Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm

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FOREWORD: A METAPHOR

The emerging concern for corporate democracy, shareholder governance and the current corporate environment requires a metaphor. Chantal Delsol, a philosopher from France provides an eye-catching viewpoint. We breathe in an epoch in which Delsol suggests, "[d]emocracy has become the sacred tabernacle of our time, and discourse that accompanies its theology. The democratic system tolerates no criticism. It carries in its wake the danger of intellectual subjection, watchful and sure of its legitimacy. It knows no adversaries, only enemies."[1] It is also equally clear that concern for authority requires perspective. The desire to eliminate hierarchical authority can be tied to Nineteenth Century currents demanding that authority in its chain-of-command sense be neutralized, with this neutralization leading, inevitably, to a society of equals in which the distinctions between the governors and the governed disappear.[2] The elevation of democracy and the evisceration of hierarchy represent "the concrete manifestation of everything we believe in, that is, the liberty and well-being of the individual."[3] Nevertheless, "we have not [yet] found a better or more efficient way to embody our humanism, which is based on individual autonomy."[4] Chantal Delsol's insights provide a luminous metaphor for the ascendant movement that views shareholders as sacred governors and directors as less than equal wardens of corporate decision-making.

I. INTRODUCTION: SHAREHOLDER VOTING RIGHTS AND THE RISING TIDE FAVORING GOVERNANCE REFORM

Against this background, board adoption of bylaw provisions, corporate coordination designed to stack the board of directors or stagger their terms possibly in combination with other takeover defenses or otherwise to abbreviate or interfere with shareholder voting rights,[5]

1. CHANTAL DELSOL, ICARUS FALLEN: THE SEARCH FOR MEANING IN AN UNCERTAIN WORLD 93 (Robin Dick trans., 2003).

2. *Id.* at 20–21.

3. *Id.* at 93.

4. *Id.*

5. One particularly effective possibility of "other takeover defenses" is the adoption of a poison pill coupled with a staggered board, which effectively provides the board with veto power. *See* Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L.

have become a disputed feature of corporate law.[6] On one account, the shareholders' franchise is a tool of discipline that acts as a reliable plinth "that legitimates the exercise of power [by corporate agents] over vast aggregations of property that they do not own."[7] In conjunction with this perspective, the customary conception of the business judgment rule coupled with judicial deference to board decisions appears inapt when directors—as putative agents—impair governance by shareholders, as presumed principals.[8] Consistent with this acquiescence to "corporate democracy,"[9] interference with the franchise constitutes a possible breach of the board's fiduciary duties as well as a basis for exacting scrutiny.[10] Another view suggests that the shareholder vote is merely an unimportant formalism that acts as a vestige or ritual of little practical importance,[11] complimented by the notion that accountability can best function in the hands of the board of directors "as a separate institution independent from and superior to the

REV. 973, 976–77 (2002) [hereinafter Bebchuk, *The Case Against Board Veto*] (arguing that boards should not have veto power in takeover bids); Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search For Hidden Value*, 96 NW. U. L. REV. 521, 561 (2002) (stating that "[n]either the finance literature nor the norms of corporate law support vesting such unbalanced power in the hands of the board"); John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, *passim* (2000) (applying John Coates's observation that poison pill efficacy depends heavily on the surrounding takeover defenses of the corporation). *But see* William J. Carney & Leonard A. Silverstein, *The Illusory Protections of the Poison Pill*, 79 NOTRE DAME L. REV. 179, 181 (2003) (stating a "poison pill is only as good as the dilution of a bidder that it provides."). *See generally* Lucian Arye Bebchuk et al., *The Powerful Antitakover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 887–951 (2002) [hereinafter Bebchuk et al., *The Powerful Antitakover Force of Staggered Boards*] (discussing the strength of staggered boards prevalent in the majority of public companies in order to combat takeovers).

6. *See, e.g.*, Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651, 652–70 (Del. Ch. 1988) (discussing whether a board acts consistently with its fiduciary duty when the board prevents or impedes shareholders from expanding the board and electing new members); s*ee also* Chesapeake Corp. v. Shore, 771 A.2d 293, 297 (Del. Ch. 2000) (explaining how the defendant, the target firm, failed to meet its burden to sustain the Supermajority Bylaw under the standards of review in *Unocal* or *Blasius*, and therefore, the Supermajority Bylaw was a preclusive, unjustified impairment of defendant's stockholders' right to influence their company's policies through the ballot box).

7. *Blasius*, 564 A.2d at 659.

8. *Id.* at 659–60.

9. *See, e.g.*, *Chesapeake*, 771 A.2d at 321 (discussing the shareholder franchise and attempts to thwart corporate democracy).

10. *See, e.g.*, *Blasius*, 564 A.2d at 663 ("Even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."); Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *1, 23–31 (Del. Ch. Dec. 4, 2000) (discussing whether the applicable standard for analyzing the claims should be judged under the *Blasius* standard or the Business Judgment Rule).

11. *Blasius*, 564 A.2d at 659.

firm's managers."[12] This is particularly true where outside and actually independent directors receive all relevant information provided by independent advisors.[13]

As an elementary matter, boards can arguably retain power pursuant to a Madisonian conception of corporate governance that allows contracting parties to agree in advance via the corporate charter to allow the board to entrench itself.[14] Indeed, it is intelligible on theoretical and empirical grounds that shareholders might reasonably opt for board entrenchment—implemented, for example, by means of a staggered board—to enable a board to employ selling strategies more effectively and thus to allow shareholders to earn a higher premium when the firm is sold.[15] According to professors Kahan and Rock, "[s]uch a decision is a kind of precommitment whereby shareholders, by binding themselves ex ante, may be able to improve their collective position ex post."[16] Despite the persuasive appeal of this contractarian approach, many doubts color the ongoing debate about whether boards should retain the power to block unsolicited acquisition offers or whether corporate action should principally reflect shareholder preferences regarding hostile bids.[17] Consistent with one perspective, most states "have control share acquisition statutes that make it practically necessary for a bidder to win a vote in order to gain control."[18] Another

12. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 738 (2002) [hereinafter BAINBRIDGE, CORPORATION LAW AND ECONOMICS].

13. *Id.*

14. Marcel Kahan & Edward B. Rock, *Precommitment and Managerial Incentives: Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 U. PA. L. REV. 473, 474–90 (2003); *see also*, HENRY N. BUTLER, ECONOMIC ANALYSIS FOR LAWYERS 785 (1998) ("Most corporation laws are enabling statutes in the sense that they reflect the philosophy of freedom of contract which has guided corporation law since the first truly modern general incorporation laws were passed in the late nineteenth century.").

15. Kahan & Rock, *supra* note 14, at 522.

16. *Id.*

17. Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 974–76. *See also* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 224 (1991) (proposing that delegation of control of the corporation be given to managers to allow them to make necessary long-term decisions).

18. Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 976. Consistent with this approach:

> [I]n most states, boards may install and maintain poison pills that prevent an acquisition. The power to maintain pills implies that a hostile bidder would be able to gain control over incumbents' objections only if the bidder first won a ballot box victory to replace the incumbents with directors that would redeem the pill.

Id. *See also* Stephen P. Dunn, *"Director Primacy": Why it May not Matter That Anti-takeover Legislation Harms Shareholders and How Delaware Courts Have Gotten it Wrong* (on file with the author) (concentrating on Michigan's control acquisition statute and arguing that *Blasius* was incorrectly decided).

position, consistently with the deduction that "[c]ompanies like many other complex assets, are almost always sold by negotiation," contends that the "hostile tender offer . . . has never been a major mode for control transaction." Thus, "rational shareholders, aware of the full range of agency costs, might commit to have their company sold through a negotiated process controlled by the board."[19] This approach leads to increased shareholder premiums.[20]

Flanked by "profound ambiguity toward the role of shareholders"[21] and a blizzard of scholarly rethinking about corporate governance,[22] the vital query, is, ultimately: "[w]ho decides? This question lies at the heart of corporate takeover jurisprudence."[23]

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19. Kahan & Rock, *supra* note 14, at 474. Evidently,

> [m]ost of the commentary on hostile takeover falls in one of two broad schools of thought. The Hamiltonian "board veto" school holds that shareholders are not well-equipped to make the decisions involved in the sale of the company and should thus leave these decisions to the board . . . . The Jacksonian "shareholder choice" school holds that boards are self-interested in responding to hostile bids and that shareholders should independently determine whether to accept or reject an offer . . . [yet, paradoxically] [w]hen shareholders consent to rules that enshrine board power, they call for legal intervention to set these rules aside.

Id. at 474–75.

20. *Id.* at 522.

21. Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: A "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 261 (2001).

22. *See, e.g.*, William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) (noting that legal academics view corporations as a web of ongoing contracts and thus as contractual governance structures); Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 3–34 (2002) [hereinafter Bainbridge, *The Board of Directors as Nexus of Contracts*] (discussing how the chief criteria for any model of the corporation should be the model's ability to predict formal governance structures); Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1, 1–4 (2004) (detailing the prevalent debates among scholars which has raged due to hostile tender offers that took place in the 1980s); John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 271–72, 279–302 (2004) (explaining that "the fundamental developments that destabilized our contemporary corporate governance system were those that changed the incentives confronting both senior executives and the corporation's outside gatekeepers"); Roberta S. Karmel, *Should a Duty to the Corporation be Imposed on Institutional Shareholder?*, Brooklyn Law Sch. Pub. Law and Legal Theory Working Paper Series, Research Paper No. 11, 1, 24–30 (May 2004), *available at* http://ssrn.com/abstract=546642 (discussing the contractarian theory, team production theory and director primacy approach which harkens back to managerialism); C. K. Prahalad, *Corporate Governance Or Corporate Value Added?: Rethinking the Primacy of Shareholder Value*, 6 J. APPLIED CORP. FIN. 40, 45–50 (1993) (suggesting a value-added conception of corporate governance that rejects the archaic notion prevelent in the finance literature that the primary market dicipline comes from the capital market); Thompson & Smith, *supra* note 21, at 261 (discussing the need to find a sacred space for shareholder self-help, free of directorial or judicial intrusion).

23. Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 792 (2002) [hereinafter Bainbridge, *Director Primacy in*

Surrounding this question are two interconnected issues: authority and accountability. Kenneth Arrow contends that "[accountability machinery] must be capable of correcting errors but should not be such as to destroy the genuine values of authority."[24] It is probable that we cannot increase director accountability to shareholders, courts and regulatory bodies without undermining their discretionary authority no matter what drives our underlying theory of the firm.[25] Therefore, establishing the proper mix of discretion and accountability emerges as the central corporate governance question.[26] Apparently, in the context of the ongoing corporate governance reform debates, "the idea that shareholders should be given more power and control rights relative to directors and management is based on the premise that the principal-agent problem is the most important governance problem to be addressed in contemporary corporations."[27] Indeed, "[t]his premise has been widely accepted by corporate legal scholars and is often assumed, almost without discussion, in the debate about takeover policy."[28]

Although board veto power might represent a serious impediment to efficient corporate governance or, on the contrary, be necessary for

Corporate Takeovers]. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (noting that takeovers raise the "issues of the [proper] allocation of authority as between the board and shareholders"). For at least one answer to this question, see Bebchuk et al., *The Powerful Antitakover Force of Staggered Boards*, *supra* note 5, at 890 ("[S]taggered boards make it extremely difficult for a hostile bidder to gain control over the incumbents' objections.") Bainbridge proposes an answer to the question that depends on context:

> In statutory acquisitions, such as mergers or asset sales, the answer is clear, the target corporation's board of directors decides. If the board rejects a proposed merger or asset sale, the shareholders are neither invited to nor entitled to, pass on the merits of that decision. Only if the target's board of directors approves the transaction are the shareholders invited to ratify that decision. In nonstatutory acquisitions, such as tender offers, the answer is more complicated. A bidder makes a tender offer directly to the shareholders of the target corporation, thereby bypassing the board of directors. . . . [T]arget boards responded by developing defensive tactics designed to impede such offers.

Bainbridge, *Director Primacy in Corporate Takeovers*, *supra*, at 792.

24. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 78 (1974); *see also* Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 464 (1992) (noting that the values of authority and accountability are antithetical).

25. For a discussion of various theories of the firm, see Nicolai J. Foss et al., *The Theory of the Firm*, *in* ENCYCLOPEDIA OF LAW & ECONOMICS 631–53 (1999), *available at* http://encylo.findlaw.com/5610book.pdf.

26. Bainbridge, *Director Primacy in Corporate Takeover*, *supra* note 23, at 807.

27. Blair, *supra* note 22, at 30; *see, e.g.*, Lucian A. Bebchuk, Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1041–43 (1982) [hereinafter Bebchuk, *The Case for Facilitating Competing Tender Offers*] (noting that negotiated acquisitions are affected by management's abuse of its role as a bargaining agent for shareholders).

28. Blair, *supra* note 22, at 30–31.

effective corporate synchronization,[29] this debate takes place—most notably—during anxious economic times. One such example is the decline of the stock market during the early part of this decade in response to an informed understanding of illusory revenue growth (premature revenue recognition)[30] and imaginary profits, that have, at times, been employed to finance hostile or friendly takeovers and that had previously fueled speculative share-price valuations. In addition, these developments have enriched speculators and gatekeepers who control and largely benefit from the flow of information and misinformation.[31] Together, this inescapably leads to increasing disparities in wealth and income distribution. Given this backdrop it is likely that "the corporate scandals of the last few years have raised serious questions about the quality and effectiveness of the governance of U.S. corporations."[32] While "[t]he transactions and corporate behavior that led to the demise of Enron, WorldCom, and others were festering like an undetected carcinoma[,] [a]t the same time, in other venues, there was a strong movement toward best practices in corporate governance."[33] Because the speculative and explosive growth in observable market capitalization that characterized the 1990's[34] has become burdened by the *frisson* supplied by an epidemic of corporate accounting scandals, myriad financial irregularities and rampant rogue managers,[35] accountability and consideration of the proper locus of control have taken center stage.[36]

Furthermore, misconduct, aided and abetted by negligent and

29. Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 974–75. Corporate synchronization apparently refers to the optimal deployment of assets aimed at enhancing long-run profitability. *Id*.

30. Coffee, *supra* note 22, at 277. "During the 1990s, however, the nature of earnings management changed, with managers shifting their focus from moderating earnings swings to advancing the moment of revenue recognition. Accounting sandals rose commensurate with this shift toward premature recognition." *Id.* at 276–77.

31. Gil Staffend has suggested this observation. The meaning of the term "gatekeeper" is not necessarily self-evident. On one account, the "term refers to intermediaries who provide verification and certification services to investors." Coffee, *supra* note 22, at 279.

32. Blair, *supra* note 22, at 2.

33. E. Norman Veasey, *Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics, and Federalism*, 152 U. PA. L. REV. 1007, 1008 (2003) [hereinafter Veasey, *Dynamics of Corporate Governance*].

34. *See, e.g.*, *id.* at 1008 ("In the 1990s, while the economy and securities markets were on the ascendancy, there was a huge paradox developing.").

35. Coffee, *supra* note 22, at 270.

36. Jeffrey R. Boles, Book Note, *Corporate Reform: The Locus of Control*, 1 BERKLEY BUS. L.J. 175, 175–78 (2004) (reviewing CORPORATE AFTERSHOCK: THE PUBLIC POLICY LESSONS FROM THE COLLAPSE OF ENRON AND OTHER MAJOR CORPORATIONS (Christopher L. Culp & William A. Niskanen eds., 2003)).

inattentive boards of directors,[37] may have breached a once-confident system of governance.[38] It is possible that misaligned incentives coupled with conglomerate mergers aimed at self-interested ends have mitigated the impact of the business cycle, generated greater cash income for managers, and reduced the risk of corporate control contests as well as the likelihood of shareholder activism.[39] Taken together, these events—on one account—diminish shareholder monitoring[40] while highlighting deficiencies in corporate coordination designed to ensure the proper discipline of corporate agents. These corporate governance deficiencies correlate directly, (if only partially), to the "takeover movement and the growing use of equity compensation."[41] A related viewpoint contends that the "most reliable evidence, when properly read, suggests that Enron and related scandals were neither unique nor idiosyncratic."[42] These scandals are traceable to "pervasive problems . . . that undercut existing systems of corporate governance."[43] On the other hand, if one regards "legal separateness as the singular accomplishment of corporate law"[44] and if one is drawn to the plausible conclusion that an important feature of the corporate form is that it helps to solve the 'team production' problem through the delegation to

37. *See, e.g.*, Coffee, *supra* note 22, at 270 (discussing who is to blame for contemporary scandals).

38. *Id.* at 272.

39. *Id.* at 272–73.

40. Evidently, according to one commentator, shareholder activism and monitoring may or may not have the potential to constrain agency costs within the firm. "Acknowledging the rational apathy phenomenon would largely preclude small individual shareholders from playing an active role in corporate governance . . . scholars focused their attention on institutional investors . . . [whose] greater access to firm information, coupled with their concentrated voting power, will enable them to more actively monitor the firm's performance . . . ." BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 514–15 (giving examples of sources in which academics argued that shareholder activism could become an important constraint on agency costs). For a perspective on the benefits of shareholder activism, see MARK J. ROE, STRONG MANGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994) (stating that even if the United States modeled its system of corporate governance on that of Germany or Japan, it would still not succeed, as there will always be problems until stockholders have more power). For a more skeptical analysis, see BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 514 n.6, and Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y 671 (1995) [hereinafter Bainbridge, *The Politics of Corporate Governance*] (discussing the various ways that shareholders have for constraining managers which include shareholder derivative suits, mandatory disclosure, and anti-fraud laws).

41. Coffee, *supra* note 22, at 275 (noting that other factors that have contributed to the destabilization in corporate governance include institutional investors and Congress).

42. *Id.* at 270.

43. *Id.*

44. Blair, *supra* note 22, at 13.

the board of directors of control rights,[45] then efforts aimed at strengthening shareholder power either driven by the impudence of scandal or the exigencies of a takeover contest may undermine one particular advantage of the corporate form: "the corporate form of organization, more than any other form facilitates the locking-in of invested capital for an extended—even indefinite—period of time.'"[46]

Governance often signifies accountability and discipline, but, "[l]ike much of life, corporate governance is about control."[47] Conflation becomes a real and distinct possibility for these interconnected, yet separable, concepts. Additionally and correlatively, "the principal-agent approach . . . often conflates the roles of directors and managers."[48] Initiatives that might increase accountability and protect the right of shareholders to exercise ultimate control of the corporate enterprise[49] compliment the recent scandals. Like some schemes within the takeover arena, these proposals are unlikely to acknowledge any role for boards of directors in addressing actual principal-agent problems by "monitoring managers to be sure that they are not self-dealing, and that their actions are directed toward long-run wealth creation by the corporation rather than get-rich-quick schemes by management itself."[50] Since accountability (including shareholder voting rights)[51] alone provides an inadequate normative account of corporate law, accountability intensification strategies may stubbornly deflect attention from "[a] fully specified account of corporate law . . . [which] must incorporate the value of authority,"[52] even if authority remains a very fragile concept from a formal point of view.[53] A more fully specified account suggests that shareholders lack authority, and, except under very limited circumstances, they should. Nevertheless, the hint of scandal coupled with various efforts designed to weaken takeover

45. *Id.* (defining the team production problem as when participants attempt to exercise too much control through delegation).

46. *Id.* at 27.

47. Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103, 103 (2003) [hereinafter Paredes, *The Firm and the Nature of Control*].

48. Blair, *supra* note 22, at 42.

49. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41 (2001) (suggesting that a growing consensus supports the view that shareholders should exercise ultimate control over the corporation).

50. Blair, *supra* note 22, at 42.

51. *See, e.g.*, Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 805 (explaining as thus understood, shareholder voting rights are not necessarily part of the firm's decision-making system but possibly one of many accountability tools).

52. Bainbridge, *The Board of Directors as Nexus of Contracts*, *supra* note 22, at 7.

53. Thomas Marschak, *Organization Theory*, *in* THE NEW PALGRAVE: ALLOCATION, INFORMATION AND MARKETS 223, 229 (John Eatwell et al. eds., 1989).

protection[54] or alternatively to enhance shareholders' exit options, thus providing more direct control over corporate assets,[55] destabilizes this conclusion by implying that corporate law should vest authority among shareholders or with the courts.

One account suggests that takeovers exist at the intersection of board and shareholder control.[56] The meaning of that claim is currently unclear but if true, suggests that judicial intervention is necessary to police this contestable space largely reserved for the residual claimants—the shareholders.[57] However, a dominant, if easily challenged argument *against* judicial intervention and enhanced judicial scrutiny (designed to protect shareholders) during a control contest is that since boards have power over *other* corporate decisions and since this "arrangement is commonly viewed as working well," the vindication of board power in a takeover context is expected to be beneficial as well.[58] The persistence of scandal gravely wounds this claim by implying that the reverse may be true despite some resistance by courts aimed at allowing takeover jurisprudence to expand into other areas of governance and thus undermine all statutory directorial prerogatives.[59]

A number of courts, perhaps goaded by the pungency of current scandals,[60] corrective federal statutory initiatives,[61] or as part of their pre-existing adherence to judicial supervision of corporate governance

54. For a catalog of such efforts that cite proposals requiring corporate manager to remain passive in the face of a takeover bid, and precluding directors from frustrating takeover bids, see Blair, *supra* note 22, at 33–36.

55. For a catalog of such efforts that cite proposals that would among other things give shareholders the power to initiate mergers or dissolution, see Blair *supra* note 22, at 36–38.

56. Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 131.

57. *See id.* at 122 ("Agreeing with Thompson and Smith's model and its normative push to expand shareholder choice in the takeover context.").

58. *See* Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 977–78 (dismissing this justification).

59. E. Norman Veasey, *D. Block, N. Barton and S. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, 15 DEL. J. CORP. L. 573, 577 (1990) (book review) [hereinafter Veasey, *The Business Judgment Rule*].

60. *See* Kurt M. Heyman & Christal Lint, *Recent Developments in Corporate Law: Recent Supreme Court Reversals and the Role of Equity in Corporate Jurisprudence*, 6 DEL. L. REV. 451 (2003) ("These reversals have already been the subject of considerable commentary, and some commentators have proclaimed them to be harbingers of a new 'post-Enron era' in which Delaware courts will scrutinize the action of corporate directors more closely.").

