Robert A. Prentice & John H. Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense:" May Target Boards "Just Say No?" Should They Be Allowed To?*, 15 DEL. J. CORP. LAW 377 (1990). They define the just say no defense in terms of the nagging question: "Is it ever permissible for target management to refuse to provide an alternative, yet still oppose the hostile tender offer?" *Id.* at 382.

In the leading case illustrating the contours of the "just say no" defense as it relates to preplanned long term corporate restructuring, *Paramount Communications v. Time, Inc.*,[175] the Delaware Supreme Court held that, absent *Revlon's* limited set of circumstances, a board of directors, while always required to act in an informed manner, is not under any per se duty to maximize shareholder value in the short term, even in the context of a takeover.[176] Although one could argue that *Paramount's* reach is limited by its eminently fact-specific holding and, as such, arguably extends only to those unusual takeover contexts where the target corporation, in that case, Time, has reached a definitive restructuring plan and has taken all steps necessary to consummate said plan -- to be sure, the proxies had already been sent to shareholders --[177] the court's broad, general approach[178] has added much fuel to the "just say no" juggernaut.[179] Thus, commentators tend to discount the fact-specific focus of *Paramount's* holding.[180] More generally, *Paramount* illustrates that business planning not primarily designed as an antitakeover scheme[181] may serve as a preplanning defensive strategy.[182]

Beyond the use of the "just say no" defense to consummate carefully negotiated plans like that found in *Paramount*, the "just say no" defense may apply:

> 1. if the offer is coercive,[183] inadequate,[184] or impaired (e.g., conditioned on merger negotiations);[185]

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175. 571 A.2d 1140 (Del. 1989).

176. *See id.* at 1150.

177. The court itself emphasizes *Paramount's* unique fact setting:

> We have purposely detailed the evidence of the Time board's deliberative approach, beginning in 1983-1984, to expand itself. Time's decision in 1988 to combine with Warner was made only after what could be fairly characterized as an exhaustive appraisal of Time's future as a corporation . . . . Time's board was convinced that Warner would provide the best "fit" for Time to achieve its strategic objectives. The record attests to the zealousness of Time's executives . . . in seeing the preservation of Time's "culture". . . .

Id. at 1151-52.

178. For example, said the court: "Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly *no basis* to sustain the corporate strategy." *Id.* at 1154 (emphasis added). Although this is dicta regarding the factual setting of this particular case, such sweeping language demonstrates the court's expansive approach.

179. *See* P. John Kozyris, *The Federal Role in Corporate Takeovers: A Framework for a Limited Second Congressional Intervention to Protect the Free Market*, 51 OHIO ST. L.J. 263, 263 n.3. (1990) (*Paramount* dealt "the ultimate blow against any serious judicial control over management oppositionism").

180. *See id.*

181. Chancellor Allen held that Time had a legitimate "interest" in combining with Warner that may be protected by defensive action.

> In my opinion, where the board has not elected explicitly or implicitly to assume the special burdens recognized by *Revlon*, but continues to manage the corporation for long term profit pursuant to a pre-existing business plan that is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan.

Paramount v. Time, Inc., [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

182. The Delaware court in *TW Servs., Inc. v. SWT Acquisition Corp.*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del.Ch.Mar.2, 1989) stated that it is "non-controversial" that:

> directors, in managing the business and affairs of the corporation may find it prudent (and are authorized) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected, and thus directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other "corporate constituencies.

The recent *Polaroid* decision also buttresses the use of long term planning as a defensive preplanning strategy. Focusing on long term corporate goals, the *Polaroid* court found Polaroid's pre-planned ESOP "entirely fair" despite its highly antitakeover timing and effect. *See* Shamrock Holdings, Inc., v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989).

2. if the board requires time sufficient to consider other alternatives or to otherwise promote shareholder value;[186]

3. where a raider insists that the target take decisive action (e.g., auction the company) upon target's receiving a bare offer[187] or upon merely negotiating with one bidder;[188] and/or

4. where resisting an offer continues to serve a valid purpose, such

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183. Whenever an offeror's coercive or inadequate offer poses a threat to a corporation, courts uphold the defensive measures as "reasonable in relation to the threat posed." *See* Shamrock Holdings, Ind., v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989) (finding that an all cash, all shares offer is coercive). For another case upholding a director's decision not to sell the company based on the coerciveness of the offer, *see* Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289 (N.D. Ill. 1988). Applying Delaware law, the court in *Desert Partners* approved USG's decision to neither negotiate nor redeem its rights plan amid a hostile, two-tiered offer by Desert Partner. *See also* Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (partial tender offer); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); and Ivanhoe Partners L.P. v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987) (two tiered offer). All of these cases involved defenses intended to defeat coercive bids. *Cf. City Capital Assoc.*, 551 A.2d at 797-98. In that case an all cash tender offer was found to be noncoercive; still, "even where an offer is noncoercive, it may represent a threat to shareholder interests in the special sense that an active negotiator with power, in effect, to refuse the proposal may be able to extract a . . . more valuable proposal, or may be able to arrange an alternative transaction . . . ." *Id.*

184. If the board in good faith determines that a bid is inadequate, that alone justifies leaving the pill in place. *See Interco*, [1988-89 Transfer Binder] Fed. Sec. L. Rep (CH) ¶ 94,084 (Del. Ch. Nov. 1, 1988). Still, inadequacy alone may not be sufficient justification for keeping the pill in place. "Applying the *Unocal* standards, I am unable to conclude that a board may in all instances preclude shareholder choice solely on the basis of its own perception of the inadequacy of the offer." Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989) (inadequacy as serious threat). *See also* Facet Enterprise, Inc. v. Prospect Group, Inc., Del. Ch. Civ. Act. No. 9746, Jacobs, U.C. (Apr. 15, 1988):

> [A] target board is not required to redeem the rights in the face of a noncoercive all cash tender offer. Where the board has determined that the offered price is inadequate and has decided to conduct an auction for the company, it may be appropriate to keep the rights in place in order to allow time for higher bids to be made.

Id.