61. *See, e.g.*, Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 917 (2003) (arguing that "[p]ressured by a parade of accounting and corporate governance scandals from Enron Corp. to WorldCom Inc. . . . Congress possessed that rare political and institutional capacity to address deep causes and systemic dysfunction. Congress used this episodic power opportunity to pass the Sarbanes-Oxley Act of 2002").

that ratifies shareholder primacy, are now circumspectly analyzing any alleged interference with shareholders' putative rights to acquiesce in or control certain challenged conduct.[62] This is irrespective of whether scandal or board inattention has been broached directly or is grounded in the suspicion that boards are largely animated by their own self-interest.[63] Enhanced scrutiny by the judiciary originates, at least partially, in the claim that shareholders are principals and that boards act as agents.[64] This theory is animated, in part, by the assertion that the shareholder franchise supplies the ideological underpinning upon which the legitimacy of directorial power rests[65] and is propelled by the conclusion that agency costs can be minimized by both shareholder governance and judicial suspicions designed to ferret out structural[66] or

62. *See, e.g.*, *In re* The MONY Group, Inc. S'holder Litig., 853 A.2d 661, 674 (Del. 2004) ("[I]n the context of the election of directors, conduct . . . 'designed principally to interfere with the effectiveness of a [shareholder] vote,' even if that action is taken in good faith, honestly, and competently, is not action that may 'be left to the [board's] business judgment.'" (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 (Del. Ch. 1988))); MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 112–22 (Del. 2003) (discussing whether the director defendants manipulated the size and composition of the Liquid Audio board during a contested election primarily to interfere with MM's ability to gain new directorships).

63. *Liquid Audio*, 813 A.2d at 1127–28.

64. *See, e.g.*, *Liquid Audio*, 813 A.2d at 1128 (noting "[a]ction designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal.").

65. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 654 (Del. Ch. 1988). *But see* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547–49 (2003) [hereinafter Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*] (describing different classifications of the firm and their insights into internal governance systems); Lynn A. Stout, *Investors' Choices: The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 669 (2003) [hereinafter Stout, *Investors Choices*] (stating that "[t]he end result is a system of public corporate governance that has been aptly described as 'director primacy' instead of 'shareholder primacy'"); Lynn A. Stout, *Do Antitakeover Defenses Decrease Shareholder Wealth? The Ex Post/Ex Ante Valuation Problem*, 55 STAN. L. REV. 845, 847–50 (2002) [hereinafter Stout, *Do Antitakeover Defenses Decrease Shareholder Wealth?*] (arguing that a successful corporation is built on more than shareholders alone—modern corporate production is a form of team production). Another alternative corporate governance model consists of the social responsibility approach. For a perspective on claims that the corporate social responsibility model which implies that "directors and mangers of large, publicly held corporations should have a legal duty . . . to take into account not only the needs of the shareholders but also other groups affected by the corporations' actions, such as its employees, customers, or the communities in which they are based," see C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 U. KAN. L. REV. 77, 78, 80–81 (2002). Wells suggests that corporate responsibility is about four things: (1) big business; (2) reform of corporate power, not its elimination; (3) challenging the notion of shareholder primacy; and (4) an unchanging solution to ever-new problems. *Id.* at 80–81.

66. For an examination of this possibility in a derivative suit context see, James D. Cox &

actual bias on the part of either the board or with respect to the officers whom the board selects. These various animating forces may potentially serve as part of a contemporary effort to restructure the business judgment rule. Following along a divergent, but unsystematically related path, much critical corporate law commentary reflects an attachment to the precatory promise of "new" approaches to corporate social responsibility. This has created a struggle to link progressive corporate law with progressive social movements.[67] Such

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Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 84–87 (1985) (stating that directors edit the decision choices posed by a derivative suit in a manner which precludes consideration of the suit's favorable effects); Harry G. Hutchison, *Presumptive Business Judgment, Substantive Good Faith, Litigation Control: Vindicating the Socioeconomic Meaning of* Harhen v. Brown, 26 J. CORP. L. 285, 341 (2000) ("Social-psychological mechanisms may generate bias in directors' assessment of the shareholder's derivative action."). The social-psychological mechanisms that may generate bias in directors' assessments include:

> (1) 'the independent directors' prior associations with the defendants, and their common cultural and social heritages; (2) 'biases established by appointment of members to the board or special litigation committee;' and (3) 'control of pecuniary or non-pecuniary rewards made available to the independent directors by the defendant members of the board of directors.

Hutchison, *Presumptive Business Judgment, supra,* at 341 (citations omitted). Such an approach is not necessarily or always incompatible with director primacy but may broaden the circumstances for non-deferential judicial review (where the court refused to deploy the business judgment rule) by broadening the conception of conflict of interest to include structural as well as actual bias. It seems likely that the business judgment rule has no, or at most limited application where the board of directors is disabled by a strong conflict of interest because in such cases concern for director accountability trumps protection of the board's discretionary authority. This seems true whether one is committed to shareholder or director primacy. *See, e.g.*, Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 603–04 (noting how the business judgment rule prevents a shift in the locus of decision-making authority from directors to the judiciary). While I retain some enthusiasm for the consideration of agency costs within the context of derivative litigation, I am now persuaded that it is nonetheless possible that a concern for agency costs carries with it the assumption that the firm is a thing that is capable of being owned and with it a presumption that the putative owners (shareholders) are entitled to manage their firm by overriding, when they deem it necessary, the decisions taken by their presumed agents. Bainbridge suggests this view is possibly in error on several grounds. Not least because:

> Agency costs analysis . . . applies only imperfectly to the modern public corporation. To be clear, the claim is not that agency cost models are irrelevant to understanding the public corporation. Rather, the claim is only that such models are incomplete. Agency costs are the inevitable consequence of vesting discretion in someone other than the residual claimant. Corporate law could eliminate agency costs by eliminating discretion. In light of the law's failure to do so, it seems reasonable to assume that accountability is not the only norm valued in corporate law. The director primacy theory in fact explains that corporate law values both authority and accountability.

Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance, supra* note 65, at 568.

67. Kellye Y. Testy, *Linking Progressive Corporate Law with Progressive Social Movements*, 76 TUL. L. REV. 1227, 1228–52 (2002).

efforts are self-assuredly viewed as a counterweight to corporate officers and directors who have "lived in a ceaseless anxiety that drove them to expand their empires ruthlessly [while] ordinary citizens lived in ceaseless fear of being fired . . . ."[68] Ceaseless anxiety, *a fortiori*, impels corporations to disregard the needs and concerns of both shareholder and non-shareholder stakeholders. If this largely imitative claim is correct,[69] it may apply within and outside of the takeover arena, and serves as a basis for restricting the power of directors by enhancing the power and control of shareholders and the potential and actual power of outside regulators and judges. If accepted, these various contentions undermine the conclusion that the corporate form properly "places control rights over the assets of the firm in the hands of a board of directors."[70] These various contentions may stem from a concern for agency costs.

While agency costs can pose difficulties, and the "corporate scandals of the last few years have made it clear that agency problems in corporations can be severe,"[71] it remains doubtful that all governance reform proposals would necessarily have prevented "the frauds that happened at Enron or WorldCom, or the insider dealing at Tyco, or even the errors in business judgment that might have been behind Time Warner's merger with AOL."[72] Nonetheless, whatever the merits of these proposals, counter-proposals, claims, and counter-claims, it is probable that these developments underline the inapplicability of the standard economic approach to principal-agent relationships in a corporate setting. The standard approach is "based on the assumption that what action the 'principal' wished his agent to perform was perfectly known, and the action could be perfectly and costlessly

68. Ellen Byers, *Corporations, Contracts and the Misguiding Contradictions of Conservatism*, 34 SETON HALL L. REV. 921, 921 (2004) (advocating against deregulation of industry and noting regulation allows industry to better advance the public interest).

69. *See, e.g.*, JACQUES ELLUL, THE TECHNOLOGICAL SOCIETY 154 (John Wilkinson trans., 1964) (stating that the concentration of enterprise arises because of a necessary concentration of capital which on the whole leads to evil human and social effects and workers are scarcely in a position to act in a distinctively human way). Progressive alternatives in the form of government regulation are unlikely to eliminate such evil. Given the need to accumulate capital the only real alternatives to an economy of corporations are a state economy or a heavily regulated statist economy—both of which are just as likely to inflict evil. *See, e.g.*, *id.* at 154–55 (contending that an economy based on individual enterprises is untenable in the absence of technical regression that leads inevitably to a society comprised of either large corporations or to a state economy. The human and social effects of this concentration are largely evil).

70. Blair, *supra* note 22, at 27.

71. *Id.* at 39.

72. *Id.*

monitored."[73] Neither assumption seems credible in a world in which shareholders are purportedly—but not necessarily—principals, while directors act hypothetically—but not always necessarily—as their agents.[74] My intuition is not that directors fail to act on behalf of shareholders when and if fiduciary duty principles require. They do and corporate law so requires such obedience. What is in dispute is whether directors act or should act under the *control* of, or subject to the *control* of the shareholders. This issue comes into focus when the board responds to hostile takeover attempts by acting to either impair shareholder voting or shareholder power while purportedly defending corporate policy.

In addition to legitimacy, discipline, and formalism, shareholder voting highlights issues of control.[75] Reification of the shareholder franchise as having "independent normative significance,"[76] provides an opportunity to conflate the necessity of accountability with the indispensable verve of authority over long-lived assets.[77] Sparked largely by this debate and recent case law, I draw a distinction between accountability concerns and authority requirements coupled with a consideration of the proper locus of both as a vehicle to further examine this issue. Furthermore, disparate conceptions of the business judgment rule serve as a vehicle to clarify this debate.

Part II first examines (A) the emerging case for restricting the discretion of directors grounded in shareholder or judicially-based accountability concerns, which may imply shareholder control—either within or outside of the takeover context;[78] (B) alternative models of corporate governance;[79] and (C) the inauguration of the courts' focus on

73. Joseph E. Stiglitz, *Principal and Agent*, *in* THE NEW PALGRAVE: ALLOCATION, INFORMATION AND MARKETS 966–67 (John Eatwell et al. eds., 1989).

74. To be sure, if the directors borrow, issue stock and otherwise raise capital this may give rise to some version of principal-agent grounded in the notion that a credit relationship exists because "[s]o long as there is some probability of default, which can be affected by the actions of the borrower [director/incorporator] there is a *moral hazard* or *principal-agent* problem (provided that that action cannot be perfectly monitored by the lender)." *Id*. at 967. For a discussion of separation of ownership and control as the starting point for the principal-agent model of the firm, see Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 109–12.

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

76. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 727.

77. The meaning of long-lived assets may not be immediately apparent. *See, e.g.*, Blair *supra* note 22, at 26–32 (noting that as understood, here, the reference is the necessity of locking in capital for relatively long periods of time necessary for maximizing productivity and wealth creation).

78. *See infra* Part II (showing how a lack of boardroom restraint can lead to corporate takeover attempts).

79. *See infra* Part II.A (explaining the shareholder primacy, managerial primacy, director primacy and social responsibility models for corporate governance).

board infringement of the shareholder franchise as a basis for constraining board authority.[80] Part III examines the evolution of the *Unocal*, *Revlon*, and *Blasius* framework before inspecting more recent claims suggesting the necessity of intense judicial intervention when the board of directors infringe upon the shareholder franchise.[81] Treading through this gauntlet, it may be important to distinguish board action that is grounded in the corporate charter (i.e. charter amendments) and board action accomplished through bylaw amendments.[82]

The real question is whether *Blasius* adds anything in the context of a takeover battle even if recent dicta suggests that outside of a contest for control, *Blasius* supplies an *independent* standard of review[83] that constrains directorial discretion. Before *Blasius*, the Supreme Court of Delaware stated that when a derivative suit, for instance, was brought challenging the board's conduct in the midst of a takeover battle "it [was] the plaintiff's burden to allege with particularity that the improper motive in a given set of circumstances, i.e., perpetuation of self in office

80. *See infra* Part II.B (discussing the roles courts have played in developing boardroom activities).

81. *See infra* Part III (expounding upon *Unocal, Revlon*, and *Blasius*).

82. This is so because (A) "[w]hen directors unilaterally adopt bylaws in response to a control threat, the response will be subject to [*Unocal*] analysis . . . [and] possibly also a [*Blasius*] analysis" and (B) "[b]y contrast, when the board and the shareholders bilaterally adopt a defensive charter provision, neither *Unocal* nor *Blasius* scrutiny [seems to apply]." Kahan & Rock, *supra* note 14, at 499. Additionally, claims calculated to defend the franchise are often riveted by fears of insufficient accountability including those related to the fiduciary obligations of loyalty, good faith and care. Fretfulness about the shareholder franchise requires positioning along a continuum between accountability and authority as part of the interplay between *Blasius* and *Unocal*. It has been maintained that before *Blasius*:

> [T]here were two [related] 'intermediate' standards of review: *Unocal* and *Revlon. Blasius* and its progeny, building upon *Schnell v. Chris Craft Industries, Inc*., appeared to add a third, namely, that board action taken 'for the primary purpose of thwarting the exercise of a shareholder vote,' . . . will not be upheld unless the board can show a 'compelling justification' for its action."

William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 885–86 (2001) [hereinafter Allen et al., *Function Over Form*]; *see also* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (holding that the board may not use the corporate machinery for purposes of obstructing legitimate efforts of dissident stockholders to commence a proxy context against management); Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. Ch. 1985) ("However, where, as here, no shareholder is presently engaged in a proxy battle, and the alleged manipulation of corporate machinery does not directly prohibit proxy contests, such an action must be brought derivatively on behalf of the corporation").

83. *See, e.g.*, MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1130 (Del. 2003) (noting that "the same circumstances must be extant before the *Blasius* compelling justification enhanced standard of judicial review is required to sustain a board's action either independently, in the absence of a hostile contest for control or within the *Unocal* standard of review when the board's action is taken as a defensive measure").

or otherwise in control, was the sole or primary purpose of the wrongdoer's conduct."[84] By contrast, in *Blasius* (a non-derivative case), despite evidence demonstrating that the board acted in good faith consistent with its duty of care,[85] and without being selfishly motivated by a desire to retain power,[86] while concurrently being motivated to defend corporate policy,[87] the defendant board retained the burden but failed to show a compelling justification for its alleged interference with the shareholder franchise. Subsequent cases confirm that the *Blasius* framework presents its own difficulties, including the possibility that the language that cabins the *Blasius* standard may serve as a basis to demolish a reasoned conception of the business judgment rule that envisions directorial authority as the correct solution to the problem of creating, managing, and monitoring a public corporation.[88]

Thus, Part IV reconsiders the *Blasius* approach with an eye toward recent decisions and in light of a 2004 article authored by two chancellors and one former chancellor of the Delaware Court of Chancery.[89] As part of their reassessment of *Blasius*, the chancellors characterize the application of *Blasius* alongside *Unocal*[90] as functionally unhelpful and unnecessary.[91] This perspective suggests "that the relationship between *Blasius* and *Unocal/Unitrin* doctrines is a fruitful subject for some doctrinal pruning."[92] Although the case law indicates that the board can neither completely block shareholders from

84. Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984).

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

86. *Id.* at 658.

87. *See id.* at 657 (finding that the board was apparently motivated to avoid a severe drain on operating cash flow, the desire to service its long-term debt, and to maintain the value of Atlas' common stock).

88. *See, e.g.*, Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, 1, 26–27 (declining to apply deferential business judgment review or examine the decision to adjourn the annual meeting without closing the polls and instead used *Blasius* as a basis for the court's substitution of its own decision-making for that of the directors). *See also infra* Part III (discussing *State of Wisconsin v. Peerless*).

89. *See infra* Part IV (discussing *Liquid Audio* and other recent voting rights cases); *see also* Allen et al., *Function Over Form*, *supra* note 82, at 884–95 (suggesting that the problem with the *Blasius* standard of review of one of practicality, not principle because as later applied the *Blasius* doctrine evolved into a flexible standard that operates much like the *Unocal/Unitrin* standard with a strong emphasis on the protection of the shareholder franchise which leads to results that fail to differ substantially from *Unocal/Unitrin* review standing alone).

90. Raymond J. DiCamillo & Evan O. Williford, *Liquid Audio: A Reaffirmation of the Blasius Standard of Review* 1, 7 n.26 (2004), *available at* http://www.rlf.com/articles/rec_art_3-090454.pdf.

91. Allen et al., *Function Over Form*, *supra* note 82, at 884.

92. *Id.*

receiving tender offers,[93] nor halt all proxy contests,[94] the compelling justification criterion, recently revitalized by *MM Companies, Inc. v. Liquid Audio, Inc.*,[95] "raises questions pertaining to whether, and to what extent, Delaware courts will [also] apply the stringent *Blasius* standard of review where the actual ability to obtain control is not thwarted but where the challenged action merely dilutes the 'substantial presence' of an insurgent on that board."[96] One could argue that permitting the dilution of the influence of a potentially hostile bidder, congruent with the teaching of *Paramount Communications v. Time Inc.*,[97] is consistent with the assumption that directors should retain discretionary control of a hierarchy that comes in the corporate form. By contrast, *Liquid Audio* apparently "presents a paragon of when the compelling justification standard of *Blasius* must be applied within *Unocal's* requirement that any defensive measure be proportionate and reasonable in relation to the threat posed."[98] The case implicates two contrasting conceptions of corporate governance: (A) that the "power of managing the corporate enterprise is vested in the shareholders' duly elected board representatives";[99] and (B) that shareholders as principals are not simply captives of the business judgment of directors who purportedly act as their agents;[100] hence, authority remains firmly in the hands of stockholders. Additionally, this case involves another "'defining tension' in corporate governance today . . . 'the tension between deference to directors' decisions and the scope of judicial review.'"[101]

Part V applies director primacy analysis to criticize the courts and the predisposition of commentators to favor shareholder governance by exposing their opinions to the implications derived from the two principal alternative approaches to corporate governance—authority and accountability.[102] Favoring the authority model that inevitably promotes director primacy, I contend shareholder choice may have little

93. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 683.

94. *Id*. at 683 n.9.

95. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003).

96. DiCamillo & Williford, *supra* note 90, at 1.

97. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990) (applying *Unocal* where there was arguably no change in control despite the possibility that Paramount's rejected offer was superior).

98. *Liquid Audio*, 813 A.2d at 1131.

99. *Id.* at 1126.

100. *Id.* at 1128.

101. *Id.* at 1127.

102. *See infra* Part V (advocating an accountability/authority paradigm to shareholder voting rights in relation to corporate governance).

independent normative significance and that the appropriate, but necessarily limited, question is whether a board's decision foreclosing shareholder choice was based on proper or improper motives.[103] In other words, did the board exercise its prerogative in ways that suggest that the transaction was driven by management self-interest?[104] Or, on the other hand, was the board properly motivated in its justifiable exercise of fiat?

II. SHOULD DIRECTOR DISCRETION BE RESTRICTED FURTHER?

As an initial matter, the fiduciary duty of directors has evolved as a rather protean concept that can be broken down into at least three categories.[105] The first category involves claims that directors did not act with requisite care.[106] In Delaware, at least, such claims before the 1980's received little or no notice.[107] Instead, directors were presumed (with little chance of rebuttal) to have behaved as reasonable persons would.[108] Hence, "instances of apparent director negligence triggered an inquiry into whether a breach of the duty of loyalty had occurred, thereby rendering the duty of care essentially unenforceable as a stand-alone concept."[109] Nevertheless, in the case of *Smith v. Van Gorkom*,[110] "the duty of care emerged in Delaware as an independently enforceable obligation, and has become one of the three typical categories of cases with which courts applying fiduciary principles must deal."[111]

The second category of claims is Duty of Loyalty claims.[112] This category has the longest pedigree and addresses primarily (but not exclusively) situations involving self-dealing, wherein the duty of

103. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 727. *But see* Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 977–78 (noting that there are strong reasons to treat the takeover contest differently, because of the severity of the agency cost problems and lack of undistorted shareholder choice).

104. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 727.

105. Allen et al., *Function Over Form*, *supra* note 82, at 861–62.

106. *Id.* at 862.

107. *Id.*

108. *Id.* "Where courts encountered troubling instances of director action in cases where the directors had no apparent conflict of interest, the courts were inclined to ask loyalty-based questions, such as whether the action constituted a fraud or a 'constructive fraud' against the corporation or its minority shareholders." *Id.*

109. *Id.*

110. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (holding that the board of directors breached its fiduciary duty of care by approving the sale of the Company upon two hours consideration, without prior notice, without written documents and without the exigency of a crisis or emergency).

111. Allen et al., *Function Over Form*, *supra* note 82, at 862.

112. *Id.*

loyalty is rigorously enforced by requiring the directors to justify as intrinsically fair any transaction in which they had a financial interest.[113] Evidently, after 1985 and three keenly felt decisions,[114] a third category emerged in which "the directors have no direct pecuniary interest in the transaction but have an 'entrenchment' interest, i.e., an interest in protecting their existing control of the corporation."[115] It is argued that corporate law has always concerned itself with this issue but that "entrenchment cases were never rationalized under a coherent theory. Instead, they were adjudicated under a standard vaguely akin to 'fairness' or 'improper motive.'"[116] This background provides the understanding necessary to grapple with attempts to further restrict the authority of directors.

A. Alternative Conceptions of Corporate Governance?

Whether the disparate and often complementary claims by judges or commentators offer a convincing argument for further restricting the authority of directors and executives (via judicial or legislative action) depends in part on whether one is predisposed to favor shareholder primacy, managerial primacy,[117] director primacy,[118] or some version

113. *Id*.

114. *Van Gorkom*, 488 A.2d at 872–73; Unocal v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985) (upholding the "validity of a corporation's self-tender for its own shares which exclude[d] from participation a stockholder making a hostile tender offer for the company's stock" because the device adopted was reasonable in relation to the threat posed and, as such, it was a proper exercise of the board's business judgment); Revlon v. MacAndrews & Forbes, 506 A.2d 173 (Del. 1980). *See also* Allen et al., *Function Over Form*, *supra* note 82, at 865 (describing the evolution of Delaware corporate law from 1920 to the present).

115. *Id*. at 862.

116. *Id*. at 863.

117. *See, e.g.*, ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (describing the manner in which directors run a corporation as analogous to the way an individual manages his own personal property). For a critique of Berle & Means, see Robert Hessen, *Corporations, in* THE FORTUNE ENCYCLOPEDIA OF ECONOMICS 563, 566 (David R. Henderson ed., 1993), where the author asserts:

> Berle and Means' criticism overlooked how corporations were formed. The 'Fortune 500' corporations were not born as giants. Initially, each was the creation of one or a few people who were the prime movers and promoters of the business and almost always the principal sources of its original capital. They were able to 'go public'—sell shares to outsiders to raise additional equity—only when they could persuade underwriters and investors that they could put new money to work at a profit.

Id.

118. In contrast to shareholder primacy, "director primacy accepts shareholder wealth maximization as the proper corporate decision-making norm but rejects the notion that shareholders are entitled to either direct or indirect decision-making control." Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 563 (contrasting director and shareholder primacy); *see also id.* at 547–606 (rejecting the concept that shareholders actually own a corporation in a philosophical sense); Lynn A. Stout, *Investors'*

of corporate social responsibility as the proper corporate governance model.[119] As recent history proves,

> [o]ften the central theme of the debate in the mergers and acquisitions area is which body has primacy to decide whether or not to accept certain proposals—the stockholders or the directors. The advocates of the property model favoring stockholder choice contend that the stockholders must have that choice although they would want the directors to negotiate for the best deal. By contrast, those who favor the entity model rest their policy choice on the primacy of director decision-making . . . .[120]

Additionally, the attractiveness of any one of several models of corporate governance may be linked to whether one accepts empirical data that demonstrates how corporations actually operate and acknowledges theories of governance, which retain some plausible predictive power.[121] Nevertheless, recent cases (particularly in

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Choices: The Shareholder As Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance, 152 U. PA. L. REV. 667 (2003) [hereinafter Stout, *Investors Choices*] (noting the lack of informed shareholders has led to almost total board control of a corporation).

119. For an introduction to the "new" corporate social responsibility, see generally Testy, *supra* note 67, at 1227–50 (seeking to bolster the corporate social responsibility movement in a more "progressive" direction). Testy further contends that the shareholder primacy model is the currently prevailing view. For an excellent exposition of the available evidence, see Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 563–74.

> Insofar as control is concerned, U.S. corporate law is far more accurately described as a system of director primacy than one of shareholder primacy. Shareholders exercise virtually no control over either day-today operations or long-term policy. Instead, control is vested in the hands of the board of directors.

Id. at 573.

120. Veasey, *Dynamics of Corporate Governance*, *supra* note 33, at 1014. Evidently, the property school largely adheres to the efficient markets theory permitting corporate control to be transferred relatively freely between buyers and sellers while those who adhere to the entity model view the corporation as a societal institution with a purpose broader than simply serving the economic advancement of stockholders. *Id*. at 1015. From an economic theoretic perspective, one might be able to view directors from the normative perspective of an organizational designer. The organization must respond to a changing and uncertain environment and good responses may be costly to obtain. In addition, good response must be incentive-compatible, that is, each member of the organization must want to carry out her part of the total organizational response in just the way the organizational designer intends. Marschak, *supra* note 53, at 223. If these claims are true, it is likely that directors are better equipped than shareholders to respond to changes in the economic environment, can more economically obtain sufficient information to provide a good response and further, their responses can be more easily made to respond to incentives. For a rich discussion of the advantages and disadvantages of the property model and the entity model, see William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1067–1100 (2002) [hereinafter Allen et al., *The Great Takeover Debate*] (advocating for a middle position between the property model and entity model).

121. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra*

Delaware) suggest a possible trend that favors shareholder governance despite the statutorily ratified reality that the "firm's nominal owners, the shareholders, exercise virtually no control over either day to day operations or long-term policy,"[122] and within large or even medium-sized public corporations are unlikely to ever do so.

In spite of the gap between the shareholders capability to *exercise* control and the assertion that they have, or should have, the right to do so, the collapse of market euphoria coupled with the rise in corporate scandals, and perhaps exacerbated by the long-term implications of a questionable legal decision in a takeover controversy,[123] has focused fresh attention on the capability or inability of shareholder governance to curb rampant and out of control managers.[124] In part this focus originates in an asserted need to revive investor confidence.[125]

note 65, at 606 (citing Milton Friedman's proposition that "the basic test for the validity of any theoretical model is its ability to make accurate predictions about the world"); *see also* Bainbridge, *The Board of Directors as Nexus of Contracts*, *supra* note 22, at 3 ("Accordingly, a model is properly judged by its predictive power with respect to the phenomena it purports to explain, not by whether it is a valid description of an objective reality.").

122. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 512. "U.S. public corporations are characterized by a separation of ownership and control." *Id*. Control consistent with Berle and Means is "vested in the directors and their subordinate professional managers, who typically own only a small portion of the firm's shares." *Id*. Disincentives to shareholder activism are provided by statutory rules assigning decision-making to the board coupled with a host of other statutory rules that indirectly prevent shareholders from exercising significant influence such as: (1) disclosure requirements pertaining to large holders; (2) shareholder voting and communication rules; and (3) insider trading and short swing profit rules. Taken together these rules either directly limit shareholder authority or indirectly discourage the formation of large stock blocks and discourage communication and coordination among shareholders. *Id*. An alternative approach concentrates on a team production model of corporate governance, which among other things argues that directors "are not subject to direct control or supervision by anyone, including the firm's shareholders." *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999) [hereinafter Blair & Stout, *Team Production in Business Organizations*] (showing that shareholders as residual claimants have a right to look over its corporate board); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *A Team Production Theory*] (illustrating the principal-agent model to demonstrate shareholders must take a more active role in corporate governance).

123. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 n.17 (Del. 1989) (citation omitted) (holding that the board of directors could use a poison pill to counter a premium offer that was not structurally coercive). This decision is seen as questionable because it significantly weakened the standards by which target takeover defenses are measured by allowing both a broad category of cognizable threats that the board could justifiably respond to and by weakening the proportionality requirements previously necessary to withstand judicial scrutiny. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 485–86.

124. *See, e.g.*, Coffee, *supra* note 22, at 305–09 (describing shareholder governance as "The Unused Lever").

125. *See* Erica Beecher-Monas, *Enron, Epistemology, and Accountability: Regulating in a Global Economy*, 37 IND. L. REV. 141, 142 (2003) (noting Congress has used changes to corporate governance as the main vehicle to prop up investor confidence).

Appalling corporate behavior re-emphasizes a reliable paradigm: "An effective board of directors is central to good corporate governance; and good corporate governance, in turn, is central to good corporate performance."[126] Thus, it is believable that "corporate corruption and abuses . . . [concentrate] attention on the board of directors and on corporate governance more broadly."[127] As a result of this attention, specific curative proposals have been vetted. These include proposals advocating that shareholders reclaim their power to reform executive compensation through proxy contests and mandating that institutional investors acquire the power to nominate one or more minority directors on the corporation's own proxy statement,[128] which might complement already existing or imaginary institutional activism.[129] Additionally, with proposals aimed at improving accountability, advocates of shareholder voting as a vehicle for attaining "undistorted shareholder choice" in a hostile takeover context have suggested a policy that constrains directors' discretion with respect to the deployment of defenses in hostile takeover context while simultaneously arguing that the vindication of shareholder decision-making in this arena "strengthens and reinforces" the legitimacy of the board's exercise of discretionary authority in other spheres of decision-making.[130] This syllogism appears uncertain.[131] While "more regulation might do more harm than good,"[132] and while all efforts designed to strengthen accountability in the context of scandal are not directly—or at least not always—related to appropriate policy recommendations in a takeover context, it is likely that every effort aimed at ensuring more shareholder

126. Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 495, 495 (Nancy B. Rapoport & Bala G. Dharan eds., 2004) [hereinafter Paredes, *Enron: The Board, Corporate Governance*].

127. *Id.*

128. *See* Coffee, *supra* note 22, at 305–07 (outlining the manner in which shareholders can exert control); *see also Federal Power Threatens Role of State Law, Former Delaware Chief Justice Veasey Warns*, 83 BNA BANKING REP., No. 7 (Aug. 16, 2004).

129. Karmel, *supra* note 22, at 17 ("Because public pension funds continue to devote an increasing amount of their assets to equities, they are the most activist on corporate governance matters and have increasing clout."). *But see* Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 803–04 ("Even the most active institutional investors spend only trifling amounts on corporate governance activism. . . . Not surprisingly, empirical studies of U.S. institutional investor activism have found 'no strong evidence of a correlation between firm performance and percentage of shares owned by institutions.'").

130. Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 996.

131. *See* Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 808 ("In my view, however, shareholder choice more likely would weaken and undermine the board's authority in a variety of areas.").

132. Paredes, *Enron: The Board, Corporate Governance*, *supra* note 126, at 495.

democracy and control may suffer the difficulties inherent in collective action.[133]

Collective action involves individuals who are incompletely, if not indifferently informed,[134] and who are driven by disparate, if not opportunistic, preferences and behavior.[135] As such, persistent adherence to the allure of the shareholder governance ideal may inadvertently but inevitably contribute to the unrelenting vigor of economist Kenneth Arrow's Impossibility Theorem[136] as well as the enduring charm of the nirvana fallacy.[137] Nonetheless, it is argued that the sundry proposals offered might lead, *inter alia*, to significant negotiation between institutional shareholders and corporate managers over specific executive compensation issues.[138] Predictably, these efforts might activate dispositive and expansive conceptions of shareholder rights in numerous contexts—including takeovers—by reconfiguring corporate governance so that shareholders' ostensible accountability qualms furnish a seductive skeleton, which trumps and

133. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 17 (1974) ("A truly rational discussion of collective action in general or in specific contexts is necessarily complex, and what is even worse, it is necessarily incomplete and unresolved"). *But see* Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 976 (arguing that collective-action problems can be effectively addressed without providing boards with veto power).

134. "Modern behavioral economics . . . recognizes that individuals, including investors, have 'bounded rationality' and do not pursue all information relevant to an optimal decision . . . . [I]ndividuals typically make decisions by using heuristics—i.e., rules of thumb—rather than by incorporating and processing all obtainable information." Coffee, *supra* note 22, at 294.

135. Dooley, *supra* note 24, at 464–65 ("'[O]pportunism' . . . refers to the constant human temptation to pursue self-interest at the expense of others, even when cooperative behavior would be most beneficial to all concerned.").

136. For an introduction to some of these issues, see Maxwell L. Stearns, *The Misguided Renaissance of Social Choice*, 103 YALE L.J. 1219, 1219–93 (1994) (introducing the concept of Arrow's Impossibility Theorem in plain language); *see also* NICOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM POSNER TO POST-MODERNISM 91 n.17 (1997) (stating that Arrow's impossibility theorem shows that there is no collective decision-making scheme that can satisfy the requisite ethical properties). The Impossibility Theorem implies that "no legislative process can simultaneously satisfy the five assumptions on legislative fairness." Stearns, *supra*, at 2. More broadly speaking, the theorem suggest "that political outcomes will be entirely incoherent and that the whole concept of the 'public interest' is meaningless because Arrow argues that no method of combining individual preferences can satisfy these specific and basic requirements: (a) minimum rationality; (b) the pareto standard; (c) non-dictatorship; (d) independence of irrelevant alternatives; and (e) universal applicability. DANIEL A. FARBER AND PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION 38–39 (1991).

137. *See* Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969) ("The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing 'imperfect' institutional arrangement . . . . In practice those who adopt the nirvana viewpoint seek to discover discrepancies between the ideal and the real and if discrepancies are found, they deduce that the real is inefficient.").

138. Coffee, *supra* note 22, at 305–07.

diminishes directors' claims of authority.

The validity or invalidity of policy recommendations within any context (scandal or takeover) may depend heavily on foundational assumptions about corporate governance. Whatever the merits of the various proposals, they may be fortified or vitiated by understanding that while it is likely that "the shareholder primacy norm is embodied neither in past or present legal standards nor corporate practice, most commentators . . . continue to place this model on quite a pedestal."[139] If true, some form of shareholder primacy will often provide the normative foundation for policy recommendations, whatever the context.[140] Contemporary policy recommendations and judicial decisions are often grounded in or attached to shareholder primacy models or other conventional models such as the corporate social responsibility model,[141] the principal-agent model[142] or models that

139. Testy, *supra* note 67, at 1231 (citing D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 278–79 (1998)); *see also* Bainbridge, *The Board of Directors as Nexus of Contracts*, *supra* note 22, at 5 ("[M]ost corporate law scholars today embrace some variant of shareholder primacy.").

140. *See, e.g.*, Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 798 (critically examining the policy recommendations of Bebchuk et al., *The Powerful Antitakeover Force of Staggered Bonds*, *supra* note 5, in a takeover context).

141. Confusingly, corporate social responsibility models of governance are often presented as "new" or "progressive." For example, one observer contends that "[t]heories of corporate social responsibility cast a potentially broader net, emphasizing all of the social costs of corporate activity, and therefore embrace, for example, environmental or political concerns as well as stakeholder interest." David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1002 n.5 (2000). This claim remains debatable since it is far from clear why any investor might or should voluntarily accept the maximization of environmental or political concerns as either a measurable or desirable goal when such goals can be pursued, however imperfectly, by investing in the public markets. An elementary understanding of public choice theory implies that:

> Individuals choose, and as they do so, identifiable economic interest is one of the "goods" that they value positively, whether behavior takes place in markets or in politics. But markets are institutions of *exchange*; persons enter markets to exchange one thing for another. They do not enter markets to further some supra-exchange or supra-individualistic result. Markets are not motivationally functional; there is no conscious sense on the part of individual choosers that some preferred aggregate outcome, some overall "allocation" or "distribution," will emerge from the process.
>
> The extension of this exchange conceptualization to politics counters the classical prejudice that persons participate in politics through some common search for the good, the true, and the beautiful, with these ideals being defined independently of the values of the participants as these might or might not be expressed by behavior. Politics, in this vision of political philosophy, is instrumental to the furtherance of these larger goals.

James M. Buchanan, *The Constitution of Economic Policy*, *in* PUBLIC CHOICE AND CONSTITUTIONAL ECONOMICS 107 (James D. Gwartney & Richard E. Wagner eds., 1988). It is accordingly doubtful that shareholders can be seen as some cohesive group who wish to maximize some independent conception of the good, the beautiful, and the true in addition to attempt to protect "shareholder property rights in control premia."[143] This constellation of alternatives shares one attribute—it may elevate shareholder, stakeholder, or judicial control without necessarily contributing to either shareholder or societal wealth.

Consider first the corporate social responsibility model. One difficulty with the corporate social responsibility model is that it may appear as an exogenously driven model in which directors cast a broad net that allows them to emphasize the political, social, and environmental concerns of putative stakeholders such as the community or workers.[144] This approach has its own reward, allowing directors to select which external value or interest to maximize particularly when and if they are congruent with their own internal preferences. These values and interests may be both immeasurable and incommensurable. Hence, fiduciary duty violations may be impossible to prove.

The second option presents similar difficulties. As a long-standing model attached to the separation of ownership and control, the principal-agent archetype is supported by the deduction that "because of collective action problems and rational apathy, dispersed shareholders are unable to coordinate their activities, and effective control of the corporation ends up in the hands of management."[145] Agency theory as the prime component of the principal-agent model "does not expressly offer a view of how authority should be allocated within a corporation, but it is suggestive . . . [of the shareholders'] ability to change the scope of her agent's authority and duties."[146] As discussed later, "the principal-agent model still has currency, particularly in the courts."[147]

some desirable economic return and then be seen to act collectively to inform and enforce what are actually incommensurable norms via the proper monitoring of their agents—or alternatively that managers and directors charged with such a task will not simply maximize their own preferences while couching their decisions in the language of the good, the beautiful and the true. Properly understood, the corporate social responsibility model allows some to exercise their preferences at the expense of others while couching that exercise in wonderful sounding language. As thus understood, the corporate social responsibility model is merely one of many conventional models of corporate governance in which actors often exercise their own self-interest and as such, the claim that this model exists in some counter-hegemonic sense remains highly speculative.

142. *See* Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 109–12 (describing the principal-agent model).

143. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 735 (discussing but rejecting this possibility).

144. For a discussion of the advantages of corporate social responsibility including the possibility that directors can cast a broad net, see Millon, *supra* note 141, at 1002 n.5.

145. Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 109.

146. *Id.* at 111.

147. *Id.*

The third option concentrates on the shareholders property rights in control premia. As a general matter, this third approach is difficult to square with the chancery opinion in *Moran v. Household International*.[148] Additionally, "a shareholder's ability to dispose of his stock . . . is not defined by notions of private property, but rather by the terms of the corporate contract, which in turn are provided by the firm's organic documents and the state of incorporation's corporate statute and common law."[149] In sum, the claim that "shareholders have the right to make the final decision about an unsolicited tender offer does not necessarily follow, for example, from the mere fact that shareholders have voting rights."[150] In contradistinction to this scaffold—which includes several versions of shareholder primacy that taken as whole, are "neither normatively persuasive nor descriptively accurate,"[151]—the director primacy model including shareholder wealth maximization[152] but excluding shareholder control may well prove inadequate—except when compared to the alternatives.

Legal scholar Stephen Bainbridge amplifies the strengths of the director primacy perspective by stating that the director primacy model

> describes the corporation as a vehicle by which the board of directors hires various factors of production. The board of directors is not an agent of the shareholders; rather, the board is the embodiment of the corporate principal, serving as the nexus of the various contracts making up the corporations.[153]

Director primacy admits that centralized decision-making is an

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148. Moran v. Household Int'l, 490 A.2d 1059, 1070 (Del. Ch. 1985) (finding that "shareholders do not possess a contractual right to receive takeover bids . . . [their] ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors"), *aff'd* 500 A.2d 1346 (Del. 1985).

149. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 710–11.

150. *Id.* at 710.

151. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 86 (2003) [hereinafter Bainbridge, *The Business Judgment Rule as Abstention*] (criticizing the shareholder primacy model specifically).

152. *See* Dooley, *supra* note 24, at 466 (outlining the questions which a governance structure can answer). Dooley writes:

> [T]he participants in a firm must have some governance structure to determine three basic questions. First, what are the general sorts of adaptive decisions that will need to be made over time? Second, what general normative principle guides decision-making—that is, for whose benefit are decisions to be made? And third, who, within the firm, shall make the adaptive decisions? The answer to the second question is the same for all capitalist firms: decisions are made to benefit the interests of the residual claimants because maximizing their wealth necessarily maximizes the wealth of the coalition.

Id.

153. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 86.

indispensable component of corporate governance.[154] Thus, authority "is vested neither in the shareholder nor in the managers, but rather in the board of directors."[155] Normatively, "vesting the power of fiat in the board of directors raises legitimate accountability concerns."[156] Resolving the tension between authority and accountability, the central problem of corporate law mandates focused attention on the principal mechanism by which corporate law resolves that conflict—the business judgment rule.[157] However, the

> business judgment rule commonly is understood today as a standard of liability by which courts review the decisions of the board of directors . . . the rule [may be] better understood as a doctrine of abstention pursuant to which the courts in fact refrain from reviewing board decisions unless exacting preconditions for review are satisfied.[158]

Consistent with this approach, the business judgment rule should be treated neither as some minor deity by its acolytes, nor as charlatan—a virtuoso of obscurantism and pretension—by its detractors.[159] The director primacy model as thus understood is a doctrine that urges judicial restraint, even in the face of scandal, conflicts of interest, and worries of entrenchment.

The foregoing discussion underscores Professor Dooley's lucid claim that there are in reality two models of corporate governance. While neither model exists in absolutely pristine form,[160] the first model of corporate governance "can be called the 'Authority Model.' Its substance appears to be the prevailing judicial and statutory precedent,"[161] despite the persistence of some contradictory judicial language[162] suggesting that the shareholders are the principal. Alternatively, the "second model of corporate governance is the 'Responsibility Model,' exemplified by the [American Law Institute's] Governance Project."[163] The Models differ in perspective. Consistent

154. *Id.*

155. *Id.*

156. *Id.* at 86.

157. *Id.* at 86–87.

158. *Id.* at 87.

159. My debt to Paul J. Griffiths should be obvious. *See* Paul J. Griffiths, *Christ and Critical Theory*, FIRST THINGS, Aug.–Sept. 2004, at 49.

160. Dooley, *supra* note 24, at 463.

161. *Id.*

162. *See, e.g.*, *infra* Part III.B(1)–(2), C (discussing *Blasius*, a case in which the court articulated a higher standard of scrutiny than even the *Unocal* standard for cases in which a board's actions have the primary purpose of impairing the shareholder franchise, and reviewing that decision in light of the tension between authority and accountability).

163. Dooley, *supra* note 24, at 463.

with contemporary conversations about scandal and the resultant demand for revitalized accountability, the Responsibility Model concentrates on the possibility that agents may engage in indiscretions by formulating an appropriate set of substantive rules and procedures that "can best remedy and deter individual deviations from the commonwealth of the firm."[164] Emphasis and particularly overemphasis on remedies and deterrence may imply a shareholder primacy norm predicated on the principal-agent theory or some other related theory. On the other hand, via reasonable conclusions about the actual control and management of firms, "the focus of the Authority Model is on the ordinary operation of the firm on a day-to-day, year-to-year basis: what set of substantive rules and procedures best supports the most efficient decision-making process for the publicly held firm?"[165] Parenthetically, Delaware general corporate law "is structured . . . to preclude equity investors from having a legally enforceable expectation of entitlement to sell the corporation without board assent . . . [because] under the statute almost every significant corporation transaction requires board approval."[166] While developing the appropriate set of rules remains a work in progress, it is probable that public corporations can be best understood as part of a nexus of contracts,[167] which inexorably implies hierarchy and bureaucracy,

164. *Id.*

165. *Id.*

166. Allen et al., *The Great Takeover Debate*, *supra* note 120, at 1086.

167. *See, e.g.*, Bainbridge, *The Board of Directors as Nexus of Contracts*, *supra* note 22, at 3–33 (arguing for a board-centered understanding of the corporation where the directors serve as the nexus for the contracts that make up the corporation). Ultimately, my views are largely influenced by my understanding Jacques Ellul's persuasive conceptualization and conclusions about law:

> [Ellul's] thinking on law derives from his wider analysis of the modern world which, from the 1930s onward, argued that the dominance and novelty of Technique was creating a wholly new situation that had to be challenged because it was destroying the human person and the central features of civilization.