For cases involving a *combination* of (1) inadequacy of cash tender offer for all shares; (2) likelihood of both further developments and higher shareholder value with retention of rights plan; and (3) no showing of lack of independence in Board's conduct, *see* Nomad Acquisition Corp. v. Damon Corp., Fed Sec. L. Rep. (CCH) ¶ 94,040 (Del. Ch. Sept. 16, 1988); BNS, Inc. v. Koppers Co., Inc., 683 F. Supp. 458 (D.Del. 1988); MAI Basic Four, Inc. v. Prime Computer, Inc., Civil Action No. 10428 (Del. Ch. Dec. 20, 1988).

185. *See* TW Servs., Inc. v. SWT Acquisition Corp., [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,173 (Del. Ch. Mar.2, 1989) (where tender offer is conditioned on merger negotiations and board has concluded that offer is not in the long-term interests of the company, the board need neither negotiate nor redeem a rights plan).

186. *See* Polaroid II, 559 A.2d 278 (Del. Ch. 1989). The *Polaroid II* court suggested that interim defensive measures are appropriate to allow target corporations sufficient time to explore and present alternatives to shareholders. The Court indicated that Shamrock's all-cash, all-shares offer would not present a "continuing threat" so as to justify long term defensive measures absent unusual circumstances (the *Polaroid II* Court held that Polaroid had proven unusual circumstances given Polaroid's patent infringement litigation against Kodak). *See also* Doskocil Cos., Inc. v. Griggy, Civil Action. No. 10095, slip op. (Del. Ch., Oct. 7, 1988). The *Doskocil* court refused to force redemption since the "auction has not yet concluded;" the court held that the target of a bidding contest could redeem a rights plan for a lower bidder but leave it intact for a higher bidder: "even if the offered price is not inadequate, it may be appropriate to maintain the rights in order to promote the continuation of the auction." *Id.*

See also CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988) (during auction process, poison pills provide directors "with a shield to fend off coercive offers and with a gavel to run an auction."). The *Doskocil* court also noted that "when conducting a *Revlon* auction, the target board may favor one bidder over another 'if in good faith and advisedly it believes shareholder interests would be thereby advanced.'" *Doskocil*, Civil Action No. 10098, slip opinion (citing *In re* Fort Howard Corp. Shareholder Litigation, Del. Ch. Civil Action No. 9991, (Aug. 8, 1988).

187. *See, e.g.*, Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D.Wis.). Applying Delaware law, the court stated that *Unocal* and its progeny do not require a target to place itself on the auction block. *See id.* at 1013. In distinguishing *Pillsbury*, the court stressed that only twenty-seven percent of Universal's shareholders had tendered (as against *Pillsbury's* eighty-seven percent tender); Universal was on an upswing, Pillsbury a downswing; Universal's board had made an informed decision as to inadequacy of Amanda's offer: Universal's board considered twelve alternative responses to the offers. *See id.* at 1013-14. Additional factors the court considered relevant in keeping pill in place: the bid posed a threat to the shareholders who did not tender if Amanda failed to obtain financing; there was a threat that the offer contained false or misleading information given Amanda's complex financing. *See id.* Apparently, Amanda requires that the offer must pose a real threat to shareholders (and thus the court does not suggest that a target may "just say no" in all circumstances).

188. *See* Buckhorn, Inc., v. Ropak, Corp., 656 F. Supp. 209 (S.D. Ohio 1987), *aff'd sum. ord.*, 815 F.2d 76 (6th Cir. 1987). Applying Delaware law, the court held that Buckhorn's board had no duty to sell merely because of preliminary negotiations with one potential bidder. *See id. See also* Ivanhoe Partners L.P. v. Newmont Mining Corp., 535 A.2d 1334 (Del.1987) (shareholder's entering into a ten year standstill agreement after raising its stake in Newmont to 49.7% (from 26%) did not amount to a sale of the company requiring Newmont to negotiate with possible bidder (but no bidding contest was yet underway)).

as fulfilling the target's pre-conceived business plan and promoting long-term shareholder value.[189]

Alternatively, the "just say no" defense may be regarded as a means of distinguishing those cases where target defensive measures fail *Unocal's* "reasonable in relation to threat posed" test.[190] In *City Capital Associates Ltd. Partnership v. Interco, Inc.*[191] the Delaware court forced redemption of a target's poison pill, finding the threat of injury to target shareholders from an all-cash offer "mild."[192] In *Grand Metropolitan PLC v. Pillsbury Co.*[193] the Delaware court stressed that the only threat was to shareholder value and the "real" threat posed was that of the bid being withdrawn.[194] Courts further analyze *Interco* and *Pillsbury* on the grounds that those decisions came at the conclusion of takeover battles in which the target was attempting to use poison pills to protect a board-approved restructuring.[195] However, *Paramount* explicitly rejected *Pillsbury's* and *Interco's* implication that an all-cash, all-shares offer at a reasonable price cannot constitute a "threat" to the corporation.[196]

The "just say no" defense, together with the defensive tool of the poison pill, paved the way for incumbent management of companies to be able to carry out existing business plans without the risk of having those plans wrecked by any above-market, all-cash takeover offer.[197] However, the combination of these factors also provided the opportunity for management entrenchment where no discernible increase in shareholder value appeared to be on the horizon. These disparate circumstances provided the background for further evolution of the corporate governance battle.

189. *See, e.g., In re* Holly Farms Corp. Shareholders Litig., 564 A.2d 342 (Del. Ch. 1989). In *Holly Farms*, plaintiff Tyson and its competitor, ConAgra, were bidding for Holly Farms. The court refused to grant a preliminary injunction requiring Holly Farms to redeem its rights plan since the pill served the valid purpose of preventing Tyson from blocking ConAgra's economically superior offer, leaving shareholders with only Tyson's inferior offer. Since there were no other bidders, the shareholders would be harmed if ConAgra withdrew its offer, rendering legitimate the unredeemed pill. *See id.*

190. *See, e.g.*, Robert M. Bass Group, Inc. v. Evans, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,924 (Del. Ch. July 14, 1988); City Capital Assocs. Ltd. Partners v. Interco Inc., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,084 (Del. Ch. Nov. 1, 1988); Grand Metropolitan PLC v. Pillsbury Co., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,104 (Del.Ch. Dec. 16, 1988).

191. 551 A.2d 787 (Del. Ch. 1988).

192. *See id.* at 798.

193. 558 A.2d 1049 (Del. Ch. 1988).

194. *See id.* at 1058.

195. The Delaware Chancery Court in *In re Time Inc. Shareholders Litigation*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989) found that *Interco* and *Pillsbury* were cases where "management was seeking to 'cram down' a transaction that was the functional equivalent of the very leveraged 'bust up' transaction that management was claiming presented a threat to the corporation." *Id.* Some courts have suggested that the "just say no" defense does not apply to cases in which the target's defensive measures amount to restructuring. *See* TW Services, Inc. v. SWT Acquisition Corp; [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. Mar. 2, 1989); MAI Basic Four, Inc. v. Prime Computer, Inc., [1988-89 Transfer Binder] Fed. Sec. l. Rep. (CCH) ¶ 94,179 (Del. Ch. Dec. 20, 1988).

196. The *Paramount* court stressed that to accept Paramount's narrow view of the *Unocal* test would "involve the court in substituting its judgment for what is a 'better' deal for that of a corporation's board of directors." *Paramount*, 571 A.2d at 1153. "The [Delaware] [S]upreme [C]ourt rejected the *Interco* view of *Unocal* unequivocally and completely . . . holding that there are more threats in the *Unocal* universe than the Chancery Court had ever dreamed of." *Id.* The court emphasized this point, stating that it rejected *Interco* and its progeny. *See id.*

197. *See, e.g.*, Moore Corp. Ltd v. Wallace Computer Services, Inc., 907 F. Supp. 1545 (D. Del. 1995).

V. THE RISE OF THE INSTITUTIONAL INVESTOR

A. Increased Shareholdings and the Incentive for Increased Activism

The past several decades have seen a phenomenal concentration of share ownership in the hands of "institutional investors," including public and private pension funds and, more recently, mutual funds. As recently as the early 1980s, these institutional investors owned as little as five percent of the market value of United States publicly-held corporations.[198]

The 1980s and 1990s witnessed a staggering increase in institutional share ownership with an equally dramatic increase in the concentration of shareholdings. In 1990, institutional investors owned forty-five percent of outstanding corporate equity.[199] Pension funds, the largest class of institutional investors, owned roughly forty-four percent of all institutional holdings in 1987.[200]

Controlling more than $2.5 trillion in assets in 1990, pension funds at that time owned more than 25% of all publicly traded equity in United States companies.[201] This is particularly noteworthy because, on average, a pension fund holds any given stock in its portfolios for two and one-half years.[202]

The most recent statistics are no less staggering. While in 1990 the assets of institutional investors as a group equaled $6.3 billion, this number grew to $12 trillion by the end of 1996 and $14.3 trillion by the end of 1997.[203] These figures represent a 125% increase from 1990 to 1998.[204] Pension funds controlled approximately 48% of these assets while mutual funds controlled approximately 21%,[205] with various other institutional players holding the remainder.

As a result of these holdings, institutional investors command approximately 48% of total United States equity markets. With respect to the largest 1,000 United States companies, their stake is even higher, approximating 59%.

Although the motivations of and variations between institutional investors is beyond the scope of this article,[206] the primary impetus for increased shareholder activism likely stems from shareholders' increased ownership concentration. Voting power is increasingly concentrated in a small number

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198. *See* John C. Bogle, *Creating Shareholder Value for Mutual Fund Shareholders*, 20 CORPORATE BOARD 1 (1999).

199. *See* Richard H. Koppes & Kayla J. Gillan, *The Shareholder Advisory Committee*, DIRECTORS & BOARDS, Spring 1991, at 29.

200. *See id.*

201. *See id.*

202. *See* James A. White, *Pension Funds Try to Retire Idea That They Are Villains*, WALL ST. J., Mar. 20, 1990, at C1. Investments in common stock by state and local pension systems ballooned from $10.1 billion in 1970 to $150.2 billion in 1986 and to an estimated $240 billion in institutional holdings in 1990. Whitewall, *supra* note 197, at 75, 79. Although equity holdings of private pension funds have been relatively stable since 1982, state and local government pension holdings have increased markedly; in 1988, they owned a total of $223.7 billion in stocks, or 9.1% of the NYS's total market value. *See id.*

203. *See U.S. Institutional Investors Sharply Step Up Asset Holdings: Public Pension Funds Continue to Gain Clout in Governance Matters*, PR NEWSWIRE (June 11, 1998).

204. *See* Matthew Greco, *Institutions Keep Growing*, INVESTOR RELATIONS BUSINESS, July 6, 1998.

205. *See id.*

206. *See generally* THEODOR BAUMS ET AL., INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE (1993); CAMILLE Q. BRADFORD ET AL., NATIONAL LEGAL CENTER FOR THE PUBLIC INTERET, INSTITUTIONAL INVESTORS, SOCIAL INVESTING, AND CORPROATE GOVERNANCE (1996) [hereinafter SOCIAL INVESTING].

of major institutions. In 1989, the top twenty funds and top ten money managers controlled 16% of all equity; by the year 2000, they may control up to 29% of the equity in the top ten corporations.[207] The twenty largest pension funds have accounted for more than 25% of all pension assets. Then, the top twenty funds have controlled at least 7.7% of the outstanding stock of American's ten largest corporations.[208]

Increasingly concentrated share ownership drives institutional activism in two ways. First, institutions that own a large stake in a corporation are less able to sell their shares and take the "Wall Street walk."[209] As James Martin of College Retirement Equities Fund (CREF) attests, "We're the quintessential long-term investors."[210] In addition, a greater stake means a greater incentive to invest time and resources in improving corporate monitoring and performance. Finally, institutional investors' size and share concentration enhance their ability to monitor and discipline management. The marked increase in management entrenchment that has accompanied the death of the takeover era, however, probably also fuels shareholder activism.