ANDREW GODDARD, LIVING THE WORD, RESISTING THE WORLD: THE LIFE AND THOUGHT OF JACQUES ELLUL 200 (2002). The living law by contrast (*le droit vivant*) "is born at the same time as human relationships. Law arises with contact between two people for it is made for people. It arises with spontaneity." *Id.* at 201. If this perspective is persuasive, it is my view that contractarian theory, which leads to director primacy, may be most consistent with Ellul's conception of law in the more general sense. As thus understood, and as part of the "domain of choice . . . [t]he founders and managers of a firm choose whether to organize as a corporation, trust, partnership, mutual or cooperative." Frank H. Easterbrook & Daniel R. Fischel, *Contractual Freedom in Corporate Law: Articles & Comments; The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417 (1989). Accordingly:

> The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy. No one set of terms will

mandating the director primacy model in which the "board . . . is a mediating hierarch" and does (and should) have extensive authority over the enterprise.[168]

B. Shareholder Choice, Director Discretion: The Current Judicial Framework

The logic of "[s]hareholder choice is grounded in several arguments."[169] The concentration on board infringement of one component of shareholder choice—the shareholder franchise—has resulted in often intrusive and possibly unrestrained judicial scrutiny. Such scrutiny is justifiable if shareholders are the owners of corporations.[170] This hypothesis[171] serves as a backdrop for a number of recent Delaware Court decisions.[172] Delaware courts maintain that

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be best for all; hence the "enabling" structure of corporate law.

Id. at 1418.

168. Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 128 (describing this view but not necessarily agreeing).

169. *Id.* at 134.

170. *See, e.g.*, Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (naming, as fundamental to Delaware law, the concept that the board has the legal duty to manage the affairs of a corporation for the benefit of its shareholder owners). *But see* Stout, *Investors' Choices*, *supra* note 118, at 667 (discussing *Malone* but ultimately disagreeing with its position because the metaphor of shareholder ownership is both empirically incorrect and misleading in that naming shareholders as owners implies certain rights of control that shareholders simply do not possess).

171. This hypothesis may be questionable. *See generally* Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 547–90 (expressing doubts and exploring instead the merits of the director primacy models). Evidently, since the publication of Ronald Coase's famous article, the Nature of the Firm, "both economists and legal scholars have devoted considerable attention to the theory of the firm." *Id.* at 547. Bainbridge suggests that directors and officers are more than mere stewards of the shareholders' interest, relying on the notion that corporations consists of a "nexus of contracts" which denies that shareholders own the corporation. *Id.* Hence, "shareholders are merely one of many factors of production bound together in a complex web of explicit and implicit contracts. Contractarian theory nevertheless continues to treat directors and officers as contractual agents of the shareholders, with fiduciary obligations to maximize shareholder wealth." *Id.* at 548. This approach leads ineluctably to the director primacy model as both a means and ends of corporate governance because it is based on contractarian theory. *Id.* at 547–62.

172. MM Cos. v. Liquid Audio, 813 A.2d 1118, 1131–32 (Del. 2003) (holding that where the board of directors expanded its size from five to seven in a defensive action, the burden was on the directors to show that the action was a proportionate, reasonable response to the threat posed); *In re* The MONY Group Inc. S'holder Litig., 853 A.2d 661, 668 (Del. Ch. 2004) (holding that where a disinterested and independent majority of directors acted in accordance with their fiduciary duties when they postponed a shareholders meeting, set a new record date, and held an election of directors, a motion for a preliminary injunction based on allegations that the directors interfered with the effectiveness of a shareholder vote will not be granted); Acker v. Transurgical, Inc., No. 201-N, 2004 Del. Ch. LEXIS 49, at *8 (Del. Ch. Apr. 22, 2004) (holding that the plaintiff stated a claim wherein he alleged that the firm failed to take all necessary and desirable actions to facilitate the election of two representatives whom the plaintiffs designated to the board of directors pursuant to a shareholder agreement, similar to the conduct at issue in *Liquid Audio*

"[a] board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.'"[173] As explicated later, the recent revitalization of this framework may have adverse consequences to the development of a reasoned conception of directorial authority.[174]

The prevailing judicial outlook applies the exacting "compelling justification" criterion in circumstances in which self-interested or faithless fiduciaries act to deprive stockholders of a full and fair opportunity to participate in the matter when such circumstances appear to frustrate the will of a majority of stockholders.[175] Courts "will not allow the wrongful subversion of corporate democracy by manipulation of corporate machinery . . ."[176] when the conduct at issue impairs shareholders ability to, for example, "replace the incumbent directors when they stand for re-election."[177] If this conclusion had been limited simply to shareholders' contract rights as articulated by Delaware statutes, this view might have been uncontroversial, but this expansive conception of shareholder rights constrains the often necessary authority of directors both within and outside of an actual or threatened control contest.

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where the Supreme Court held that Liquid Audio's incumbent board harmed MM Companies when it expanded the board from five to seven members which diminished the influence of MM's nominees). The consideration of claims by shareholders that certain categories of board conduct interfere with shareholders voting rights has not been limited to Delaware. *See, e.g.*, Simon Prop. Group, Inc. v. Taubman Ctrs., 261 F. Supp. 2d 919, 943–44 (E.D. Michigan 2003) (reasoning that public interest is served in protecting shareholder rights to control and a heightened standard of review is appropriate where the board denies shareholders the right to vote on a tender offer).

173. Allen et al., *Function Over Form*, supra note 82, at 889 (citing Stroud, v. Grace 606 A.2d 75, 82 (1992).

174. *See* Parts III.C and IV, *infra* (setting forth the court's holding in *Blasius* and the development of case law which was first marked by a reluctance to apply *Blasius*, but has recently been seen as an expansion of its doctrines).

175. When such circumstances are not present the business judgment rule will ordinarily apply in recognition of the fact that directors must continue to manage the business and affairs of the corporation, even with respect to matters that they have placed before the stockholders for a vote. *MONY Group*, 853 A.2d at 667; Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170 (Del. Ch. Dec. 4, 2000). While *Peerless* did not "involve issues touching on control, the court applied the *Blasius* standard because it perceived that the self-interested CEO's actions [the postponement on vote that he apparently favored] were taken to interfere with the stockholder vote, *which at the time was running against the proposal.*" *MONY Group*, 853 A.2d at 675 n.51. The totality of the circumstances and actions taken in connection with the adjournment evidently suggested an improper purpose. Therefore the defendants retained the "burden of showing a compelling justification for their actions." *Id.*

176. *Liquid Audio*, 813 A.2d at 1127 (quoting Giuricich v. Emtrol Corp., 473 A.2d 232, 239 (Del. 1982)).

177. *Id.* (citing Unocal Corp. v. Mesa Petroleum, 493 A.2d 946, 946 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984)).

Furthermore, courts have enjoined supermajority bylaw provisions adopted by boards during a contest for control where the design of such provisions is to make it more difficult for the acquirer to eliminate the target firm's classified board structure, remove incumbent directors, and take control of the new board.[178] Before probing the evolving framework that attempts to resolve the tension between directors and shareholders, and between authority and accountability, consider briefly the adoption and/or amendment of corporate bylaws patterns:

> Bylaws are the rules a corporation adopts to govern its internal affairs. Bylaws tend to be far more detailed than articles of incorporation . . . [and] typically deal with such matters as number and qualifications of directors, board vacancies, board committees, quorum and notice requirement for shareholder and board meetings, procedures for calling special shareholder and board meetings, any special voting procedures, any limits on the transferability of shares, and titles and duties of the corporation's officers.[179]

Moreover, bylaw amendments, unlike charter amendments, attract far more judicial scrutiny.[180] One can convincingly argue that when provoked by efficiency considerations,[181] the separation of ownership and control signifies that the "preservation of board discretion should always be the null hypothesis."[182] There is substantial scholarly authority cited by the Delaware courts suggesting "that bylaws cannot be used to impede the managerial authority of the board to use a shareholder rights plan"[183] even if "a core function of the bylaws is to

178. Chesapeake Corp. v. Shore, 771 A.2d 293, 297 (Del. Ch. 2000). *See* Seth Goodchild, *Delaware Court Enjoins Supermajority Bylaw Adopted During Contest for Control* (2000), *at* http://library.lp.findlaw.com/articles/file/00088/003326/title/Subject/topic/Securities%20Law_Shareholder%20Disputes/filename/securitieslaw_1_292 (2000) (discussing the *Chesapeake* decision).

179. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 43. Typically, the incorporator or the initial directors at the corporation's organizational meeting adopt the corporation's initial bylaws. At early common law, only shareholders had the power to amend the bylaws but today many states allow shareholders to delegate the power to amend bylaws to the board of directors. *Id.* at 43–45.

180. Kahan & Rock, *supra* note 14, at 499.

181. *See* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 47–48 (discussing the economic justifications of the board's authority and primacy). Bainbridge asserts:

> The board's primacy has a compelling economic justification. The separation of ownership and control mandated by corporate law is a highly efficient solution to the decision-making problems faced by large corporations . . . because collective decision-making is impracticable in such firms, they are characterized by authority-based decision-making structures in which a central agency (the board) is empowered to make decisions binding on the firm as a whole.

Id.

182. *Id.* at 517.

183. Hollinger Int'l v. Black, 844 A.2d 1022, 1079 n.130 (Del. Ch. 2004).

address the process by which the board makes decisions."[184]

While board conduct may be lawful, "inequitable action does not become permissible simply because it is legally possible."[185] In agreement with this observation, one early case disallowed a board-initiated bylaw proposal because changing "the date of the corporation's annual meeting . . . was a legally permissible amendment for the equitably impermissible purpose of defeating a proxy contest in which insurgent shareholders sought to oust the incumbent board."[186] The principles embedded in this approach demonstrate that Delaware courts "likely would examine the purpose for which the board amended or repealed a shareholder-adopted bylaw. If the board did so to disenfranchise shareholders and/or entrench itself in office, for example, the action likely would not pass muster."[187] Conversely, when shareholders act to constrain the discretion of the board through the adoption of shareholder-initiated bylaws, courts have not always permitted such limitations. In one case, the Supreme Court of Delaware addressed a bylaw proposed by shareholders limiting the number of directors.[188] As proposed, the bylaw contained a provision prohibiting the board from amending or repealing it.[189] The court noted that the corporation's articles gave "the board broad authority to fix the number of directors . . . through adoption of bylaws" and opined that the proposed bylaw "would be a nullity if adopted."[190] Consequently, the court accepted the necessity and value of the private ordering of business relationships while protecting the control of directors. In reality, court decisions inspecting shareholder actions and efforts aimed at vindicating corporate democracy hint at two contradictory

184. *Id.*

185. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (1971).

186. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 45 (citing *Schnell*, 285 A.2d at 439).

187. *Id.* at 45 (invalidating board action undertaken "for the primary purpose of preventing the effectiveness of a shareholder vote." (citing Blasius Indus., Inc., v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988))). The broad principles embedded in this view have been extended. For example, it is possible that when a board erects anti-takeover defenses which prevent shareholders from receiving any tender offers or when the defensive measure acts to prevent proxy contests, the courts will step in to invalidate such provisions. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (recognizing that the board can erect certain defenses which deter certain types of bids but implied that the board must allow some opportunity for the bidder to present a bid to shareholders).

188. Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 929 (Del. 1990) (addressing a situation in which shareholders passed a bylaw limiting the number of directors, and which could not be repealed by the board of directors).

189. *Id.*

190. *Id.*

conclusions: that the board manages the corporation and that the board is subject to statutory provisions or shareholder initiated corporate bylaws that seem to limit the discretion of the directors.[191]

In any case, sustaining shareholder voting rights as integral to corporate governance, and the attendant denial of directorial authority, has proven irresistible to a number of courts and commentators.[192] This viewpoint, facilitated by a trend that treats the business judgment rule as a substantive doctrine that expands the scope of director liability and allows judges room to examine the substantive merits of the board's decision[193] may be in error or even worse, since shareholder voting has very little to do with corporate decision-making and has only limited vitality as one of many corporate accountability mechanisms.[194] Shareholders can theoretically vote inattentive directors out of office.[195] In practice, this device is of limited usefulness.[196] In fact, the product capital and employment markets may be more important than voting as a constraint on agency costs[197] because they affect management more quickly and directly than voting in the form of rather cumbersome proxy contests. Nevertheless, shareholder voting does matter in the contest for corporate control and if agency costs rise high enough, it will become profitable for some outsiders to acquire a controlling block of shares and exercise their associated voting rights to oust the incumbent board.[198] These conclusions imply (1) that director primacy may be more consistent with the actual authority expected of directors; (2) that

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191. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 43–48.

192. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (disallowing board action undertaken for the primary purpose of preventing the effectiveness of a shareholder vote); Phillips v. Insituform of North America, Inc., 1987 WL 16285 (Del. Ch. 1987) (granting a preliminary injunction against board-adopted bylaws which were apparently intended to preclude one class of shareholders from controlling the corporation); Chesapeake Corp. v. Shore, 771 A.2d 293, 244–45 (Del. Ch. 2000) (applying the *Blasius* standard to the board's conduct when they adopt a supermajority bylaw as a vehicle to reduce the voting power of minority shareholder/hostile acquirer and here the defendant board could not satisfy the compelling justification standard). It is possible that the court's decision in *Chesapeake* would have been the same without *Blasius*. *See supra* Part III (discussing *Chesapeake*).

193. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 87 (noting that the business judgment rule is commonly understood as a standard of liability employed by the courts in reviewing board of director decisions, but suggesting that the rule should be viewed instead as a doctrine of abstention).

194. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 441.

195. *Id.*

196. *Id.* Voting directors out of office is of limited value because in "the real world . . . so-called proxy contests are subject to numerous legal and practical impediments that render them largely untenable as a tool for disciplining managers." *Id.*

197. *Id.*

198. *Id.*

shareholder governance remains more sought after than real,[199] despite judicial and scholarly attachment to shareholder voting;[200] and (3) that courts may do well to heed the case for judicial restraint premised on the justifiable claim that the board of directors is not an agent of the shareholders.[201] Lastly, arguments aimed at restricting the board's authority in the tender offer or takeover context will likely "undermine the board's authority in other contexts."[202] In sum, the case for further restricting directorial discretion remains brittle.

III. THE EVOLVING FRAMEWORK

The transition from the older body of law developed during the period between 1920 and 1980 to the current design was not easy but reflects changes in the global capital and international product markets[203] as well as the capability of lawyers to develop novel theories in response to these developments. Judges have led this transition by creating changes in judicial standards of review without necessarily adequately taking into account the policy purposes those standards were intended to achieve and by simply creating additional[204] and less deferential judicial standards when fewer and more modest standards might be preferable. These changes reflect an emerging consensus that suggests an increased willingness by the courts to interfere with the management of the corporate entity.[205]

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199. Apparently:

> Some proponents of shareholder primacy concede that shareholders lack formal control of the corporation, but argue that they still exercise ultimate de facto control. According to John Coates, for example, the market for corporate control ensures a residual form of shareholder control, transforming the 'limited de jure shareholder voice into a powerful de facto form of shareholder control.

Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 802. In reality, while the market for corporate control depends on the existence of shareholder voting rights, the shareholders maintain the right to fire directors but not the capability to exercise fiat, or in other words, not the capability to issue arbitrary decrees of control. *Id.*

200. *See supra* Parts I & II (discussing the concept of shareholder governance as an illusion).

201. *See generally* Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 84–102 (noting that the business judgment rule is designed to effect compromise between authority and accountability and recognizing that while ownership and control of publicly traded companies raises accountability concerns, efficiency is accomplished through granting the board of directors' decision-making authority).

202. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 711.

203. *See, e.g.*, Allen et al., *Function Over Form*, *supra* note 82, at 863–64 (arguing that unprecedented developments in the capital and international product markets created the environment for a sweeping change in Delaware law).

204. *Id.* at 864.

205. *See infra* Part III (warning that an unrestrained understanding of *Blasius* could lead to judicial enhancement of shareholder rights and authority).

A. Balancing Director-Shareholder Power in a Takeover Context

The "watershed year of 1985"[206] furnished three decisions that keenly affected the then emerging firestorm of often hostile corporate takeover activity in the United States.[207] These decisions also affected the debate over allocation of power in the context of takeovers. "One reason that could be given for granting boards a veto power is a concern that shareholders facing a takeover bid might be unable to exercise an undistorted choice. In the absence of any restrictions on bidders, shareholders might be pressured to tender."[208] A related reason suggests that director entrenchment may increase shareholder premiums when and if the firm is ultimately sold.[209] In *Unocal*, the board's defensive response changed neither the bylaws nor the corporate charter and hence it was possible that the board's conduct complied with the incorporators' decision to "endow directors with significant power over whether and how to sell the company"[210] consistently with the firm's "constitutional choice of governance structure."[211]

Altering previous formulations of the business judgment rule,[212] which implied judicial restraint, the Supreme Court of Delaware (after evaluating the validity of a corporation's self-tender excluding the hostile bidder in response to a potentially coercive hostile bid),[213] "commenced the development of an 'enhanced' business judgment rule in contests for corporate control . . . in *Unocal* and its progeny."[214] "[E]nhanced judicial scrutiny, as a threshold or a condition precedent to an application of the traditional business judgment rule, is now well

206. Veasey, *The Business Judgment Rule*, *supra* note 59, at 576. *See also* Allen et al., *Function Over Form*, *supra* note 82, at 865 (noting that from 1985 through 1993 and the period thereafter the courts endeavored to shape the revolutionary decisions of *Van Gorkom, Unocal* and *Revlon* into a consistent and coherent body of legal doctrine).

207. Paul L. Regan, *What's Left of* Unocal*?*, 26 DEL. J. CORP. L. 947, 948 (2001) (discussing the trilogy of *Unocal Corp. v. Mesa*, *Moran v. Household Int'l, Inc.*, and *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*).

208. Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 981.

209. *See, e.g.*, Kahan & Rock, *supra* note 14, at 522 (advancing a rationale that it is reasonable for shareholders to opt for a board veto in order to enable the board to employ selling strategies and increase the premium shareholders might receive).

210. *Id*. at 473.

211. *Id.*

212. Unocal Corp. v. Mesa Petroleum, 493 A.2d 946, 949 (Del. 1985); *see also* Veasey, *The Business Judgment Rule*, *supra* note 59, at 576 (stating that the traditional formation of the business judgment rule was altered in *Unocal* because of the omnipresent specter of director interest in entrenchment).

213. *Unocal*, 493 A.2d at 949.

214. Veasey, *The Business Judgment Rule*, *supra* note 59, at 576.

known."[215] By steering an intermediate or middle course, "the Delaware Supreme Court [sic.] reaffirmed the target's board['s] general decision-making primacy, which includes an obligation to determine whether the offer is in the best interests of the shareholders."[216] Because of the possibility that the board will place its interest ahead of the shareholders, judicial review is somewhat more intrusive than under the traditional business judgment rule.[217]

First, the initial burden of proof is placed on the directors to show that they had reasonable grounds for believing that a danger to corporate policy or effectiveness existed.[218] Showing good faith and a reasonable investigation can satisfy this burden.[219] Good faith obliges the directors to prove that they were motivated to act in response to a perceived threat to the corporation and not for the purpose of entrenching themselves in office.[220] A reasonable investigation "requires a demonstration that the board was adequately informed with the relevant standard being one of gross negligence."[221] If the directors carry their initial burden, they must *next* prove that the defense created was reasonable in relationship to the threat posed by the hostile bidder.[222] Apparently both the decision to adopt and any subsequent decision to implement a set of takeover defenses are subject to challenge and judicial review.[223] In practice, "the board's initial burden of proof quickly became the whole ball game"—if the directors carried their two-step burden, the business judgment rule was applied to test the proportionality of their response to the perceived threat—but if the directors failed to carry their initial burden, the duty of loyalty's intrinsic fairness test applied.[224] Properly understood, *Unocal* solves the problem of outcome determination not so much by creating a different standard of judicial review as by creating a vehicle for determining on a case-by-case basis which of the traditional doctrinal standards was appropriate for the particular case at issue.[225] "If the directors carried their [initial] two-step burden, the business judgment

215. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995).
216. *Id.* at 702.
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.*
221. *Id.* at 702–03.
222. *Id.* at 703.
223. *Id.*
224. *Id.*
225. *Id.*

rule applied, but if the directors failed to carry their initial burden, the duty of loyalty's intrinsic fairness test applied."[226] For this reason, the "*Unocal* test is more properly seen as a conditional version of the business judgment rule, rather than an intermediate standard."[227]

Whether it is simply a conditional version of the business judgment rule or not, enhanced scrutiny is triggered by an "'inherent conflict of interest' during conflicts for corporate control."[228] This inevitably leads to "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[229] Without question, "[a]lthough authority is essential for organization efficiency, it must be exercised responsibly. Because human cognitive powers are limited and subject to being overwhelmed by information flows, unaccountable authority is likely to make unnecessary errors."[230] The case law largely confirms, "unaccountable authority may be exercised opportunistically. The central decision maker may divert organizational resources to its own benefit rather than the good of the organization and its constituents."[231]

The *Unocal* solution to this problem insists "before the board is accorded the protection of the business judgment rule, and that rule's concomitant placement of the burden to rebut its presumption on the plaintiff, the board must carry its own initial two-part burden."[232] Whether this solution is absolutely correct or not exceeds the scope of this article. As we have seen, this migration from the traditional rule and its rationale has two elements: first, a threshold alteration in the burden of proof requiring directors to show by their good faith and reasonable investigation that they reasonably perceived a threat to corporate policy and effectiveness; and second, the court must review the reasonableness or proportionality of the corporate action taken in

226. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 703 (discussing the two-step process in which the burden is applied to directors: first to show that there were reasonable grounds for believing the corporation was in danger; and, second to show that the response was reasonable to the threat posed).

227. *Id.* Thus, "[t]he *Unocal* rule solved the problem of outcome determination not so much by creating a different standard of review, as by creating a mechanism for determining on an individual basis which of the traditional doctrinal standards was appropriate for the particular case at bar." *Id.*

228. Unitrin Inc. v. Amer. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (quoting Unocal Corp. v. Mesa Petroleum, 493 A.2d 946, 954 (Del. 1985)).

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

230. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 107 (footnote omitted).

231. *Id.*

232. *Unitrin*, 651 A.2d at 1373 (interpreting and citing *Unocal*).

response to a threatened takeover.[233] An important limitation implies that the "*Unocal* analysis should be used only when a board unilaterally (i.e., without stockholder approval) adopts defensive measures in reaction to a perceived threat."[234] Since "[n]either issues of fairness nor business judgment are pertinent without the basic underpinning of a board's legal power to act,"[235] the court's search for principles originates "with the basic issue of the power of a board of directors of a Delaware corporation to adopt a defensive measure."[236]

Although it has been briskly argued (by three present and former members of the Court of Chancery) that the corporation law of Delaware (case and statutory) remains robustly ambivalent, overall the statutory foundation, the Delaware General Corporation Law ("DGCL") "broadly empowers corporations to accomplish virtually any lawful act, subject only to the requirement that the acts be accomplished in the manner provided in the statute and they be approved by directors acting in conformity with their fiduciary obligations."[237] In general terms established in unambiguous statutory language, the "board has a large reservoir of authority upon which to draw. Its duties and responsibilities proceed from the inherent powers conferred by 8 Del. C. § 141(a), respecting management of the corporation's 'business and affairs.'"[238] Among other things, *Unocal* states that a "Delaware

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233. *Unocal*, 493 A.2d at 954. This departure from the traditional view may weaken the presumption that "in managing or overseeing the management of a business, directors must have wide discretion to delegate, to take risks, and not be second-guessed by courts." Veasey, *The Business Judgment Rule*, *supra* note 59, at 576. Under the traditional approach:

> [the] only real limitations on [director's] discretion are: (1) the directors should not enjoy the presumption of the business judgment rule if they were not making a business decision or if they were interested, not independent, not acting in good faith or grossly negligent in their decision-making process; and (2) to be sustainable, their decision may not be shown to have been devoid of any rational business purpose or to be so irrational that no person of ordinary prudence would have believed the decision to have been in the best interests of the corporation.

Id. at 576–77 (citing D. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 77–78 (1989)).

234. Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996).

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

236. *Id.* at 953.

237. Allen et al., *The Great Takeover Debate*, *supra* note 120, at 1068.

238. *Unocal*, 493 A.2d at 953 (citing DEL. CODE ANN. tit. 8, § 141(a)). Title 8, section 141(a) of the Delaware Code provides:

> The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

corporation may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office."[239] Moreover, "the 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."[240] Boards are not required to be passive instrumentalities of corporate governance[241] in the face of a threat to corporate policy. Thus, confirming *Smith v. Van Gorkom's*[242] mandate that "even in the traditional areas of fundamental corporate change, i.e., charter amendments . . . mergers . . . sale of assets . . . and dissolution . . . director action is a prerequisite to the ultimate disposition of such matters."[243] Although "directors are given substantial—but not unlimited—authority to forge corporate strategies, while leaving room for stockholders to vote down management-preferred mergers and to use the election process to avail themselves of a tender offer,"[244] the prevailing but at times hazy *Unocal*- inspired case law and the relatively clear statutory rules appear largely congruent with director preeminence in the hierarchy called corporate governance.[245]

In concert with *Unocal*'s deduction that directors must be given substantial, if limited authority, the Supreme Court of Delaware upheld the "most recent defensive mechanism in the arsenal of corporate takeover weaponry—the Preferred Share Purchase Rights Plan"[246] in *Moran v. Household International*.[247] In *Moran*, an action brought individually and derivatively, certain shareholders sought to invalidate

DEL. CODE ANN. tit. 8, § 141(a) (2004).

239. *Unocal*, 493 A.2d at 953–54.

240. *Id.* at 954.

241. *Id.* at 954.

242. Smith v. Van Gorkom, 488 A.2d 858, 888 (Del. 1985) (holding that in a merger a director may not abdicate the duty to act in an informed and deliberate manner).

243. *Unocal*, 493 A.2d at 954 n.8 (citing *Van Gorkom*, 488 A.2d at 888).

244. Allen et al., *The Great Takeover Debate*, *supra* note 120, at 1081. *See also* Moran v. Household Int'l Inc., 490 A.2d 1059, 1070 (Del. Ch. 1985) (laying out the causes of action the court recognized for the right of the shareholder to receive takeover bids is limited by the defensive tactics taken by the directors), *aff'd* 500 A.2d 1346 (Del. 1985) .

245. Confusingly, courts are often inconsistent on this score as they express support for both director and shareholder primacy norms. *See, e.g.*, Blasius Indus. v. Atlas Corp., 564 A.2d 651, 658–59 (Del. Ch. 1988) (suggesting that shareholders hold ultimate authority as principals).

246. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1348 (Del. 1985). The Rights Plan provides that Household common stockholders are entitled to the issuance of one Right per common share under certain triggering conditions. *Id.* There are two triggering events. *Id.* The first is the announcement of a tender offer for 30 percent of Household's shares and the second is the acquisition of 20 percent of Household's shares by any single entity or group. *Id.*

247. *Id.*

the rights plan adopted by the board.[248] Denying the plaintiff's contention that certain Delaware statutory provisions authorizing the issuance of stock failed to apply within a corporate control contest, the court declined to limit the directors' authority.[249] The authority to use poison pills is not absolute because the directors, when they are "faced with a tender offer and a request to redeem the Rights, they will not be able to arbitrarily reject the offer."[250] Without focusing on the company's corporate charter and its accompanying governance contract, the court focused on the board's statutory power[251] and common law default rules connected to the business judgment rule. The court, accordingly, held that not only was the plan within the board's authority, but it failed to entrench the board in contravention of their fiduciary obligations under *Unocal's* business judgment rule formulation.[252] Moreover, if the lower court's opinion retains viability, it is likely that:

> [S]hareholders do not possess a contractual right to receive takeover bids. The shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics.[253]

Revlon stressed and reaffirmed *Unocal's* requirements.[254] While "[t]he ultimate responsibility for managing the business and affairs of a corporation falls on its board of directors," [255] consistent with the firm governance charter, "lock-ups and related agreements are permitted

248. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1063 (Del. Ch. 1985), *aff'd* 500 A.2d 1346 (Del. 1985).

249. *Moran*, 500 A.2d at 1351–55.

250. *Id.* at 1354.

251. *See, e.g.*, *id.* at 1351 n.7 (stating that the power to issue rights to purchase shares is conferred by 8 Del. C. § 157 which provides in relevant part: "[s]ubject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the sale of any shares of stock . . . rights or options . . . ."); *see also id.* at 1353 (noting the inherent powers of the Board conferred by 8 Del. C. § 141(a) provide that the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of board of directors).

252. *Id.* at 1356–57.

253. *Moran*, 490 A.2d at 1070.

254. The *Revlon* court affirms the following points: (1) "when a board implements anti-takeover measures there arises the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders;" (2) the potential for conflict therefore, "places upon the directors the burden of proving that they had reasonable grounds for believing there was a danger to corporate policy and effectiveness, a burden satisfied by a showing of good faith and reasonable investigation;" coupled with (3) an affirmative showing that the action taken was reasonable in relation to the threat posed. Revlon v. MacAndrews & Forbes, 506 A.2d 173, 180 (Del. 1980) (citing Unocal v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)).

255. *Id.* at 179.

under Delaware law where their adoption is untainted by director interest or other breaches of fiduciary duty."[256] Once a company shifts from resistance to a sale posture, however, the duty of the board is transformed "from the preservation of [the firm] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[257] In such a setting, "the whole question of defensive measures [becomes] moot."[258] The directors cannot be viewed as defenders of corporate policy, but instead as "auctioneers charged with getting the best price for stockholders."[259] Conceding the corporation can no longer control its destiny, the role of Directors shifts from a concentration on fundamental operational duties to direct the enterprise as hierarchs who further both short- and long-run corporate policy and purposes to a new role as corporate salespersons, acting on behalf of and for the benefit of equity owners. This determination implies that the board's primary role is to manage the business for the benefit of a variety of stakeholders and contract beneficiaries, including shareholders with a view to the longer-term, but when and if the entity is put up for sale, maximizing rather immediate returns to shareholders should become the directors' focus.

The *Revlon* court's analysis was primarily driven by its focus on potential self-interest. As a result, compliance with the board's fiduciary obligations became a predicate to the deployment of the business judgment rule assumption. This example indicates that courts will restrain the board's authority to create certain defensive measures after a change of control becomes inevitable[260] to safeguard shareholder interest as the residual claimants and to ensure the responsible exercise of authority by directors.

After the *Revlon* decision, Delaware takeover jurisprudence involving shareholder voting became inextricably intertwined with the *Blasius* framework.[261] This development undergoes examination later.[262] The *Unitrin* case presents a number of developments in addition to its interaction with, but non-reliance on *Blasius*, and its accompanying rule precluding board disenfranchisement of shareholders unless the board

256. *Id.* at 176.

257. *Id.* at 182.

258. *Id.*

259. *Id.*

260. *Id.*

261. *See, e.g.*, Allen et al., *Function Over Form*, *supra* note 82, at 885–95 (discussing the *Blasius* standard of review and its application).

262. *See infra* Part III.C (discussing the interplay between *Unocal*/*Revlon*/*Unitrin* and *Blasius*).

can demonstrate a compelling justification.[263] One observer contends that among other things, *Unitrin* reinforced *Time-Warner*'s flexible interpretation of substantive coercion that leads to a narrowing of the scope of *Unocal* review.[264] The case maintains that "'[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and [because its alternative is] the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of [the] litigation.'"[265] Whether the entire fairness test is actually so exacting is a matter of some debate,[266] but in any case, this asserted tension led to the application of *Unocal* as a putatively intermediate standard of review given the facts of the *Unitrin* case.[267]

In *Unitrin*, American General and a parallel class action initiated by shareholders sought to enjoin a proposed repurchase plan. While the board did not attempt to amend the corporate charter, it adopted a poison pill, amended the bylaws to add shark repellent features[268] and initiated a defensive stock repurchase.[269] Deeming the latter unnecessary in light of the poison pill, the Court of Chancery struck this device as disproportionate in light of the threat posed.[270] The Supreme Court of Delaware reversed, holding that the "Court of Chancery should have directed its enhanced scrutiny: first, upon whether the Repurchase Program the Unitrin Board implemented was draconian, by being either preclusive or coercive; and second, if it was not draconian, upon whether it was within the range of reasonable responses to the threat . . .

263. Unitrin, Inc. v. Amer. Gen. Corp., 651 A2d 1361, 1379 (Del. 1993).

264. Regan, *supra* note 207, at 962–68 (contending that *Unitrin* unnecessarily constrains the *Unocal* framework by, among other things, resurrecting the specter of substantive coercion as a threat justifying a defensive response and suggesting that even non-coercive offers can constitute a threat to shareholder interest).

265. *Unitrin*, 651 A.2d at 1371 (quoting Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988)).

266. *See, e.g.*, Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *26–27 (Del. Ch. Dec. 4, 2000) (suggesting that the entire fairness test is consistent with deferential review and less demanding than the compelling justification standard invoked under *Blasius*).

267. *Unitrin*, 651 A.2d at 1373. Equally true, *Unocal* can be seen as a conditional version of the standard business judgment test. *See* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 703 (discussing *Unocal* and the business judgment rule); *supra* Part III (discussing *Unocal*).

268. Broadly speaking "[a] shark repellent is an amendment to the firm's articles of incorporation designed to persuade potential bidders to look elsewhere." BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 677.

269. *Unitrin*, 651 A.2d at 1366–67.

270. *Id.* at 1367.

posed,"[271] as a component part of the multiple defenses adopted.[272] Conceding the effectiveness of a poison pill (repurchase program) in conjunction with the longstanding supermajority vote provision in the Unitrin charter, the Supreme Court of Delaware disagreed with the Chancellor's conclusion that "the Repurchase Program would operate to provide the director shareholders with a 'veto' to preclude a successful proxy contest by American General."[273] The court also asserted that Unitrin's efforts would not make American General's attempt to wage a proxy fight and institute a merger "mathematically impossible or realistically unattainable,"[274] and affirmed the "range of reasonableness" standard.

Unitrin cautions that robust judicial review of defensive measures might "involve the court in substituting its judgment as to what is a 'better' deal for that of a corporation's board of directors."[275] Although this approach contemplates some substantive review by courts, this view may be quite compatible with the notion of judicial reticence implied by the traditional version of the business judgment rule. It may also harmonize with the observation that the "power to hold to account is ultimately the power to decide."[276] Emphasizing that judicial deference is generally warranted[277] because the board of directors requires "latitude in discharging its fiduciary duties to the corporation and its shareholders when defending against perceived threat,"[278] the Supreme Court of Delaware held that the "Unitrin Board had the power and the duty, upon reasonable investigation, to protect Unitrin's shareholders from what it perceived to be the threat from American General's inadequate all-cash for all-shares Offer."[279]

Providing latitude for such decision-making affirms that board action in responding to a perceived threat can withstand *Unocal* scrutiny when and if the board's conduct falls within the bounds of reasonableness.[280] Affording such latitude tips the actual judicial balance "towards authority values even in a context charged with conflicts of interest.

271. *Id.*

272. *Id.* at 1389.

273. *Id.* at 1380.

274. *Id.* at 1389.

275. Regan, *supra* note 207, at 964 (quoting Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990)).

276. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 108.

277. *Unitrin*, 651 A.2d at 1388.

278. *Id.*

279. *Id.* at 1389–90.

280. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 737.

Given the significant conflicts of interest posed by takeovers, courts recognize the need for some review. But the Delaware courts also seemingly recognize that their power of review easily could become the power to decide."[281] Often this struggle entails disputed conceptions of the scope and application of the business judgment rule. On one account, the *Unocal/Revlon/Unitrin* framework affirms the "search for conflicted interests reflects the Delaware court's solution to the irreconcilable tension between authority and accountability."[282] The result is that "[c]oncern for accountability drives the courts' expectation that the board will function as a separate institution independent from and superior to the firm's managers."[283] This paradigm reasons that only if the directors have "ultimate decision-making authority, rather than incumbent management, will the board's conduct pass muster."[284] If and when board conduct is deemed irreproachable, "respect for authority values will require the court to defer to the board's substantive decisions. The board has legitimate authority in the takeover context, just as it has in proxy contests and a host of other decisions that nominally appear to belong to the shareholders."[285] Bainbridge persuasively contends that the board's authority cannot "be restricted in this context without impinging on the board's authority elsewhere. Authority thus cannot be avoided anymore than can accountability; the task is to come up with a reasonable balance."[286] It is possible that *Unocal* as refined by *Unitrin* strikes the correct balance by allowing the board of directors latitude in discharging its fiduciary obligations in compliance with the "range of reasonableness" criterion that allows the board to act upon reasonable investigation in good faith to protect the target's shareholders.

However persuasive the *Unocal/Revlon/Unitrin* framework may be, the Supreme Court of Delaware's recent decision in *Omnicare v. NCS* disturbed this scaffold.[287] In that case, in an effort to escape the

281. *Id. But see* Bebchuk, *The Case Against Board Veto*, *supra* note 5, at 979 ("[N]one of the arguments made in favor of board veto, nor all of them combined, provides a basis for concluding that board veto serves target shareholders.").

282. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 738.

283. *Id.* This claim remains largely correct whether one accepts or rejects the claim that as a practical matter, the *Unocal* framework has "been reduced to the vitally important—but incomplete—task of ensuring that the shareholders retain the ability to remove their board of directors through the proxy machinery." *See, e.g.*, Regan, *supra* note 207, at 970 (contending that the *Unocal* framework has been reduced).

284. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 738.

285. *Id.*

286. *Id.*

287. Omnicare Inc. v. NCS Healthcare Inc., 818 A.2d 914, 917 (Del. 2003). In "NCS Healthcare, Inc. ("NCS"), a Delaware corporation, was the object of competing acquisition bids,

tentacles of impending insolvency, which was partially related to the difficulty in collecting accounts receivables,[288] NCS agreed to merge with Genesis. Several months after this agreement—but before the stockholders had an opportunity to vote—the board withdrew its recommendation. Instead it proposed that the Genesis transaction be rejected in favor of a purportedly superior transaction with Omnicare.[289] The dispute in the case is grounded in a number of provisions within the initial merger agreement, which were authorized by Section 251 (c) of the DGCL.[290]

One disputed provision mandated that the Genesis transaction be put to a shareholder vote, even if the NCS board no longer recommended it. Additionally, the NCS board omitted any effective fiduciary clause. Two shareholders who collectively held a majority of voting power agreed unconditionally to vote all of their shares in favor of the Genesis merger. Effectively, "the combined terms of the voting agreements and merger agreement guaranteed, *ab initio*, that the transaction proposed by Genesis would obtain NCS stockholder's approval."[291] These agreements were driven in part by the exigency of the NCS's financial situation but also by the fact that Genesis lost a bidding war with Omnicare in a different transaction.[292] NCS was provoked by prior negotiations with Omnicare, which failed to satisfy its objective of providing NCS shareholders with some financial consideration should the various merger/transaction/proposals be consummated particularly in light of its more recent financial improvement.[293]

The most highly contested provision within the merger agreement, however, was a stipulation preventing NCS from entering into discussions with third parties concerning an alternative acquisition of NCS or providing non-public information to such parties, unless: (1) the third-party provided an unsolicited, *bona fide* written proposal; (2) the NCS board believed in good faith that the proposal provided superior terms; and (3) before providing non-public information, the third-party would execute a confidentiality agreement consistent with

one by Genesis Health Ventures, Inc. ("Genesis"), a Pennsylvania corporation, and the other by Omnicare Inc., ("Omnicare") a Delaware corporation." *Id.*

288. *Id.* at 920.

289. *Id.* at 918 ("The competing Omnicare bid offered the NCS stockholders an amount of cash equal to more than twice the then current market value of the shares to be received in the Genesis merger. [It] also treated the NCS corporation's other stakeholders on equal terms with the Genesis agreement.").

290. *Id.*

291. *Id.*

292. *Id.* at 921.

293. *Id.* at 921–22.

the terms of the one already in place between NCS and Genesis.[294]

Disagreeing with the Court of Chancery's determination that "the voting agreements, when coupled with the provision in the Genesis merger agreement requiring that it be presented to the stockholders for a vote pursuant to 8 Delaware Code § 251 (c), constituted defensive measures within the meaning of *Unocal Corp. v. Mesa Petroleum*,"[295] the Supreme Court of Delaware held "that in the absence of an effective fiduciary out clause, [the] defensive measures are both preclusive and coercive."[296] Hence, the "defensive measures are invalid and unenforceable."[297] More importantly, defendant Jon Outcalt, Chairman of the NCS board, owned 202,063 shares of NCS Class A common stock and 3.5 million shares of Class B common stock.[298] Defendant Kevin B. Shaw, President, CEO, and a director of NCS, owned 28,905 shares of NCS Class A common stock and 1.14 million shares of Class B common stock.[299] One issue was whether Omnicare had standing with respect to (1) its fiduciary duty breach claims[300] and (2) its claim that "the NCS charter should be interpreted to cause an automatic conversion of Outcalt and Shaw's Class B stock (with ten votes per share) to Class A stock (with one vote per share)."[301] Both the Chancery and Supreme Court of Delaware agreed that Omnicare had standing with respect to the automatic stock conversion issue. The fiduciary duty issue remained alive, in part, because of a class action initiated by certain NCS stockholders to enjoin the merger.[302] While the Court of Chancery held that Omnicare had standing to challenge the validity of the voting agreements, the lower court reached a decision adverse to Omnicare's interest.[303]

Asserting that "[t]he 'defining tension' in corporate governance today has been characterized as 'the tension between deference to directors' decisions and the scope of judicial review,'"[304] the majority opinion of the Supreme Court of Delaware began by presuming that the business judgment rule assumption provides the initial standard of review.[305]

294. *Id.* at 926.
295. *Id.* at 918.
296. *Id.*
297. *Id.*
298. *Id.*
299. *Id.* at 918–19.
300. *Id.* at 919.
301. *Id.* at 919–20.
302. *Id.* at 920.
303. *Id.*
304. *Id.* at 927.
305. *Id.*

Suggesting that "[u]nder normal circumstances, neither the courts nor the stockholders should interfere with the managerial decision of the directors,"[306] the court accepted that certain circumstances mandate that courts take a more active role in supervising "decisions made and actions taken by directors."[307] Adverting first to the *Unocal/Revlon* scaffold, the court accepted that the *Unocal* analysis applies in a variety of circumstances, including a change of control or where the target firm initiates an active bidding process.[308] Thus, the court assumed, *arguendo,* that the business judgment rule applies to the NCS's decision to merge with Genesis. The deal protection devices designed to enforce this agreement, however, required enhanced scrutiny[309] because "Delaware corporation law expressly provides for a balance of power between boards and stockholders which makes merger transactions a shared enterprise and ownership decision."[310] The absence of an effective fiduciary out clause purportedly prevented the board from discharging its fiduciary obligations to minority shareholders and alternatively was seen as preclusive and coercive.[311] As a result, the objectionable provisions became unenforceable as illustrated by *Unocal*.

This process again raises the "critical distinction between 'enterprise' decisions—whether they be routine or extraordinary—and 'ownership' decisions—particularly those involving contests for control."[312] But in the context of this case, directors motivated to salvage some financial return for shareholders from an imminently insolvent entity find their enterprise decision eviscerated by the Supreme Court of Delaware's holding that re-characterizes the board's decision as an ownership one. While the dissent lucidly disagrees with this assessment by concentrating on whether the board's conduct can be seen as in the best interest of the entity at the time the transaction was agreed to,[313] ownership decision-making, according to the majority, apparently and easily fits the property model, suggesting shareholder primacy safeguarded by intrusive judicial review. The majority's conclusions in concert with *Blasius* may combine to shift the court's focus to accountability worries and thus to severely constrain board discretion

306. *Id.* at 928.
307. *Id.*
308. *Id.* at 929.
309. *Id.*
310. *Id.* at 930.
311. *Id.* at 936.
312. Veasey, *The Business Judgment Rule*, *supra* note 59, at 574.
313. *Omnicare*, 818 A.2d at 939–46 (Veasey, J., dissenting).

formerly and properly protected by the business judgment rule.