In his comprehensive study of global competition, Michael E. Porter identifies the growth of institutional investors in the United States to a position of dominance over corporations as the most significant factor in the decline of the country's competitiveness:

> Unlike institutional investors in nearly every other advanced nation, who view their shareholdings as nearly permanent and exercise their ownership rights accordingly, American institutions are under pressure to demonstrate quarterly appreciation .... With a strong incentive to find companies whose shares will appreciate in the near term and incomplete information about long-term prospects, portfolio managers turn to quarterly earnings performance as perhaps the single biggest influence on buy/sell decisions.[211]

B. Increased Institutional Shareholder Activity

Even before the massive holdings of today's institutional investors, shareholder activism existed. At least from the 1930s through the early 1980s, however, the likely points of focus were social and political issues, such as apartheid, the environment, and international labor concerns. These social responsibility issues gave rise to 130 shareholder proposals in 1976 and 230 proposals in 1994.[212]

Beginning in the mid-1980s, however, corporate governance matters

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207. *See* William Taylor, *Can Big Owners Make a Big Difference?*, HARV. BUS. REV., Sept.-Oct. 1990, at 70, 72.
208. *See* Koppes & Gillan, *supra* note 199.
209. *See* Matheson & Olson, *supra* note 10, at 1477-82 (describing behavior differences between institutional investors and individual investors).
210. David Pauly, *Wall Street's New Musclement*, NEWSWEEK, June 5, 1989, at 46.
211. Michael E. Porter, The Competitive Advantage of Nations 528 (1990).
212. *See* SOCIAL INVESTING, *supra* note 206, at 26-27.

started to come to the forefront. These issues included changes in the composition, compensation and operation of the board of directors, confidential and cumulative voting issues for shareholders, as well as a number of issues relating to takeover matters, including the poison pill shareholder rights plans. The focus on these matters resulted in a nearly 400% increase in such proposals from 1986 to 1990.[213] In 1995, 520 shareholder resolutions were proposed on a variety of governance matters. In 1998 that number stood at 429, with 261 social issue proposals being made, and forty-seven proposals that overlapped the two categories.[214]

Of particular relevance for our analysis, shareholder proposals seeking to redeem or require a shareholder vote on rights plans have been a favorite area for institutional investors. Between 1989 and 1996, poison pill proposals averaged affirmative votes of 40% of more. During the same period, fifty-two of these proposals received majority affirmative votes.[215] In 1996, proposals to redeem or vote on poison pills averaged 53.4%, with eight resolutions receiving majority backing.[216] In 1997, poison pill votes averaged 54.9%, with fifteen receiving majority support, including three that were framed in terms of binding bylaw amendments.[217] Finally, in 1998, poison pill proposals garnered a record 57.4% support.[218]

Institutional shareholder activism on corporate governance has not been limited to making shareholder proposals. Several prominent shareholder groups promulgated "corporate governance guidelines" for suggested adoption by companies.[219] These guidelines reflected a revised operation of the boards of directors and management of companies to be more attuned to the desires of the companies' shareholders to enhance shareholder value.

Beyond proposals and guidelines, the institutional investors have begun to exercise their clout directly. More and more often there are calls for replacing the board of directors or the chief executive officer.[220] Last year one institutional investor, TIAA-CREF, spearheaded an insurgent effort that resulted in the complete ouster and replacement of the Furr's/Bishop's board of directors.[221] Another investor group, during a three-year period, helped to remove eight board members and two CEOs from Stone & Webster Engineering Corporation.[222]

Clearly, the ascendancy of the institutional investor foreshadowed a showdown for corporate boards and management. The most logical place for this showdown to focus was in the continued retention and use of share-

213. *See id.* at 28.
214. *See* IRRC, Summary of 1998 U.S. Shareholder Resolutions, Feb. 3, 1999 [hereinafter "IRRC Summary"].
215. *See* IRRC, Corporate Governance Service 1997 Background Report F: Poison Pill, Feb. 21, 1997, at 1.
216. *See id.*
217. *See* IRRC, Corporate Governance Service 1998 Background Report E: Poison Pill, June 25, 1998, at 2.
218. *See* IRRC Summary, *supra* note 214, at 2.
219. *See, e.g.*, Calpers, *CII Approve Corporate Governance Gulletin*, IIRC CORPORATE GOVERNANCE BULLETIN, Vol. XV, No. 1 (Jan.-Mar. 1998), at 1.
220. *See* Weld Royal, *Impeach the Board*, INDUSTRY WEEK, Nov. 16, 1998, at 47.
221. *See id.*
222. *See id.*

holder rights plans. After all, from the institutional shareholder perspective, to the extent that these poison pill rights plans were effective in deterring hostile acquisition overtures, shareholders were being deprived of the opportunity to maximize the value of their substantial investments in the subject companies.

VI. THE DETOXIFICATION OF THE POISON PILL

A. The Importance of Staggered Boards and the "Continuing Director" Concept

The increased holdings of institutional investors in the mid-1990s demonstrated that they had the potential to recreate the corporate governance framework. This power they employed in some relatively minor ways, such as making shareholder proposals and proffering governance guidelines. More rarely and episodically, institutional investors displayed dispositive power, such as replacing a board of directors or pressuring for the resignation of a CEO.

In order for institutional investors to fundamentally affect the governance landscape, however, they needed to be able to demonstrate that they could regularly initiate or cooperate with a third party in change of control transactions with respect to companies that were deemed not to be performing adequately. But the factor that arguably prevented maximum share value realization also prevented change of control transactions, namely, the poison pill. Still, poison pills could be redeemed by the board of directors of a company and, now that institutional shareholders held sufficient shares to potentially replace a board of directors, a potential hostile party could consider making a tender offer and combining it with a proxy contest to replace the target company board and redeem the poison pill before the tender was completed. Thus, in a little over a decade, and much to the dismay of incumbent public company management, the proxy contest poison pill redemption scenario that the court in *Moran v. Household International, Inc.*[223] identified as one justification for upholding rights plans as not precluding hostile takeovers had become a realistic possibility.

The prospect of poison pill redemption after replacing a recalcitrant or underachieving board seemed a likely scenario except for several factors. Initially, many publicly traded companies have classified, or staggered boards,[224] like the structure of the United States Senate. With a classified board, directors are typically divided into three classes, serve for three year terms, with only one-third of the directors being up for election in any given year. Arguably serving the positive goals of stability and continuity for

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223. 500 A.2d 1346 (Del. 1985). For a discussion of the *Moran* case, *see supra* notes 151-62 and accompanying text.