B. Protecting the Franchise

It seems clear that collective action problems described in Part II, and as amplified by Bainbridge, prevent the shareholder from exercising meaningful day-to-day control over firm decisions.[314] Equally true, shareholder claims including their voting rights are freely transferable and thus vesting the right to vote in the hands of the firm's shareholders makes possible the market for corporate control and provides a vehicle to minimize shirking by the firm's agents.[315] Consistent with this conclusion, a board may erect takeover defenses that deter certain types of bids, but broadly speaking, the board must leave some mechanism by which the bidder can present and offer to the shareholders.[316] Apparently, this view led to the Delaware rule that a "board may not erect takeover defenses that disenfranchise its shareholders without a 'compelling justification.'"[317]

1. The *Blasius* Rule

In a decision preceding *Unitrin*, the Delaware court suggested that the *Unocal*/*Revlon* framework could be seen as insufficiently rigorous: "The plaintiff, Blasius Industries, the largest stockholder of Atlas Corporation proposed to management that Atlas engage in a series of transactions involving a leveraged recapitalization and a distribution of cash to shareholders."[318] After the Atlas board failed to adopt the proposal, Blasius Industries attempted to take control of the Atlas board through bylaw amendments to expand the board to the maximum number allowable under the Atlas charter.[319] To prevent this, the Atlas board voted to amend the bylaws to increase the size of the board from seven to nine and appointed two individuals to fill those newly created positions.[320] It was the board's intent that the newly appointed directors—consistent with the Certificate of Incorporation—would

314. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 470.

315. *Id.* ("[I]f management fails to maximize the shareholders' residual claim, an outsider can profit by purchasing a majority of the shares and voting out the incumbent board of directors.").

316. *Id*. at 683.

317. *Id*. at 683 n.9. (citing Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995); Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992); Blasius Indus., Inc. v. Atlas Corp., 564 A2d 651 (Del. Ch. 1988)).

318. Cadwalader, Wickersham & Taft, LLP, *Recent Development in Judicial Review of Interference with Stockholder Franchise: Chesapeake Corp. v. Shore* (2000), *available at* http://library.findlaw.com/2000/May/1/129400.html (last visited Apr. 15, 2005).

319. *Blasius*, 564 A.2d at 654.

320. *Id.* at 655.

serve staggered terms,[321] thereby reducing the likelihood of a swift takeover. The board's amendment power was appropriately grounded in the corporate charter, but its timing was suspect. Despite testimony in support of "the proposition that, in acting [when it did] the board was principally motivated simply to implement a plan to expand the Atlas board that preexisted . . . the emergence of Blasius as an active shareholder,"[322] an alternative view implies that the board "was principally motivated to prevent or delay the shareholders from possibly placing a majority of new members on the board . . ."[323] Although it seems clear that the Atlas corporate governance charter provides the board with authority to act in the manner intended to protect shareholders from the risk associated with Blasius Industries' proposal, the possible existence of a dual motivation for the board action and its suspect timing led to more exacting scrutiny than required by *Unocal*. Although *Unocal* and its progeny teach that

> "[c]orporate boards are subject to heightened judicial scrutiny when they respond to circumstances portending a potential change of control of the corporation . . . [*Blasius*] articulated an even higher standard of scrutiny where a board's actions have the primary purpose of impairing the stockholder franchise,"[324] particularly but not exclusively in the context of the election of the directors.[325]

In practice, "lawyers are often consumed by the question of the defendant's motive or purpose. They sometimes fail to appreciate that courts make an equally important inquiry into whether the defendant's action, whatever its purpose, had the proscribed effect."[326] In subsequent cases decided under the *Blasius* doctrine, the conduct predicate becomes a question of whether or not the action at issue precludes or delays "the effectuation of an *imminent* shareholder vote or practically [prevents] or severely [prejudices] pending or proposed shareholder action, [even if] not imminent."[327] Declining to adopt a *per se* rule invalidating such conduct, because such a rule might sweep too broadly, the *Blasius* court instituted a two-part test: (1) a board

321. *Id.*

322. *Id.*

323. *Id.*

324. Cadwalader, Wickersham & Taft, LLP, *supra* note 320.

325. The *Blasius* issue evidently also applies outside of the context of an election of directors. *See, e.g.*, *Blasius*, 564 A.2d at 660 (stating that the allocation of power between directors and shareholders is at issue in "every instance in which an incumbent board seeks to thwart a shareholder majority").

326. David C. McBride & Danielle Gibbs, *Interference with Voting Rights: The Metaphysics of Blasius Industries v. Atlas Corp.*, 26 DEL. J. CORP. L. 927, 930 (2001).

327. *Id.* (emphasis added).

manipulation of the election machinery to thwart or dilute the voting power of certain shareholders, and (2) that the burden of persuasion falls on the board to demonstrate a compelling justification for its conduct.[328] This proposition explicitly incorporates robust (non-deferential) fiduciary duty analysis by suggesting that an action "taken in good faith . . . [may constitute] an *unintended* violation of the duty of loyalty."[329]

Furthermore, the *Blasius* court contends that the question "posed is not one of intentional wrong (or even negligence), but one of authority *as between the fiduciary and the beneficiary* . . ."[330] which suggests that the non-deferential business judgment paradigm can and will be used to constrain directors' authority even when grounded in both their statutory remit and the firm's charter. Borrowing from Bainbridge's discussion of the business judgment rule in a duty of care context, it is possible that on one level the court's approach is consistent with the modern restatement of the business judgment rule signifying that "[d]irectors who violate their duty of care [or any one of the other triads of fiduciary duty] do not get the protections of the business judgment rule; indeed, the rule is rebutted by a showing that the directors violated their fiduciary duty of 'due care'"[331] or loyalty. Unfortunately this conception "is exactly backwards."[332] An alternative understanding of the business judgment rule "prevents plaintiff from litigating that very issue,"[333] because the courts "refrain from reviewing board decisions unless exacting preconditions for review are satisfied."[334]

The *Blasius* court clearly goes further by permitting liability to attach even where the board acts in good faith, without *selfish* motivation, in apparent compliance with its duty of care, but to thwart implementation of a plan that it feared might (within its business judgment) cause great injury.[335] Injury took the form of a risky, highly leveraged restructuring

328. *Blasius*, 564 A.2d at 661–62; *see also* Joshua L. Vineyard, *Let (Corporate) Freedom Ring: Reaffirming the Importance of the Shareholder Franchise in State of Wisconsin Investment Board v. Peerless Systems Corporation*, 71 U. CIN. L. REV. 1443, 1451 (2003).

329. *Blasius*, 564 A.2d at 663 (emphasis added). The *Blasius* proposition continues to be restated and reaffirmed by the Supreme Court of Delaware. *See, e.g.*, Stroud v. Grace, 606 A.2d 75, 92 (Del. 1992) (noting that the standards of review of both *Stahl* and *Blasius* arise from questions of divided loyalty and are well-settled).

330. *Blasius*, 564 A.2d at 658.

331. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 152, at 94–95.

332. *Id.* at 95.

333. *Id.*

334. *Id.* at 87.

335. *Blasius*, 564 A.2d at 658.

proposal that was inconsistent with ongoing corporate policy.[336] Doctrinally, if a breach of the duty of loyalty requires intent, then a board decision that nevertheless exhibits conformity with the triads of their fiduciary duty—good faith, loyalty, and due care—and remains motivated by a commitment to defensible corporate policy, would still fail to receive the protections of the business judgment rule. Alternatively, if a breach of duty of loyalty can be grounded in unintentional conduct, then judicial interference becomes plausible under virtually any set of circumstances.

Against this backdrop, one can discover a persistent shareholder preference against judicial intervention. This preference, however,

> extends only to board decisions motivated by a desire to maximize shareholder wealth. Where the directors' decision is motivated by considerations other than shareholder wealth, as where the directors engage in self-dealing or seek to defraud the shareholders, however, the question is no longer one of honest error but of intentional misconduct.[337]

This is unequivocally missing in *Blasius*. By contrast, in cases where strong self-interest exists, "[d]espite the limitations of judicial review, rational shareholders would prefer judicial intervention with respect to board decisions so tainted."[338]

Either direct or unarticulated misconceptions about the necessity of an aggressive conception of accountability based on a preference for shareholder control, coupled with a concurrent focus on the defendant corporation's motives, possibly lead to the truncation of board authority and discretion without the necessary predicate: self-interest. As Bainbridge notes, "directors are vested with wide powers to exercise their discretion by fiat, those powers are limited by their contractual obligations—both explicit and implied in law—to the factors of production with whom they contract."[339] Clearly, the protection of shareholders' contract rights fits within this paradigm but does not necessarily admit that *Blasius* provides either the best—or even an intelligible—solution. This is particularly true since in *Blasius*, the charter explicitly confirmed the board's authority to engage in the prohibited conduct—to stagger the board and to therefore effectively entrench itself.[340]

336. *Id.* at 654 (noting that the Blasius Group proposed a highly-leveraged recapitalization).
337. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 152, at 122–23.
338. *Id.* at 123.
339. *Id.* at 103.
340. Kahan & Rock, *supra* note 15, at 514.

One might attempt to justify the *Blasius* decision "even though the shareholders opted for a charter-staggered board, [because] the directors undermined the shareholders' commitment to this form of governance by failing to appoint a sufficient number of directors to make the choice effective"[341] before the disputed election contest. Kahan and Rock suggest that because of this, the "directors cannot redress their mistake once the choice actually matters, that is, once a contest for control begins."[342] Nevertheless, a robust commitment to the *Blasius* criteria, particularly where self-interest remains essentially absent[343] and where the directors act in accord with explicitly agreed upon authority, may extirpate desirable judicial reticence and emasculate the determination that "[c]ontrol belongs to a board of directors that is legally independent of shareholders, managers, employees, and all other corporate participants. Taken together, a *Blasius*-inspired approach may eviscerate the integrity of the structure provided by the corporate form.[344] *Blasius*, properly understood, allows insufficient latitude to directors in discharging their fiduciary obligations. Implicitly, if not explicitly, elevated inspection raises the specter of a restricted interpretation of the business judgment rule that might, under certain circumstances, discourage beneficial risk-taking. Although one might assert that the challenged conduct at issue implicates suspect timing, as a general matter, accountability mechanisms must be found that are capable of correcting errors, a frequently invoked and sufficiently strict organ of accountability can easily amount to a denial of board discretion that shifts power if decision-making to judges.[345]

2. *Blasius*'s Progeny in a Takeover Setting

The law firm Cadwalader Wickersham & Taft notes, in its recent treatise on corporate governance, that on several occasions, "Delaware courts have dealt with the application of the *Blasius* standard of review in cases where *Unocal* would also govern."[346] Often a hostile tender offer is coupled with a proxy contest or alternatively with a consent solicitation. Such maneuvers can interfere with shareholder voting.[347]

341. *Id.* at 515.

342. *Id.*

343. *See, e.g.*, Chesapeake Corp. v. Shore, 771 A.2d 293, 318 (Del. Ch. 2000) (citing Chancellor Allen's opinion in *Blasius*). Whatever strict scrutiny means, this review is required even where a good faith belief rather than entrenchment motives drives the board's actions. *Id.*

344. *Id*. at 318–19.

345. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 152, at 109.

346. Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

347. *Id*.

Furthermore, the authors state that "in these cases, it is difficult to distinguish a board's legitimate attempt to counter a hostile tender offer, which is governed by the *Unocal* (and *Unitrin*) standard, with an impermissible attempt to impede stockholder voting, which is reviewed under the more rigorous *Blasius* standard."[348] If the *Blasius* model is sustainable, board motivation is likely to be some combination of proper and improper motives leading to ambiguity. Ambiguity grounded in motivational ambivalence, or in judicial preferences to defer to shareholders or the court's own judgment, unavoidably anticipates judicial intervention. This approach presents difficulties that implicate the appropriate locus of control. Thus, courts have had difficulty in applying *Blasius*, and consequently consistent applications of its holding are rare.

Evidently, in *Stahl v. Apple Bancorp, Inc.*, Chancellor Allen applied a narrow reading to his *Blasius* decision."[349] The Chancellor declined to invoke *Blasius* but upheld the board's action under *Unocal*.[350] Similarly, *Kidsco v. Dinsmore* provides support for the conclusion that some board interference with the shareholder franchise is allowable without triggering a *Blasius* review.[351] Since the court determined that the primary purpose of the board's action was not calculated to prevent effective shareholder action, and since the court accepted the board's argument that its decision to delay the proxy contest was not motivated by a desire to entrench itself, the court considered *Blasius* but declined to apply it.[352] Instead, it applied *Unocal* in upholding the board's action.[353]

Correspondingly, in *H.F. Ahmanson & C. v. Great Western Financial Corp.*, the chancery court declined to apply *Blasius*, relying instead on *Unocal*.[354] Responding to a hostile bid by Ahmanson & Co., the Great Western board cancelled the company's annual stockholders' meeting

348. *Id.*

349. *Id.* In *Stahl v. Apple Bancorp*, Chancellor Allen allowed the board to defer to the planned date, but not to the declared date of the annual meeting in response to a thirty percent stockholder's announced tender offer and planned proxy contest.

350. Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1117–20 (Del. Ch. 1990). *See* Cadwalader, Wickersham & Taft, LLP, *supra* note 318 (discussing *Stahl v. Apple Bancorp, Inc.*)

351. Kidsco v. Dinsmore, 674 A.2d 483, 495 (Del. Ch. 1995).

352. Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

353. *Kidsco*, 674 A.2d at 496 (stating "[o]ur case law clearly establishes that board action [amending the by-laws to give the board an additional 25 days to call a shareholder-initiated special meeting], when taken as a defensive measure against a hostile tender offer coupled with a proxy contest, does not implicate the *Blasius* standard of review").

354. H.F. Ahmanson & C. v. Great W. Fin. Corp., No. 15650, 1997 Del. Ch. LEXIS 84, *1 (Del. Ch. June 3, 1997).

and rescheduled the meeting causing a delay of fifty days while entering into a merger agreement with a "white knight."[355] Because the court determined that the directors' decision did not frustrate the effective and substantive exercise of the shareholders' franchise in light of the threat posed, the court sustained the delay by applying *Unocal* as explicated by *Unitrin*.[356]

These decisions signify the judicial resistance to deploying *Blasius.* For example, Allen explains that, "[j]udicial reluctance to surface the difficult policy choices . . . often manifests itself in elision, that is, the tendency for courts to omit or blur the distinctions between contradictory ideas."[357] Unvaryingly, with this perspective, the Supreme Court of Delaware, in *Williams v. Geier*, accepted certain board-sponsored amendments to the firm's certificate of incorporation.[358] When pursuant to a recommendation of directors, shareholders actually vote on a charter amendment and recapitalization plan granting "a form of 'tenure voting' whereby holders of common stock on the record date would receive ten votes per share . . . [but] [u]pon sale or other transfer, however, each share would revert to one-vote-per-share status until that share is held by its owner for three years."[359] Although the *Williams* plan purportedly favored the majority group of shareholders at the expense of others, the affirmative shareholder vote provided the court with a reason to avoid resolving the possible tension[360] between *Blasius* and the practical necessity that authority be wielded by directors particularly where such authority is attached to the firm's charter. Citing *Stroud*, the Supreme Court of Delaware refused to analyze the disputed conduct through the lens of the "compelling justification" criterion, particularly because it imposed an onerous, even harsh burden.[361] Citing *Aronson v. Lewis*[362] with approval, it employed "the traditional [business judgment] review of disinterested and independent director action in recommending . . . the vote of the stockholders in approving, the Amendment and resulting

355. *Id.* at *2, *57–58. A white knight is a "person or entity friendly to the target company which makes a tender offer in competition to that of the initial bidder." STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 17 (2003).

356. *H.F. Ahmanson*, 1997 Del. Ch. LEXIS 84, at *56 ("Because *Blasius* is inapplicable, the appropriate standard of review is set forth in *Unocal*, as explicated by *Unitrin.*").

357. Allen et al., *The Great Takeover Debate*, *supra* note 121, at 1070.

358. Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996).

359. *Id.* at 1370.

360. Allen et al., *The Great Takeover Debate*, *supra* note 121, at 1070–71.

361. *Williams*, 671 A.2d at 1376.

362. Aronson v. Lewis, 473 A.2d 805 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

recapitalization."[363] The lower court applied *Unocal* and relied on the claim that the plan was reasonably calculated to impede a corporate threat in the form of corporate raiders.[364] Finding a "rational business purpose," the Supreme Court of Delaware did not find any evidence suggesting a primary purpose to impede the Milacron stockholders' vote with respect to the firm's recapitalization plan.[365] Despite the determination that "the Amendment received less than 50 percent of the votes of all the unaffiliated shares outstanding,"[366] the court ruled that neither *Unocal* nor *Blasius* was applicable because the board's action was neither unilateral nor "an act of disenfranchisement."[367] In sum, the Supreme Court of Delaware found that judicial reticence connected to the business judgment rule applies to the action of the independent majority of the board in recommending the advisability of the amendment to the Milacron stockholders and since a fully informed majority of the stockholders voted in favor of the amendment pursuant to "the statutory authority of 8 Del. C. § 242 . . . the stockholder vote is dispositive."[368] Whether the court's analysis is factually correct or not, this case confirms that accountability was primarily at issue. Since the court found that the plaintiff had adduced insufficient evidence to rebut "the presumption of the business judgment rule,"[369] the dispute is largely tested via deferential review. Thus, the *Williams* court failed to find any breach of the Milacron board's fiduciary duty.[370] This decision confirms that shareholder approval of board initiated conduct acts as an additional barrier to intrusive judicial scrutiny.

The dissent maintained a different perspective:

> The question is what is the appropriate standard of review to be employed by the Court of Chancery in reviewing the Milacron Recapitalization Plan that was approved by a vote of the shareholders pursuant to 8 Del. C. § 242, the effect of which will inevitably

363. *Williams*, 671 A.2d at 1377. *See* Vineyard, *supra* note 328, at 1453–54 (discussing the *Williams* decision).

364. *Williams*, 671 A.2d at 1371 (affirming but for different reasons).

365. *Id.* The court found that beyond any desire to obstruct the shareholders' voting rights, among the goals of the recapitalization were the promotion of long-term value by the enhancement of voting rights of long-term shareholders, the ability to issue additional shares of common stock for financing or other purposes with minimal dilution of voting rights of long-term shareholders, and the discouragement of hostile takeovers. *Id.* at 1376.

366. *Id.* at 1374.

367. *Id.* at 1377.

368. *Id.* at 1371.

369. *Id.* at 1377–78.

370. *See id.* at 1378 (finding that the business judgment rule presumption is not rebutted by simply showing that Geier family owned a dominant stock interest); *see also* Vineyard, *supra* note 328, at 1454 (discussing the holding and reasoning of the *Williams* court).

> entrench the majority stockholders, to the ultimate detriment of minority stockholder who did not approve the Plan.[371]

Since the "[p]lan implicates the duty of loyalty,"[372] confers unequal benefits on the majority shareholders' group,[373] and since the intended beneficiaries of the plan own a majority of the outstanding stock virtually assuring approval, the outcome of a shareholder vote could neither serve to immunize the board's decision, nor "lessen judicial scrutiny into the reasonableness of the plan and its fairness to the minority shareholders."[374] The dissent further stated that, "the action of the Milacron Board in instituting and recommending adoption of the Recapitalization Plan implicates the duty of loyalty and therefore, must be subject to full judicial scrutiny, not to judicial deference because of the business judgment rule."[375] More importantly, the dissent agreed with the fairly obvious conclusion that the franchise can permissibly be diluted "where reasonably necessary to accomplish an appropriate corporate business policy."[376] Nevertheless, the dissent relied largely on the *Unocal/Stroud* framework as refined by *Blasius*[377] to reach a decision that differs substantially from the majority view.

Because the shareholders vote approving the plan was essentially meaningless, the dissent's perspective leans heavily on an accountability calculus that constrains board discretion. In the dissent's account, board proposals to reduce the voting power of minority shareholders are required to jump though an elevated gauntlet, even if the proposal complies with the technical mandates of the appropriate statute.[378] Since the dissent must concede that virtually all board decisions in the anti-takeover arena involve some actual or potential conflicts of interest, and since the issue of control was not concurrently at issue, its concern for the viability of future proxy contests or future tender offers engineered by hostile bidders implies one of two alternative viewpoints: (1) that even minority shareholders must retain some decision-making power because they are principals; or (2) judicial scrutiny is necessary to protect shareholders' contract rights, even where the alleged impingement is unlikely to have any substantive

371. *Williams*, 671 A.2d at 1385 (Hartnett & Horsey, JJ. dissenting).

372. *Id.* at 1386 (Hartnett & Horsey, JJ. dissenting).

373. *Id.* (Hartnett & Horsey, JJ. dissenting).

374. *Id.* (Hartnett & Horsey, JJ. dissenting).

375. *Id.* (Hartnett & Horsey, JJ. dissenting).

376. *Id.* at 1387 (Hartnett & Horsey, JJ. dissenting).

377. *See id.* at 1386–89 (Hartnett & Horsey, JJ. dissenting) (criticizing the majority's reliance on *Stroud* and affirming the analysis under *Blasius*).

378. *Id.* at 1387 (Hartnett & Horsey, JJ. dissenting).

effect on later contests for control because even minority shareholders retain rights as property owners to share in any potential control premia. Neither option is necessarily persuasive. Since the benefits of the disputed plan allegedly favor the controlling group and since this group is neither interested in giving up control nor required by law to do so, the dissent's view implies, contrary to earlier precedent, that shareholders possess a contractual right to receive takeover bids.[379]

The *Carmody v. Toll Brothers* case involved a challenge to the Toll Brothers' adoption of a Rights Plan coupled with a "dead hand" feature that "authorizes only a specific, defined category of directors—the 'Continuing Directors'—to redeem the Rights."[380] The Rights Plan contained both a dilutive mechanism triggered by a certain defined event as well as flip-in and flip-over features[381] aimed at dissuading a hostile acquirer from attempting a takeover.[382] The purported purpose of the Rights Plan was "to protect [Toll Brother's] stockholders from coercive or unfair tactics to gain control of the Company by placing the stockholders in a position of having to accept or reject an unsolicited offer without adequate time."[383] While it is settled law "that a corporate board could permissibly adopt a poison pill, the next litigated question became: under what circumstances would the directors' fiduciary duties require the board to redeem the right in the face of a hostile takeover proposal?"[384]

In general, Delaware courts are reluctant to order the redemption of poison pills based on fiduciary duty claims because a persistent bidder can defeat the pill by initiating a tender offer and simultaneously soliciting shareholder proxies aimed at replacing incumbent board members with the bidder's nominees. The nominees can then simply redeem the pill after taking office.[385] Hence, it is clear that some

379. *See, e.g.*, Moran v. Household Int'l, 490 A.2d 1059, 1070 (Del. Ch. 1985) (stating that control over proxy machinery does not involve a contractual right of shareholders), *aff'd* 500 A.2d 1346 (Del. 1985).

380. Carmody v. Toll Bros., 723 A.2d 1180, 1184 (Del. Ch. 1998).

381. *See* BAINBRIDGE, MERGERS AND ACQUISITIONS, *supra* note 355, at 317 (defining a flip-over as a shareholder rights plan that is triggered following the acquisition of a specified percentage of the target's common stock which gives target shareholders the option to purchase acquiring company shares at a steep discount to the market which causes dilution for the bidder's pre-existing shareholders and may have undesirable effects on the bidder's balance sheet). A flip-in plan grants target shareholders rights which become exercisable upon a triggering event. The flip-in enables shareholders of the target company to purchase target stock at a steep discount. Often flip-in plans are adopted in tandem with flip-over plans. *Id.* at 321.

382. *Carmody*, 723 A.2d at 1183–84.

383. *Id.* at 1183.

384. *Id.* at 1186.

385. *Id.*

mechanism exists, which allows for a change of control.[386] The "dead hand" changed everything. The plaintiff filed a complaint alleging

> that the board violated its duty of loyalty because: (a) the 'dead hand' provision was enacted solely or primarily for entrenchment purposes; (b) it was also a disproportionate defensive measure, since it precludes the shareholders from receiving tender offers and engaging in a proxy context . . . and (c) the 'dead hand' provision purposefully interferes with the shareholder voting franchise without any compelling justification . . . .[387]

Although Delaware law precludes equity investors from having a legally enforceable right to sell their interest without board approval, the chancery court sustained all three counts of the complaint, including both the *Blasius*-based fiduciary duty claims[388] as well as the *Unocal*/*Unitrin* fiduciary duty claim.[389] Nevertheless, because the *Unocal*/*Unitrin* framework is adequate, it is doubtful that *Blasius* review can be seen as outcome-determinative.

Since the facts of the case did not implicate control,[390] the chancery court had no occasion to confront takeover concerns in the next case. Hence, *State of Wisconsin Investment Board v. Peerless Systems Corp.*,[391] is included within this subsection for analytical and comparative purposes. In *Peerless*, the plaintiff asserted that the "defendants inequitably, and in breach of their fiduciary duties interfered with and manipulated the voting at the Annual Meeting and deprived Peerless shareholders of their voting rights"[392] when the Chairman adjourned and then reconvened the meeting to facilitate passage of an option plan. Although the adjournment is consistent with section 9 of the Company's Amended and Restated By-Laws,[393] the court reconsidered the firm's conduct in connection with Proposal 2 "to add 1,000,000 shares to the Peerless stock option plan."[394] The court determined that *Blasius* review was required where there was no "formal board action approving the [contested] adjournment [and] it is

386. *Id.*

387. *Id.* at 1189–90 (internal citations omitted).

388. *Id.* at 1194.

389. *Id.* at 1195.

390. *In re* The MONY Group, Inc. S'holder Litig., 853 A.2d 661, 674–75 (Del. Ch. 2004) (noting that "when the matter to be voted on does not touch on issues of directorial control, courts will apply the exacting *Blasius* standard sparingly").

391. Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *1 (Del. Ch. Dec. 4, 2000).

392. *Id.* at *2.

393. *Id.* at *9.

394. *Id.* at *2.

undisputed that Peerless took action through its CEO, director, and co-defendant Galvadon."[395] Thus, Galvadon assumed the position normally reserved for the board in these situations.

Under the *Blasius* review, the court first considered whether Peerless and Galvadon breached the fiduciary duty of loyalty by adjourning the annual meeting without closing the polls on Proposal 2.[396] Second, tying interference with voting-rights to the ideological underpinning of directorial power and accompanying fiduciary duties in a takeover contest, the court stated that the board derives its power from shareholders and cannot interfere with the shareholder vote without collapsing the distinction between the principal (stockholders) and the agent (directors).[397] Agency theory is also suggestive of the shareholder's penultimate decision-making authority. Finding a primary purpose to interfere with or impede the exercise of the shareholder franchise, the court[398] declined to apply deferential business judgment review and also declined to examine the adjournment under the rubric of entire fairness as proposed by the defendant.[399] By denying deferential review, the court increased the possibility that the plaintiff might succeed, because when deferential review is applied, "an attack on a fully informed majority decision to ratify a disputed action or transaction 'normally must fail.'"[400] Equally possible, the court may have accepted the implications of the principal-agent paradigm as well as the modern version of the business judgment rule, implying that the court should substitute its judgment for that of the directors as a general matter. Equally important, the court contends that "*Blasius* sets forth a relatively simple, yet extremely powerful two-part test based on the duty of loyalty."[401]

Whether denying or embracing deferential review, "Delaware courts have struggled with the question of whether and how *Blasius* should be applied in cases involving defensive responses that impact on shareholder voting rights."[402] Should *Blasius* "be treated as standard of review independent of *Unocal* or should the *Blasius* analysis be

395. *Id.* at *22.

396. *Id.* at *23.

397. *Id.* at *24–25.

398. *Id.* at *40–41.

399. *Id.* at *26–27.

400. Stroud v. Grace, 606 A.2d 75, 90 (Del. 1992) (quoting Gerlach v. Gillam, 139 A.2d 591, 593 (Del. Ch. 1958)).

401. *Peerless*, 2000 Del. Ch. LEXIS 170, at *27.

402. Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

incorporated within the framework of *Unocal*?"[403] The recurrent specter of ambiguity coupled with judicial reluctance may imply difficulty with both actual shareholder control and the practical implications of a capacious conception of corporate democracy. Nonetheless, in applying *Blasius* under these circumstances, the *Peerless* court seems to tip the balance toward accountability values including shareholder control as a component of its conception of the proper parameters of its principal-agent model, or, alternatively, the court reifies accountability values based on its desire to protect shareholder property rights in control premia.

The *Chesapeake Corp. v. Shore* opinion once again "confronted the ambiguity of precedent and attempted to reconcile the issue of *Blasius'* status in the context of *Unocal*"[404] during a control contest.[405] The *Chesapeake Corp. v. Shore* decision confirms that reluctance in deploying *Blasius* can be overcome while corroborating the inference that the actual outcome of a case would not necessarily change if *Blasius* review vanished. This case involved a control contest between two corporations in the specialty packaging industry. The plaintiff, Chesapeake Corporation, and the defendant, Shorewood Packaging Corporation, and both boards of directors believed that the companies should be merged.[406] The boards disagreed "on which company should acquire the other and who should manage the resulting entity."[407] However, they recognized that it was susceptible of being devoured by Chesapeake "through a contested tender offer or proxy fight, the Shorewood board adopted a host of defensive bylaws to supplement Shorewood's [existing] poison pill."[408] The purpose of this activity was evident: the new bylaws "were designed to make it more difficult for Chesapeake to amend the Shorewood bylaws to eliminate its classified board structure, unseat the director-defendants, and install a new board amenable to its offer."[409]

403. *Id.*

404. *Id.*

405. Chesapeake Corp. v. Shore, 771 A.2d 293, 296 (Del. Ch. 2000).

406. *Id.*

407. *Id.*

408. *Id.*

409. *Id.* at 296.

> These bylaws, among other things, eliminated the ability of stockholders to call special meetings and gave the Shorewood board control over the record date for any consent solicitation.
>
> Most important, the bylaws raised the votes required to amend the bylaws from a simply majority to 66 2/3% of the outstanding shares. Because Shorewood's management controls nearly 24% of the company's stock, the 66 2/3% Supermajority

The court's concentration on the mathematical impossibility that the hostile bidder might prevail indicates that the board conduct falls outside the "range of reasonableness" rhetoric of *Unitrin*.

Chesapeake, which later purchased more than fourteen percent of Shorewood's outstanding stock,[410] challenged the Supermajority Bylaw's validity on several grounds: (1) that the Shorewood board, dominated by inside directors, without informed deliberations, adopted the Bylaw to entrench itself; (2) the Bylaw provision raised the "required vote to unattainable levels and is grossly disproportionate to the modest threat posed;" and (3) "the defendants' argument that the Bylaw is necessary to protect Shorewood's sophisticated stockholder base, which is comprised predominately of institutional investors and management holders, from the risk of confusion is wholly pretextual and factually unsubstantiated."[411] Chesapeake's argument can be broken down as follows: (A) that the Supermajority Bylaw was intended to have and did have the effect of disenfranchising Chesapeake and precluded it from conducting a successful consent solicitation; (B) that the Shorewood board was trying to entrench itself; and (C) that the board was uniformed in rendering its decisions.[412] Noting that the assertion that "substantive coercion can be invoked by a [target] corporate board in almost every situation," [413] and that therefore, the use of this threat as a justification for aggressive defensive measures could easily be abused,[414] the chancery court found that defendants failed to meet "their burden to sustain the Supermajority Bylaw under either the *Unocal v. Mesa Petroleum Co.* or *Blasius Indus. v. Atlas Corp.* standards of review."[415]

More specifically, finding the proscribed effect[416] present because

> Bylaw made it mathematically impossible for Chesapeake to prevail in a consent solicitation without management's support, assuming a 90% turnout . . . .
>
> Shortly before trial, the Shorewood Board amended the Bylaw to reduce the required vote to 60%.

Id. at 296–97.

410. *Id.* at 311.

411. *Id.* at 297.

412. Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

413. *Chesapeake*, 771 A.2d at 327.

414. *Id.*

415. *Id.* at 297.

416. Evidently,

> [the] proscribed effect of thwarting a shareholder vote or impeding the shareholder franchise has been found in two types of cases . . . The first type of case involves a board's attempt to interfere with an imminent shareholder action. In the second type of case, the threatened or proposed shareholder action is not imminent, but the board action effectively precludes the shareholders from obtaining their objectives, at least

the board raised the required shareholder vote to unattainable levels, the "court reviewed *Blasius* and its progeny to determine the circumstances under which the compelling justification standard should be applied and the relationship between the *Blasius* and *Unocal* standards."[417] Although *Shorewood* unconvincingly asserted that Supermajority Bylaw was not preclusive, the real debate is grounded in whether *Blasius* adds anything to judicial review, which is not already cabined by *Unocal* and its progeny. The *Chesapeake* court citing *Blasius*, and despite evidence suggesting a possible fiduciary duty violation implicating *Unocal*, contended that the real issue is authority—not entrenchment—involving the "'allocation, between shareholders as a class and the board, of effective power with respect to the governance of the corporation.'"[418] If correct, an unrestrained understanding of the *Blasius* framework offers a tempting basis for enhancing shareholder authority. Even so, such authority is provisional and not absolute. The *Chesapeake* opinion noted that the *Blasius* court declined to advance a *per se* rule precluding every board action taken for the "'primary purpose of thwarting the exercise of a shareholder vote,'"[419] hence the compelling justification defense. The compelling justification standard provides a theoretical escape valve, but once the circumstances require *Blasius* review, it is doubtful that defendant boards can prevent judicial reversal of their conduct. Nevertheless, while proponents of *Blasius* contend that directors are not Platonic masters[420]—leaving open the question of who can actually manage and control the corporation ripe for further scholarly and judicial debate—it is possible that in practical terms *Blasius* adds little to the *Unocal* framework *except* to buttress claims unavoidably attached to principal-agent theory that directors are merely wardens of shareholder control. This scheme tips the scales towards presumptive judicial review and away from judicial abstention concerning conduct that appears consistent with board authority.

C. *The Interplay Between* Unocal/Revlon/Unitrin *and* Blasius *Review.*

Assessing the interplay between the *Unocal/Revlon/Unitrin*

until the next election.

McBride & Gibbs, *supra* note 326, at 930. It is argued that "[c]ases involving the second type of conduct are more numerous." *Id.* at 931.

417. Cadwalader, Wickersham & Taft, LLP, *supra* note 318. *See also Chesapeake*, 771 A.2d at 317–24 (analyzing whether the *Blasius* or *Unocal* standard should apply).

418. *Chesapeake*, 771 A.2d at 318 (quoting Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651, 659–60 (Del. Ch. 1988)).

419. *Id.* at 319 (quoting *Blasius*, 564 A.2d at 660).

420. *Id.* (quoting *Blasius*, 564 A.2d at 663).

framework and the *Blasius* criterion is an admittedly messy enterprise. This is true because neither the circumstances nor the judicial language supplied by the courts in this arena is separable into tidy categories. Both frameworks are crucially concerned with the duty of loyalty.[421] *Blasius* locates possible breaches of the duty of loyalty even where the board is not selfishly motivated. Additionally, the language of accountability located within the interplay between *Unocal/Unitrin* and *Blasius* frameworks has negative implications for authority. The reverse is also true. Accordingly, the analysis that follows will at times overlap, suggesting that clarity remains opaque.

DiCamillo and Williford suggest that "while no Delaware court has ever held that a board had a 'compelling justification' under *Blasius*, there have been multiple occasions on which a board action has been held to withstand *Unocal* scrutiny."[422] While the debate simmers over the locus of control, the courts have "recognized the high degree of overlap between the concerns animating the *Blasius* standard of review and those that animate *Unocal*."[423] Parenthetically, "[a] judicial standard of review is a value-laden analytical instrument that reflects fundamental policy judgments. In corporate law, a judicial standard of review is a verbal expression that describes the task a court performs in determining whether action by corporate directors violated their fiduciary duty."[424] Indisputably, "[t]here exists a close, but not perfect, relationship between the standard by which courts measure director liability (the 'standard of review') and the standard of behavior that we normatively expect of directors (the 'standard of conduct')."[425] Standards of review and behavior may change with the context: "[i]t is quite different for a corporate board to determine that the owners of the company should be barred from selling their shares than to determine what products the company should manufacture."[426] Although this claim implies that more searching judicial scrutiny is appropriate when directors make decisions about 'ownership' rather than 'enterprise'

421. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (suggesting that certain board conduct in the context of a possible takeover attempt is possible "provided the directors have not acted out of a sole or primary purpose to entrench themselves in office"); Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *27 (Del. Ch. Dec. 4, 2000) (stating that "*Blasius* sets forth a relatively simple, yet extremely powerful, two-part test based on the duty of loyalty"); *see also supra* Part III.A & B (discussing shareholder voting power as compared to directorial control of corporate governance).

422. DiCamillo & Williford, *supra* note 90, at 3.

423. *Chesapeake*, 771 A.2d at 320.

424. Allen et al., *Function Over Form*, *supra* note 82, at 867.

425. *Id.*

426. *Chesapeake*, 771 A.2d at 328.

issues,[427] and while the claim suggests that shareholders are in fact principals, it fails to either illuminate or locate a bright boundary separating ownership from enterprise issues. This distinction, therefore, remains murky. Still, under the circumstances, the language of ownership likely requires substantive judicial review of board decisions.

1. *Blasius* and *Unocal*: General Observations

Confirming that the *Blasius* and *Unocal* standards of elevated judicial review are not mutually exclusive,[428] the court in *Stroud v. Grace* held that *Unocal* applies to any defensive measure which affects control regardless of whether the measure affects voting rights.[429] Because of the ever present "possibility that subjectively, well-intentioned, but nevertheless interested directors, will subconsciously be motivated by the profoundly negative effect a takeover could have on their personal bottom lines and careers,"[430] *Unocal* on this account justifies substantive judicial review without the necessity of resorting to *Blasius*. In concert with this conclusion, *Chesapeake* stated consistently with *Stroud v. Grace* that "[a]llowing . . . directors to use a broad substantive coercion defense without a serious examination of the legitimacy of that defense would undercut the purpose the *Unocal* standard of review was established to serve."[431] However compelling, it fails to substantiate the necessity of the *Blasius* review because the *Unocal /Unitrin* standard, standing alone, might be up to the task of providing a serious examination of any defensive measure.

Nevertheless, when the board interferes with the franchise in response to a hostile threat to control, the trial court cannot "ignore the teaching of *Blasius* but must 'recognize the special import of protecting the shareholders' franchise within *Unocal's* requirement that any defensive measure be proportionate and reasonable in relation to the threat posed.'"[432] This analysis appears unconvincing on several grounds.

427. E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 394 (1997) (noting that "enterprise" issues, such as what product to manufacture, face less scrutiny than ownership issues, such as mergers).

428. Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992).

429. *Id*.

430. *Chesapeake*, 771 A.2d at 328–29.

431. *Id.* at 329.

432. *Id.* at 320. In a similar vein, *Unitrin* endorsed the Supreme Court of Delaware's "acceptance of the 'basic tenets' of *Blasius* . . . [where] [t]he court explicitly stated that it began its examination of the repurchase program 'mindful of the special import of protecting the shareholder's franchise within *Unocal's* requirement that a defensive response be reasonable and proportionate.'" Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

Vice Chancellor Strine offers this breakdown: the "*Unitrin* opinion [goes] even further than *Stroud* in integrating *Blasius's* concern over manipulation of the electoral process into the *Unocal* standard of review . . . [the Supreme Court of Delaware] emphasized the 'assiduousness of its concern about defensive actions designed to thwart the essence of corporate democracy by disenfranchising shareholders.'"[433] This contention is doubtful because "when it came time to assess whether the [c]hancery [c]ourt's determination that the repurchase program was invalid was correct, the Supreme Court [of Delaware] in *Unitrin*] appeared to eschew any application of the compelling justification test."[434] Furthermore, the court did not mention *Blasius* again during the remainder of its opinion or apply the *Blasius* test.[435] The court relied solely on *Unocal*,[436] and "thus left unanswered the question most important to litigants: when will the compelling justification test be used, whether within the *Unocal* analysis or as a free-standing standard of review?"[437] Nonetheless, the language suggesting an assiduous concern for defensive action designed to thwart corporate democracy, while not necessarily outcome determinative, carries a banner charged with the power to tip the accountability/authority continuum toward shareholders and the courts, and away from directors.

The validation of voting rights independent of the shareholders' contract rights may imply stockholder control and shareholder-based authority as the null hypothesis.[438] This may also be viewed as a thorny, exacting, but rather infrequent, constituent of the accountability nexus that is framed by *Unocal* and its progeny. The latter conclusion may imply that courts are committed to the determination that directors must be permitted to exercise the power of fiat regardless of the circumstances subject to caveats surrounding self-interest that require the responsible exercise of authority. Since the *Blasius* rule is often intertwined with the *Unocal/Revlon* framework, it is possible that "there may be no more difficult area in which to draw lines."[439] As one set of observers notes, "[a] court's first challenge . . . is to determine the ever-elusive 'purpose' of the board's action. . . . Moreover, there is the

433. *Chesapeake*, 771 A.2d at 320–21.

434. *Id.* at 321.

435. *Id.*

436. Cadwalader, Wickersham & Taft, LLP, *supra* note 318.

437. *Chesapeake*, 771 A.2d at 321.

438. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659–60 (Del. Ch. 1988) (discussing the importance of shareholder voting to the legitimacy of directorial power and the allocation of authority between the board and shareholders).

439. McBride & Gibbs, *supra* note 326, at 928.

equally daunting task of determining what acts constitute 'thwarting a stockholder vote' or 'interfering with or impeding the shareholder franchise.'"[440]

Further, the court's concern for accountability in its *Blasius* sense is extremely difficult to separate from its similar concern addressed directly within the *Unocal* framework, one that requires elevated scrutiny of the business judgment rule paradigm, but which also provides the board with substantial discretion within the range of reasonableness criterion. This observation destabilizes the claim that *Blasius* should have independent significance. Consistent with this observation, (even) persistent proponents of *Blasius* concede that certain cases indicate that *Blasius* review will be applied to *actual* business transactions that are approved by the board. If true, this implies that there are substantial practical problems in proving improper purpose because it may become difficult to determine the primary purpose of a transaction that could truthfully have two equally significant purposes.[441] Nonetheless, they concede that business decisions are more appropriately evaluated under the business judgment standard.[442] If this perspective is accepted, it implicates and preserves *Unocal* and diminishes the necessity of applying *Blasius*. This determination implicates and preserves the *Unocal* standard.[443]

Attorneys McBride and Gibbs further argue that, "[w]here the challenged board action involves a business transaction, *Blasius* usually has been found not to apply, even where the transaction had the effect of diluting or interfering with voting rights."[444] McBride & Gibbs point out that the judicial precedent in Delaware courts strongly reaffirms the *Blasius* court's admission that when the board recommends a course of action that is decided by a shareholder vote without any coercion, the proposed action will withstand scrutiny regardless of potential constraints on future shareholder action or adverse effects on the future operation of the shareholder franchise.[445] Hence, board interference with future shareholder voting rights remains entirely plausible without

440. *Id.* at 928–29.

441. *Id.* at 939.

442. *Id.*

443. *Id.*

444. *Id.*

445. *Id.* at 934 (noting that this situation does not raise a Blasius issue). *See also* Williams v. Geier, 671 A.2d 1368, 1370–71 (Del. 1996) (affirming a form of tenure voting that might favor stockholders who are members of a majority bloc by allowing them to retain control even after selling some of their shares because a majority of fully informed stockholders voted in favor of the amendment).

the necessity of proving the "compelling justification" defense if the process following shareholder approval unmistakably confirms the locus of control in the hands of the board of directors. This perspective verifies judicial concentration on the timing of the disputed board action and harmonizes with an earlier observation that if a business transaction has the effect of diluting or interfering with voting rights, *Blasius* does not and should not apply.[446] This is the case, presumably, because control of business decisions properly resides with directors. Equally correct, if *Unocal* requires less intensive judicial review than *Blasius*, coupled with less expansive language concerning shareholder control, it may have the advantage of preserving more directorial authority[447] by implying that directors rather than shareholders are the embodiment of the principal: the corporation itself.

When courts limit the application of the *Blasius* criterion, it is possible that *Unocal* becomes the only standard left standing. In practice, Delaware courts have constrained *Blasius* review under several circumstances, some of which are interconnected. To repeat, the timing or the form of the alleged interference acts as an important limitation on the application of *Blasius*. At issue is whether the board is attempting to block action that in some sense threatens its immediate control, or whether future shareholder votes retain the possibility (not necessarily the likelihood) of succeeding[448] in some reasonable time period; or, alternatively, whether the action taken occurred in such a form that the court can safely ignore any collateral yet substantive impact on the purported rights of shareholders to decide. This latter alternative may be consistent with judicial formalism. For example, when "the factual predicate of unilateral board action intended to inequitably manipulate the corporate machinery is completely absent,"[449] the *Blasius* criterion does not seem to apply. That analysis remains unpersuasive because

446. McBride & Gibbs, *supra* note 326, at 939.

447. *Blasius*, for instance, contains the following example of expansive language: "[j]udicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not in my opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment." Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 (Del. Ch. 1988).