224. *See* IRRC, Corporate Governance Service 1998 Background Report C: Classified Boards, Mar. 3, 1998, at 1-2 (stating that 58.4% of the 1,900 companies in the IRRC research universe and 59.7% of the Standard & Poor's 500 companies have classified boards).

company policy making and management, from a cynical perspective staggered boards are a means of management entrenchment.

Particularly when paired with a poison pill rights plan, a classified board has the potential to assist incumbent management to "just say no" to hostile overtures without fear of immediate reversal by institutional shareholders. That is, while the rights plan prevents the hostile party from completing the tender offer at a presumed premium price to current shareholders, the staggered board prevents the institutional shareholders from immediately replacing a majority of the board who could redeem the rights and let the tender offer proceed. Since it would take at least two successive annual meetings to replace the target board of directors, the effect of the poison pill, combined with the classified board, is to provide a substantial roadblock to the hostile takeover, even in companies where a substantial majority of the shares are held by institutional investors.

Given these facts, it is not surprising that shareholder proposals to repeal classified boards have been on the increase. In 1997, shareholder support for proposals to repeal classified boards averaged 43.8% of the votes cast, an increase of 1.6% over the 1996 average, and 17.5% higher than in 1986.[225] In 1998, over seventy shareholder proposals to repeal classified boards were made, with those that were voted on receiving an average of 47.3% of the vote.[226]

However, the benefits of a classified or staggered board were not available to those companies without that device currently in place. In light of the history of repeal proposals listed above, institutional investors would not look favorably upon a management attempt to implement a classified board. Moreover, even companies with existing classified boards faced the risk that shareholders would find a way to eliminate the classification or that the board would voluntarily seek to eliminate the classification in response to shareholder pressure.

Another device was needed to protect the rights plans from potential redemption as part of a proxy fight. That is, what could a current board of directors do to prevent redemption of a rights plan even if a hostile party, with the support of institutional investors, was able to wage a proxy contest and replace the whole incumbent board? If repeal of the rights plan could not be accomplished under these circumstances, the proxy contest itself would most likely be seen as futile and would not take place. The desired device was the "continuing director" or "dead hand" redemption provision. A "continuing director" or "dead hand" provision gives exclusive authority to redeem the rights plan, and thereby allow an acquisition proposal to proceed, to the "continuing directors," that is, either (1) members of the board at the time of adoption of the rights plan, or (2) those future members of the board recommended by the current board members. This latter clause,

225. *See id.* at 1.
226. *See* IRRC Summary, *supra* note 214, at 1.

requiring current board members to approve of any future board members who would have the right to redeem the rights plan is what gives the provision its "dead hand" feature. Even if removed from office, the "dead hand" of the replaced directors would control the rights plan redemption decision since only new board members approved by the replaced board members would have the power to redeem the rights.

B. The Continuing Director Concept is Defeated

The first blow to the continuing director concept came in *Carmody v. Toll Brothers, Inc.*[227] The *Carmody* case was the first Delaware decision addressing the "continuing director" or "dead hand" redemption feature included in many shareholder rights plans.[228] In response to a motion to dismiss the complaint, the court determined that the complaint stated a valid claim that the "dead hand" provision violated both the Delaware corporate statute and the fiduciary duties of the board that adopted it.

Toll Brothers, Inc. adopted its Shareholder Rights Plan prior to any takeover overture, and the court reaffirmed the propriety of adoption of a shareholder rights plan in light of what a board of directors might perceive as harmful potential hostile proposals. The Toll Rights Plan, however, contained a provision giving the decision of whether to redeem the Rights Plan (and thereby allow an acquisition proposal to proceed) exclusively to the "continuing directors," that is, (1) members of the Board at the time of adoption of the Rights Plan, and (2) those future members of the Board recommended by the current Board members (the "continuing director" or "dead hand provision"). This dead hand provision was challenged in a suit by Toll shareholders as violating Delaware statutes and the fiduciary duties of the Board that adopted it.

On the statutory claim, the court found that the dead hand provision impermissibly created two separate classes of directors, namely, those serving at the time of the Rights Plan adoption and their designated successors, as distinguished from all others. The court held that such distinctions under Delaware law could only be accomplished by creating a classified board and expressing the distinctions among classes of directors in the articles of incorporation. Since this was not done, the provision was likely to be found to violate the Delaware statute. In addition, the Court also accepted the claim that the dead hand provision might impermissibly restrict the authority of a Board to manage the Company by limiting the discretion of newly elected board members to redeem the Rights Plan. The Company responded by arguing that board authority for certain decisions is often validly delegated to committees of the board. The court rejected this analogy, respond-

227. 1998 WL 418896 (Del. Ch. July 27, 1998).

228. Two other courts had addressed the concept, reaching conflicting conclusions. *Compare* Bank of New York Co., Inc. v. Irving Bank Corp., 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988) (invalidating the provision) *with* Invacare Corp. v. Healthdyne Techs., Inc., 968 F. Supp. 1578 (N.D. Ga. 1997) (validating provision under Georgia law). Because of Delaware's importance as the home state for many publicly held corporations, these decisions did not carry substantial weight.

ing first, that no committee had been created and second, that any board committee would still be subject to abolition at any time by the board.

On the fiduciary duties claim, the court found that the plaintiffs stated a claim that inclusion of the "dead hand" provision by the Toll Board violated the Board's duty of loyalty. First, the court concluded that the "dead hand" provision impermissibly interfered with the shareholder voting franchise without any compelling justification. The disenfranchisement occurs because, in a hostile proxy situation, Toll shareholders would be unable to "elect a board that is both willing and able to accept the bid" since new pro-bid directors would be unlikely to have been recommended by the current Board, and those recommended by the current Board would be unlikely to redeem the Rights Plan.

Second, the court found that inclusion of the "dead hand" provision constituted a disproportionate defensive measure under the analysis of the Delaware Supreme Court decisions in *Unocal v. Mesa Petroleum*[229] *and Unitrin v. American General*[230] because it was both coercive and preclusive. First, the court stated that the complaint stated a claim that the "dead hand" provision "coerced" Toll shareholders into voting for incumbent directors or their designees in order to preserve the option of redeeming the Rights Plan. Second, the court found that the complaint also alleged that the dead hand provision effectively "precluded" hostile bids since a proxy contest could not succeed in electing a board with the power to redeem the Rights Plan

For the many companies with continuing director provisions in their shareholder rights plans, *Carmody* was a serious blow. Still, some hope existed. First, the court's decision was not a final adjudication, having come in response to a motion to dismiss the complaint. However, while the manner of addressing issues in that context means that the court thinks that the plaintiffs have stated a valid claim, the court's analysis and language left little doubt as to the ultimate result. Second, and more hopefully, the court made it clear that it was not deciding whether some lesser form of redemption-limiting provision, such as a delayed or "slow hand" provision precluding redemption of the Rights Plan for a specified period, such as six months, would be acceptable.[231]

The Delaware Supreme Court put this latter issue to rest on December 31, 1998, with its decision in *Quickturn Design Systems, Inc. v. Shapiro*.[232] That case involved Mentor Graphics, a hostile bidder, who sought control of Quickturn by launching a tender offer and a proxy contest. The tender offer was commenced when Quickturn's stock was depressed below historical levels, but still offered Quickturn shareholders a fifty percent premium over Quickturn's immediate pre-offer price.[233] The proxy contest was launched

229. 493 A.2d 946 (Del. 1985).
230. 651 A.2d 1361, 1379 (Del. 1995).
231. *See Carmody*, 1998 WL 418896, at n.52.
232. 721 A.2d 1281 (Del. 1998).
233. *See id.* at 1285.

with the express intention of replacing Quickturn's board with members sympathetic to the hostile overture.[234]

Quickturn had in place a state of the art Shareholder Rights Plan with both flip-in and flip-over rights. In addition, the Rights Plan contained a "continuing director" or "dead hand" redemption provision.[235] When the board of directors of Quickturn met on August 21, 1998 to take action in response to Mentor's actions, the decision in *Carmody* had come down less than a month before, leaving the validity of the continuing director provision in serious doubt. Quickturn's Board, therefore, amended the Rights Plan to substitute a delayed redemption provision for the continuing director provision (DRP).[236] Pursuant to the DRP, no newly elected Board could redeem the Rights for 180 days if the redemption would facilitate a transaction with an "Interested Person," defined to include Mentor.[237] It is this DRP provision of the Rights Plan that Mentor chose to challenge because of its potential to delay any proposed takeover of Quickturn by Mentor.

The Delaware Supreme Court viewed the issue as one of fundamental corporate law. While affirming the authority of a board of directors to adopt a Rights Plan, the Court noted that the authority of the board is constrained by fiduciary obligations in its determination of whether to redeem the Rights.[238] More directly, the Court stated that "one of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation" and Delaware law "requires that any limitation on the board's authority be set out in the certificate of incorporation."[239]

Turning to the DRP, the court found that this provision "would prevent a newly elected board of directors from *completely* discharging its fundamental management duties to the corporation and its stockholders for six months."[240] These duties apply in all situations, including a contest for corporate control. Indeed, that was one of the fundamental holdings in *Unocal*. Therefore, because the DRP "impermissibly circumscribed the board's statutory power . . . and the directors' ability to fulfill their concomitant fiduciary duties, [the *Unocal* Court held] that the [DRP was] invalid."[241]

With the *Quickturn* decision, hostile suitors and institutional investors won a significant victory. In effect, a Shareholder Rights Plan, by itself, is only a significant defensive mechanism if the incumbent board is able to

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234. *See id.* Quickturn's Board, however, was not staggered or classified and therefore could be replaced all at once at a special or annual meeting of the shareholders.

235. *See id.* at 1287. In fact, the Quickturn version of the continuing director provision was limited in its operation. Generally, the Board as a whole had the right to redeem the Rights. If, however, an insurgent person or group acquired 15% or more of Quickturn's stock and replaced the Board, only continuing directors, that is, pre-replacement directors or those directors nominated by pre-replacement directors, could redeem the Rights. *See Quickturn*, 721 A.2d at 1289.

236. *See id.*

237. *See id.* at 1289-90.

238. *See id.* at 1291 (citing Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); *Unocal*, 493 A.2d at 954-55, 958).

239. *Quickturn*, 721 A.2d at 1291 (relying on DEL. CODE ANN. tit. 8, § 141(a) (1991).

240. *Id.*

241. *Id.* at 1293.

prevail in a proxy contest to replace the board. That is, if a corporation does not have a staggered board, all directors may be removed at any regular or special meeting of the shareholders.[242] For companies with institutional shareholders holding a major portion of the company's stock, which is the case with many publicly-held companies, this factor gives these institutional shareholders great power and leverage with management and the board of directors

For corporations with staggered boards, however, and where directors otherwise may be removed only for cause,[243] the *Quickturn* decision is less significant. In this circumstance, only a third of the directors may be replaced at any given election. It would take two successive elections to replace a majority of the board. Since only the entire board by majority vote has the authority to redeem the Rights under a Shareholder Rights Plan, the net result is effectively somewhere between a one and two-year delayed redemption provision, given the timing of the elections. After *Quickturn*, the importance of a staggered board to the efficacy of a poison pill is evident.

Thus, while the combined results in *Carmody* and *Quickturn* serve as an antidote to the operation of the poison pill for some publicly-traded companies, still others, those with staggered boards, are left with their defenses effectively in place. Another means to neutralize the shareholder rights plan was necessary. The means of choice for institutional investors has been the mandatory shareholder rights plan bylaw.[244]

C. Mandatory Bylaw Provisions: Whose Company Is It Anyway?

For companies with poison pills and staggered boards, institutional shareholders unhappy with incumbent management face the prospect of winning two proxy contests to replace a majority of the board of directors in order to redeem a poison pill. Even where a company does not have a classified board, the issue of redemption cannot be addressed by the shareholders directly. Rather, shareholders must first replace the board of directors and then have the new directors redeem the Rights under the Rights Plan. This may not be palatable, however, especially where the shareholders are not generally dissatisfied with board performance, but rather would simply prefer not to have a poison pill in place. Add to these issues the fact that boards have generally ignored the non-binding votes of shareholders asking that a poison pill be redeemed, even where a majority shareholder vote favored the action,[245] and the stage was set for a more direct way to deal with institutional shareholder unhappiness with Rights Plans.

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242. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 141(b), (k) (1998).

243. This is the result under the Delaware statute. *See id.* § 141 (k)(1) (1998).

244. *See generally* Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511 (1997); Jonathan R. Macey, *The Legality and Utility of the Shareholder Rights Bylaw*, 26 HOFSTRA L. REV. 835 (1998).

245. *See* 1998 Poison Pill Report, *supra* note 8, at 1-2.

In 1997 three shareholder proposals upon which votes were taken took the form of proposed binding bylaw amendments.[246] One of these, at Fleming Companies, received majority shareholder approval[247] and was the subject of dispositive litigation in early 1999.[248] Fleming Companies had adopted a Rights Plan in 1986, which was scheduled for renewal or lapse in 1996. In that year the International Brotherhood of Teamsters, a Fleming Companies shareholder, put forth a non-binding rights plan redemption proposal that received a majority shareholder vote. Fleming ignored the vote and renewed the Rights Plan.[249]

In 1997 the Teamsters raised the stakes and proposed a binding bylaw amendment requiring shareholder approval of any future Rights Plan and immediate redemption of the existing Rights Plan.[250] Fleming filed suit, challenging the proposal as an improper subject for shareholder action and seeking to delay the vote on the issue. The delay was denied and the resolution passed by approximately sixty percent of the voted shares.[251] Having lost the battle of the vote, Fleming sought to win the war by seeking a judicial determination that the bylaw was invalid, arguing that the decision to adopt or redeem a Rights Plan is uniquely a function of the board of directors.[252]

The Oklahoma Supreme Court addressed this issue as one primarily of statutory interpretation, with the Oklahoma statutes representing fairly typical formulations of the matters addressed.[253] On the one hand the Oklahoma corporate statute generally reposes responsibility for managing the company with the board of directors. In addition, the board has general authority to issue rights to purchase stock, of which the Rights Plan is one form, and to designate the rights and preferences of those rights to purchase. On the other hand, the same statute provides that the shareholders may adopt bylaws to govern the corporation and those bylaws may contain any provision relating to the operation of the corporation.[254] In the context of the shareholder rights plan bylaw requiring board redemption or termination of a poison pill, the tension between these provisions is apparent. Presumptively, one of these sets of provisions had to prevail.

As a matter of statutory interpretation, it should be seen that there is no ineluctable result.[255] Does the board's power to create rights to purchase prevail over the shareholders' right to adopt bylaws governing corporate activi-

246. *See id.* at 2.
247. *See id.*
248. *See* International Brotherhood of Teamsters v. Fleming Cos., Inc., 1999 WL 35227 (Okla. Jan. 26, 1999). An earlier case, *Invacare Corp. v. Healthdyne Technologies, Ind.*, 968 F. Supp. 1578 (N.D. Ga. 1997) held that a proposed bylaw requiring redemption of a Rights Plan was invalid as an unlawful restriction on the board's authority. Georgia, however, had explicitly adopted a statute endorsing the board's authority to create a Rights Plan and to determine its terms. *See id.* at 1580.
249. *See Fleming*, 1999 WL 35227, at *2.
250. *See id.* at n.3.
251. *See id.* at *2.
252. *See id.* at *3.
253. Indeed, as the Court noted, the Oklahoma statutes at issue were "substantially similar" to their Delaware counterparts. *Fleming*, 1999 WL 35227, at *3.
254. *See id.*

ties or vice versa? The *Fleming* court, while required to reach a result, found no compelling rationale. It noted that some option plans, of which a Rights Plan is one kind, are required to be put to shareholder approval.[256] The court also noted that some states, although not Oklahoma, had adopted statutes giving directors explicit and exclusive authority to adopt Rights Plans.[257] Ultimately, the court upheld the bylaw's validity, concluding simply: "we find shareholders may, through the proper channels of corporate governance, restrict the board of directors' authority to implement shareholder rights plans."[258] But the statutory provisions interpreted in *Fleming* and existing in many other states' corporate codes are malleable. That is, given the inconclusive nature of the statutory provisions involved, the Court could just as easily have concluded that "we find no basis to allow shareholders to limit the otherwise statutorily defined management discretion and authority of the board of directors to issue rights to purchase securities, including the implementation and redemption of shareholder rights plans."

Beneath the surface issue of the validity of these binding bylaw amendments lies a fundamental corporate governance issue: do the shareholders or the directors have the ultimate authority to determine whether, and on what terms, a proposed acquisition of a target company's shares occurs? Phrased differently, should the board of directors of a company have exclusive authority to determine if the market for corporate control acts as a check on corporate management?

These questions take us back to a reconsideration of the role of the board of directors in potential change of control transactions, such as hostile tender offers. The Delaware Supreme Court in *Unocal* stated that the role of the board, when faced with a hostile takeover proposal, is "no different from any other responsibility it shoulders . . . ."[259] But there are differences! The board's role as "gatekeeper" for other fundamental corporate transactions is statutorily specified.[260] Indeed, the reason that the most recent poison pill proposals come in the form of "bylaw" amendments as opposed to "article" amendments is that, under Delaware and many other states' corporate laws, no amendment of the articles or certificate of incorporation can take place without initial board approval.[261] For these statutorily defined gatekeeper functions, then, the board has not only initial but also exclusive authority to determine if the transaction proceeds.

The board's authority to preempt takeover proposals, on the other hand,

255. *Compare* Chazen, *The Shareholder Rights Bylaw: Giving Shareholders a Decisive Vote*, 5 THE CORPORATE GOVERNANCE ADVISOR Jan.-Feb. 1997, at 8 (Delaware law permits shareholder rights bylaw) *with* Hamermesh, *The Shareholder Rights Bylaw: Doubts from Delaware*, 5 THE CORPORATE GOVERNANCE ADVISOR Jan.-Feb. 1997, at 9 (Delaware does not permit shareholder rights bylaw).

256. *See Fleming*, 1999 WL 35227, at *4.

257. *See id.* at *5 (citing Matheson & Olson, *supra* note 10).

258. *Id.* at 6.

259. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1985).

260. *See supra* note 90 and accompanying text.

261. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b)(1) (1991) ("its board of directors shall adopt a resolution"). *Compare, e.g.*, MINN. STAT. 302A.135 (1999) (shareholders holding three percent or more of the voting power of the shares may initiate amendment to articles).

does not find explicit statutory recognition. That is why the *Unocal* court had to address the issue of board authority in that context. *Unocal*, however, only explicitly recognized the *existence* of board authority to address takeover proposals or other corporate control transactions. The *existence* of authority does not necessarily imply either *exclusivity* of that authority or that the authority is *ultimate* and cannot be limited or countermanded.

Accepting, then, the board's presumptive initial authority to address potential corporate control transactions, for example, by adoption of a shareholder rights plan, can that authority be limited by the shareholders through a shareholder rights bylaw? Is the board's initial authority also exclusive or do the shareholders have a voice on the matter as well? Further, whose authority is ultimate? The answers to these questions are crucial because "[t]he market for corporate control lies at the heart of the American system of corporate governance."[262]

These fundamental issues have more to do with policy and politics than with statutory interpretation. The policy issue relates to the determination of the relative roles of the board and the shareholders in relation to the market for corporate control. That is, there is an opportunity here for Delaware and other states that have to address these issues to reach a reasonable accommodation or balance of the competing interests. A court could realign these roles so that, while the board has presumptive initial authority to address takeover issues and, for example, to adopt a poison pill, that authority is neither exclusive nor ultimate. Rather, the shareholders, either before or after adoption by the board of a defensive mechanism, such as a poison pill, can limit board authority or discretion. Additionally, from this perspective, if the board and the shareholders reach differing conclusions on the same issue as it relates to the market for corporate control, the view of the shareholders should ultimately prevail. Under this analysis, while board-adopted poison pills would continue to be valid, appropriately adopted shareholder rights plan bylaws would also be valid and could modify or terminate board-adopted structural defensive mechanisms, such as a poison pill.

At least one prominent Delaware case supports this conclusion. In *Frantz Manufacturing Co. v. EAC Industries*,[263] EAC sought control of Frantz and purchased approximately fifty-one percent of the stock of Frantz from various parties.[264] EAC then tendered shareholder consents to Frantz which made changes in the *bylaws* and required, *inter alia*, (1) that all directors to be present for a quorum; (2) unanimous vote of directors for any board action; and (3) stockholder approval for indemnification of directors.[265] Frantz challenged these bylaw changes. In language that could be applied, with slight variation, to the current shareholder rights plan bylaw

262. Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 STAN. L. REV. 73, 101 (1992).
263. 501 A.2d 401 (Del. 1985).
264. *See id.* at 405.
265. *See id.*

dispute, the Delaware Supreme Court upheld these bylaw amendments:

The bylaw amendments were unique in that they required attendance of all directors for a quorum and unanimous approval of the board of directors before board action can be taken, *and they thereby limited the functioning of the Frantz board*. . . . In this case, however, the Court of Chancery found that *the restrictions placed on the Frantz board were intended to limit the Frantz board's anti-takeover maneuvering* after EAC had gained control of the corporation. We agree with the Court of Chancery that the EAC bylaw amendments were a permissible part of EAC's attempt to avoid its disenfranchisement as a majority shareholder and hold that the bylaw amendments should be given effect . . . .[266]

These issues, however, also have political, and economic, dimensions. The management of many publicly held companies have come to rely on the Delaware courts to regularly, though not without exception, reach a decidedly pro-management result on disputed corporate issues. The pro-management result here is invalidation of shareholder rights bylaws. While apparently, and historically this is the politically expedient result, such a conclusion could backfire for Delaware and other states so inclined. Arguably, if institutional shareholders have enough clout to adopt a shareholder rights bylaw, they may also have the ability, at least in some corporations, to adopt a proposal to reincorporate in a state, such as Oklahoma, willing to find a balance between board authority and shareholder mandates.[267] The net result could be a possible loss of status, and revenues, for states insensitive to achieving a balance on these crucial corporate governance issues.

VII. CONCLUSION

Much has changed in the fifteen years since the first adoption of a shareholder rights plan. At the time of its introduction, the poison pill operated as a show stopper, giving the target company board of directors plenary authority to determine which takeover proposal, if any, to accept. Since then, however, the ownership profile for publicly-held corporations has become increasingly concentrated in the hands of institutional shareholders. These shareholders typically view the primary antitakeover mechanism, the shareholder rights plan, or poison pill, with anathema, and have sought to remove it or limit its applicability. The most recent means for accomplishing these restrictions comes in the form of shareholder rights plan bylaws.

While appearing to be presumptively a matter of statutory interpretation, the validity of these proposed rights plan bylaws implicates more fundamental issues of corporate governance, as well as the policy and politics

266. *Id.* at 407.

267. This is not a favored option for a variety of reasons. First, reincorporation implicates more than simply the particular defensive mechanism involved and therefore complicates the issue even more than the current situation, which requires shareholders to remove the board in order to achieve poison pill redemption. Second, given the complexity of the issue, it is unlikely that even institutional shareholders will have the time and energy to focus on the matter to the extent necessary to present the proposal adequately to the shareholders.

of court resolution of corporate law issues. The shareholder rights plan bylaw dispute provides state courts with a convenient opportunity to clarify and define the relative roles of the board of directors and the shareholders in corporate issues as they relate to the market for corporate control. As suggested in this Article, one reasonable balance of these roles is to allow the board authority and discretion initially to adopt antitakeover measures, but concurrently to recognize the ultimate authority of the shareholders to limit or preempt that authority.

In any event, the stage is set for another round of state-by-state experimentation with respect to important issues of corporate law and governance. With fifty states as experimental corporate governance labs, not only will a variety of resolutions result, but an array of corporate governance options will be presented to companies and their shareholders. Especially where, as here, the issue is one where there is a reasonable basis to provide alternative corporate governance formulations, structures and results, this state-by-state resolution may in fact be the best means to provide the participants with a smorgasbord of corporate law and governance options.