448. *See, e.g.*, Chesapeake Corp. v. Shore, 771 A.2d 293, 344–45 (Del. Ch. 2000). *Blasius* criterion applies to defendants conduct and they could not satisfy the "compelling justification" standard because they adopted a supermajority bylaw as a way of reducing the voting power of the minority shareholder/hostile acquirer and in doing so it treated Chesapeake's votes as less equal than others. *Id.* at 344–45. The primary purpose was to impair Chesapeake's ability to win the Consent Solicitation by raising the required majority to a preclusive level thereby making it mathematically impossible for Chesapeake to win. *Id.* at 344–45.

449. Stroud v. Grace, 606 A.2d 75, 92 (Del. 1992).

what constitutes inequitable manipulation remains an abstract question. It is possible to legally recast a transaction from a merger requiring a vote under NYSE rules, but not under the Delaware General Corporate law, into a tender offer that does not require a vote without triggering *Blasius* review.[450] Instead, *Unocal* analysis (which is arguably well qualified to test inequitable and equitable conduct) appears necessary. Shareholder voting rights are therefore not formally "thwarted [*qua* voting rights] when a board's action prevents a shareholder vote that is not required by the corporate law."[451] The substantive outcome of the board's action is evidently lost in the court's adherence to formalism. Further, although the courts are concerned with board decisions that limit shareholders voting rights in apparent contravention of the enabling language of the Delaware code,[452] they are not necessarily animated by the consequence of the corporate decision when it has the effect of limiting or constraining shareholder voting. Taken together then, consistently with *Unocal* and nearly all of its progeny, directors can permissibly engage in conduct that impairs the franchise as long as it is done within a proscribed boundary.[453]

The *Blasius* and *Unocal* analyses originated in somewhat different contexts: proxy contests and hostile tender offers. Those contexts frequently overlap because given the otherwise preclusive effect of a poison pill, "hostile takeover attempts often could not be successfully pursued without a proxy contest to elect a new board."[454] Accordingly, replacement of the board became an essential feature of the hostile offering strategy, and absolutely necessary if the poison pill was to be redeemed.[455]

Given this confluence of issues, and upon further analysis, most of "the post-*Blasius* decisions surfaced the reality that a sorting mechanism was needed to insulate [the board] from the severe 'compelling

450. McBride & Gibbs, *supra* note 326, at 934 n.38. *See also* Paramount Communications, Inc. v. Time Inc., No. 10866, 1989 Del. Ch. LEXIS 77, at * 76, 78 (Del. Ch. July 17, 1989) (finding no "intrusion upon the effective exercise of a right possessed by the shareholders" where the board resisted a merger agreement, because "Delaware law created no right in these circumstances to vote upon the original Warner merger").

451. McBride & Gibbs, *supra* note 326, at 934.

452. Therefore, the courts protect the statutory mode for the elimination of classified boards by shareholder voting even where the circumstances lead to the ultimate removal of a director in a classified position. *See, e.g.*, *Chesapeake*, 771 A.2d at 346 (citing title 8, section 109 of the Delaware Code for the proposition that shareholders of the target company have the power to amend the company's bylaws to eliminate a classified board structure).

453. *See, e.g.*, *id.* at 345–46 (focusing on the extent of the hostile threat and the reasonableness of the response—mirroring *Unocal's* elements).

454. Allen et al., *Function Over Form*, *supra* note 82, at 887.

455. *Id.*

justification' test, situations where directors took direct action to influence the electoral process, but in a manner that was consistent with their legitimate authority;[456] but "*Unocal*, rather than *Blasius*, provided the more attractive vehicle for judicial review in those latter circumstances."[457] *Unocal* "requires directors to establish the corporate objectives their actions were intended to serve, and requires the court examine the objective effects of the directors' actions."[458] Thus, *Unocal*, by requiring the court to decide whether any defensive measure, including any attempt to manipulate the vote, is preclusive or coercive gives courts the tools necessary to answer this predicate question: did the directors act with the primary purpose of disenfranchisement implying entrenchment or some other proscribed motive?[459]

Evidently, *Blasius* "contained no such analytical guideline to help the court decide that threshold issue."[460] If *Blasius* retains vitality, it should be placed squarely on the accountability side of the accountability/ authority continuum while courts remain wary of the possibility that accountability can devour authority. Despite obvious limits to the *Unocal* approach,[461] and despite the possibility that *Unocal* is itself objectionable, these observations likely remain crucial despite the Supreme Court of Delaware's recent *Liquid Audio* decision reinvigorating *Blasius* review.

Despite its difficulties, *Blasius* continues to attract scholarly support. One narrative overlaps earlier analysis but nonetheless offers a succinct operational summary of the *Blasius* doctrine. First, "conduct, which has the proscribed effect, often involves a weighing of two factors: the imminence of shareholder action and the degree to which the director's

456. *Id*.

457. *Id.*

458. *Id.*

459. Specifically, *Unocal*—as refined by *Unitrin*—requires the court to decide whether any 'defensive measure' (as any attempt to manipulate a vote presumably is) is preclusive or coercive. The elements of the *Unocal*/*Unitrin* analysis therefore gave courts the tool to answer the predicate question to the application of *Blasius*: did the directors act with the primary purpose of disenfranchisement? *Id*.

460. *Id. See also* McBride & Gibbs, *supra* note 326, at 939 (stating "[w]hile the cases do not articulate any standard of proof other than the standard applicable in any civil action, an examination of the cases suggests that the court usually finds the necessary improper motive when the defendant admits to the improper motive or when the defendant offered a plainly illogical or incredible purportedly proper motive").

461. One asserted limitation is the claim that the courts, by endorsing the concept of substantive coercion, have essentially reduced the *Unocal* review to an assurance that shareholders will retain the power to remove the board in a proxy contest at the next election. *See* Regan, *supra* note 207, at 968.

action precludes, delays, or renders the shareholder action more difficult."[462] Second, "the court is much more likely to find that action having the proscribed effect was undertaken for that purpose if the board action does not involve a business decision, but only relates to the governance or electoral process of the corporation."[463] This account contends that the "*Blasius* standard serves a purpose not served by *Unocal* [because] *Blasius* applies when the board action at issue does not [necessarily] involve a contest for control or a defensive action but does involve the requisite purpose and effect."[464] Third, "the evidence of the proscribed motive must be particularly strong."[465] Finally, it has so far proved impossible for directors to establish a "compelling justification."[466] The latter two points either limit the application of *Blasius* or hint that once improper motive is found, the exacting defense persists as an implausible hypothetical.

For a number of reasons, this summary is of limited usefulness. For example, McBride & Gibbs assert that *Blasius*—as opposed to *Unocal*—has the advantage of precluding board action that interferes with the franchise outside of the contested takeover context.[467] If true, that distinction might be capable of separating *Unocal* and *Blasius* review while failing to explain the necessity of *Blasius* evaluation within the context of a control dispute, or when the board amends either its bylaws or its charter for defensive purposes in the face of anticipated or actual threats by hostile acquirers. Furthermore, in its most common circumstance—the contest for control—if the retention of control truly constitutes a business decision intended to protect corporate policy,[468] it

462. McBride & Gibbs, *supra* note 326, at 929.

463. *Id.*

464. *Id.*

465. *Id.*

466. *Id.*

467. In settings outside of takeovers, one might seek to invoke *Blasius* by arguing that the board's non-business decision concerning the electoral process interferes with the pre-commitments of the parties; in particular, the contract right of equity holders. If this line of analysis is persuasive, *Blasius* could still be characterized as a contentious and often-muddled device to vindicate shareholders' rights to participate in an election. By contrast, in a takeover setting, the board's alleged interference with voting rights might be simply aimed at entrenchment and could be properly tested under *Unocal*.

468. *See, e.g.*, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989) (affirming the board's revised merger agreement between Time and Warner that precluded shareholders from accepting Paramount's tender offer because "[d]irectors 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); Unocal v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985) (upholding the "validity of a corporation's self-tender for its own shares which exclude[d] from participation a stockholder making a hostile tender offer for the company's stock" because the device adopted was reasonable in relation to the threat posed and,

is doubtful that the courts can neatly separate the electoral component from the board's business decision opposing coercive tender offers, or offensive proxy solicitations, any more than they can supply a bright line cleanly separating accountability concerns from authority mandates. Nonetheless, amplifying their prior analysis, McBride & Gibbs insist that "actions governed by the *Blasius* standard are most typically actions that involve the electoral process or the election of directors as distinct from business transactions that have either the incidental effect or primary purpose of affecting the voting process."[469] As a predicate to invoking *Blasius* review, the conduct at issue must have the effect of interfering with or impeding the franchise of the shareholders, and that effect must be its primary purpose. The proscribed effect is easier to establish for conduct relating to the electoral process. Nevertheless they assert that "a business transaction, such as the issuance of shares, [which dilutes the voting rights of shareholders] may be found to have the sole or primary purpose of interfering with the shareholder franchise even through it arguably has an independent business justification and effect."[470] Overall, this paradigm lacks clarity although it may implicate the contested distinction between purported enterprise decisions and ownership decisions, even if this distinction cannot be clearly made. Additionally, McBride & Gibbs' latter conclusion, which discounts transactions that have an independent business justification and effect, weakens directors' authority to manage the business.

In addition, most of the cases cited as having an independent electoral effect also implicate takeover decisions.[471] This raises a question whether the motivating force was entrenchment and resistance requiring fiduciary duty analysis or some other independent desire to interfere with the stockholder's franchise that, in many cases, also requires fiduciary duty analysis, while concurrently implicating the proper locus of control. At issue is whether the board's actions are preclusive

as such, it was a proper exercise of the board's business judgment).

469. McBride & Gibbs, *supra* note 326, at 936.

470. *Id.* at 938.

471. *See, e.g.*, *id.* at 935–38 (citing cases involving non-business decisions concerning the electoral process including *Blasius* itself, *Aprahamian*, *Peerless*, *Carmody* and *Chesapeake*—four of the five cases involve a contested takeover attempt and an attempt to use or misuse the electoral process to thwart the hostile takeover—only *Peerless* can be plausibly seen outside of the takeover context). Always at issue in a *Blasius* type case is whether the board's action had the *primary* purpose of impairing the shareholder franchise and secondly, whether the action had the *proscribed* effect. The proscribed effect seems to implicate board conduct that precludes, delays or otherwise impairs the effectuation of an imminent shareholder vote or severely prejudices pending or proposed shareholder action that is not necessarily imminent. *Id.* at 930.

(preventing the election of a new board majority or otherwise allowing a change of control) or whether there is also a primary purpose to interfere with the shareholder franchise.[472] Further, of the cases cited for the proposition that *Blasius* "is not limited to board decisions involving the electoral process or the election of directors," a number were decided before and not after *Blasius*.[473] Together, it is likely that after inspecting the decisions cited in support of the asserted distinction between business decisions that implicate *Blasius* and non-business/electoral decisions that require *Blasius* review, one may be left with a distinction that makes little difference in a takeover setting, but which may have expansive interpretative implications for corporate governance in virtually every situation in which a *Blasius* appraisal is mandated. In fact, if strong evidence of the proscribed motive can be found, it is difficult to locate an objective basis for the finding of an entrenchment motive that is different from the one that is already highly testable under *Unocal*'s fiduciary duty focus.[474]

2. *Blasius* Review in the Mirror of Accountability and Authority

The *Blasius* court observed that board action designed principally to interfere with a shareholder vote provides an opportunity for conflict between the board and its shareholder majority.[475] In such circumstances, judicial review "involves a determination of the legal and equitable obligation of an agent towards his principal," which gives rise to a question that cannot be left to the agent's business judgment even when done honestly and in good faith.[476] That contention is fragile, because it assumes, but cannot prove, that directors are simply

472. In fact, the cases substantiate that:

> In the more typical case involving board actions touching upon the electoral process, the question of whether the board's actions are preclusive is usually hotly contested. And the preclusion question and the issues of the board's "primary purpose" are not easily separable. The line between board actions that influence the electoral process in legitimate ways (e.g., delaying the election to provide more time for deliberations or to give the target board some reasonable breathing room to identify alternatives) and those that preclude effective stockholder action [in the typical case] is not always luminous.

Chesapeake Corp. v. Shore, 771 A.2d 293, 320 (Del. Ch. 2000).

473. McBride & Gibbs, *supra* note 326, at 938. *See id.* at 938 n.57 (citing Condec Corp. v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967) (enjoining a stock issuance); Canada S. Oils, Ltd. v. Manabi Exploration Co., 96 A.2d 810 (Del. Ch. 1953) (same); Phillips v. Insituform of N. Am., Inc., No. 9173, Del Ch. LEXIS 474 (Del Ch. 1987)) ("In each of these cases, the court found that the primary purpose for the business transaction at issue was not to advance the interests of shareholders, but to dilute the voting rights of dissident shareholders.").

474. *See supra* Part III.A (discussing the *Unocal* standard).

475. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660 (Del. Ch. 1988).

476. *Id.*

shareholders' agents. On the other hand, consistent with the principal-agent model, the court's contention is suggestive—suggestive of principal (stockholder) control. While the principal-agent model discovered by Berle and Means verifies collective action problems and rational apathy, it exudes a preference for shareholder control with directors acting as their trustees.[477] If courts accept this invitation, they fail to fully appreciate the so far uncontroversial possibility (accepted in a derivative suit context) that the corporation itself is the true principal—not the shareholder.

All observers, no matter their theory of corporate governance, are likely to agree with the claim that "[t]he right to respond to a hostile takeover bid is about control."[478] Equally true, the courts of Delaware confirm their profound suspicion of board activity that has the capability to manipulate or interfere with the shareholder franchise. Judicial disquiet is driven by a concern for accountability and agency costs on the one hand, and ultimate control on the other without fully understanding that the "board cannot be made more accountable without shifting some of its decision-making authority to shareholders or judges."[479] While virtually no one believes that the board should have unfettered authority, it is possible that accountability concerns can become so prominent that they trump the general need for deference to the board's authority.[480] Nevertheless, courts may be taken by either of two complementary claims: (1) "whatever is better for shareholders at any point in time is 'better' in some larger social sense;" or alternatively (2) awarding shareholders more power is better because such a view is more consistent with the conclusion that shareholders are owners of the corporation and that more power honors their property rights in the firm.[481]

While it is not altogether clear that a corporation is a thing that is capable of being owned,[482] whatever the source of judicial suspicion and whether it originates with or independent of the commentators, it may lead to incongruity. For example, overt concern for board manipulation, shareholder voting as an instrument of undistorted shareholder choice, and possibly even corporate social responsibility

477. Paredes, *The Firm and the Nature of Control*, *supra* note 47, at 109–10.

478. *Id.* at 177.

479. Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 108.

480. *Id.* at 108–09

481. Blair, *supra* note 22, at 37–38.

482. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 564 (comparing Milton Friedman's implicit view that a corporation is a thing capable of being owned with the view of contractarians who espouse the opposite).

may deepen an earlier stated paradox. It has been energetically stated by proponents of "shareholder choice," that since "boards are self-interested in responding to hostile bids that shareholders should independently determine whether to accept or reject an offer . . . [nevertheless] [w]hen shareholders consent to rules that enshrine board power, they call for legal intervention to set these rules aside."[483] This outlook and its accompanying paradox may be consistent with the contemporary perception that the business judgment rule is a standard of liability as well as a vehicle for intrusive judicial review. By contrast, this view remains inconsistent with director primacy, which reckons that directors are not agents of shareholders but rather effectively embody the corporate principal.

The *Unocal/Revlon/Unitrin* scaffold may either dispute or more likely imply that authority is most appropriately vested in the directors while providing a sufficient accountability framework. It appears that the latter view, at least before *Unocal* jurisprudence took on a life of its own,[484] is sufficiently appealing. Alternatively, one may be drawn to an over-eager accountability framework that seems more consistent with *Omnicare*. Still, disquiet connected to board manipulation of voting rights and board veto of shareholder action persists. Nonetheless, it is likely that the concerns about scandal, unchecked management, and the meltdown of several large public companies in recent years continues to ensure that accountability, agency costs problems, and efforts aimed at enhancing shareholder control take center stage despite the actual structure of the corporate form that confirms that directors, either out of practical necessity or through a process of gap-filling get "to decide."[485] Operating from a team production perspective, Margaret Blair clarifies the problem of choosing the appropriate organizational form involving a large number of actors by suggesting that organizations must deal with contingencies, lack of trustworthiness, bounded rationality, opportunism and self-interest.[486]

483. Kahan & Rock, *supra* note 14, at 475.

484. *See infra* Part V (discussing this possibility in conjunction with the Omnicare case).

485. Blair, *supra* note 22, at 43.

486. Stating:

> The problem of choosing appropriate organizational forms and rule arises whenever people agree to work together to accomplish complex and long-term goals. If people could foresee all contingencies, and if they were all completely cooperative and trustworthy, almost any organizational form would work, because no one would try to take advantage of private information or unforeseen events. But as Oliver Williamson noted long ago, people are "boundedly rational" and behave opportunistically. Thus, productive activity that involves many people is susceptible to being co-opted or diverted to serve the interests of one or more participants at the expense of others. It is

In contradistinction with Blair's observations, overemphasizing purported board manipulation may conflate the embedded concern for accountability (grounded in a potential or actual conflict of interest) with the dictates of authority that require that directors act as more than stewards of shareholder interest.[487] In harmony with that observation, shareholder voting rights implicated by adverse board action, whether reviewed within or outside the *Blasius* framework, should not be viewed as part of the firm's decision-making continuum, but one of many accountability tools.[488] While it has been asserted that *Blasius* "serves the purposes of promoting clarity,"[489] I am persuaded that if clarity and coherence place the *Blasius* criterion along the accountability/authority continuum, it is unlikely to or may only reluctantly serve a purpose independent of *Unocal/Revlon*/*Unitrin* other than to enhance shareholders' authority claims. Given this background and coupled with actual court opinions construing and analyzing *Blasius*, it adds, if anything, redundancy to judicial review in a typical case in the takeover pantheon. This weakness underscores judicial reluctance to rely on this case. Nevertheless, an unreflective commitment to the *Blasius* language and its shareholder status-enhancing claims, just like the persistent invocation of scandal can serve to strengthen shareholder claims to control either outside or within the takeover arena. Perforce, if judicial reluctance is overcome and if the *Blasius*'s criteria are fully accepted, they have the capability of symmetrically expanding shareholder power by constraining the often necessary authority granted to directors by relevant jurisdictional statutes and the pre-commitment of the parties.

> therefore impossible to write complete contracts that will elicit best efforts and cooperation by all participants in the enterprise. Productive organizations, or firms, provide an alternative solution to this problem by establishing a set of gap-filling rules about who gets to decide what as the enterprise proceeds. Corporations in particular come with a set of default rules that, under U.S. law . . . provide continuity and possibly perpetuity of existence; they provide for control by a board of directors; they provide free transferability of interest; and they provide a mechanism for locking in the capital used in the enterprise without locking in the investors.
>
> Hence, under current corporate law, it is possible for investors to form an organization, invest capital in that organization, turn control over to an independent board of directors, and pre-commit not to withdraw their invested capital prematurely, or capriciously, or in ways that harm other participants in the enterprise.

Id.

487. *See, e.g.*, Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, *supra* note 65, at 547 (noting that, under a shareholder primacy theory, shareholders own the corporation and "directors and officers are mere stewards of the shareholders' interest").

488. Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 805 (stating that "shareholder voting rights are not part of the firm's decision-making system, but [are] simply one of many accountability tools").

489. Vineyard, *supra* note 328, at 1466.

The rise of *Blasius* review, even where no improper entrenchment motive can be found, is congruent with the rise of the modern business judgment rule and the reduction in judicial deference to board authority.

IV. *LIQUID AUDIO* AS THE PARAGON OF RECENT VOTING RIGHTS CASES

The panorama of recent cases applying *Blasius* is not vast. Some supply evidence of a substantial commitment to private ordering, particularly where a statutory basis and the firm's corporate charter reflect such a commitment.[490] Other cases provide empirical evidence of the tension between fiduciary duties and the adverse effects of dilution on the one hand, and board authority on the other.[491] Still others involve a shareholder challenge to a merger transaction based on several contentions, including one that the directors failed to make certain material disclosures and that a vote connected to old proxies required invalidation of the newly scheduled shareholder vote.[492]

The last instance, referencing In re *MONY*, verifies that *Blasius* review is most critically applied in the context of an election of directors, but nevertheless affirms the possible application of *Blasius* review to any action taken by the board that affects the shareholder vote.[493] Another case involved a complex claim brought by a publicly-traded subsidiary against its publicly-traded parent to enjoin the parent from selling its controlling interest and to void certain subsidiary bylaws adopted by the parent and controlling shareholder.[494] In still another case, the Supreme Court of Delaware faced an adoption of certain defensive measures by the board of directors, which changed the size and composition of the board's membership.[495] This review primarily concentrates on the last case described, *Liquid Audio*, first because it was decided by the Supreme Court of Delaware; second because it directly confronted the intersection of *Blasius* and *Unocal*;

490. *See, e.g.*, Jones Apparel Group, Inc. v. Maxwell Shoe Co., Inc., No. 365-N, 2004 De. Ch. LEXIS 74, at *17 (Del. Ch. May 27, 2004) (stating that a company's choice of the statutory rule for record dates "avoids the need for the board to enmesh itself in a record-date setting process that can give rise" to claims under *Blasius*).

491. *See, e.g.*, Acker v. Transurgical, Inc., No. 201-N, 2004 Del. Ch. LEXIS 40, at *49 (Del. Ch. Apr. 22, 2004) (denying a corporation's motion to dismiss claims for the board's alleged breach of fiduciary duties).

492. *In re* The MONY Group, Inc. S'holder Litig., 853 A.2d 661 (Del. Ch. 2004); *see also In re* The MONY Group, Inc. S'holder Litig., 852 A.2d 9 (Del. Ch. 2004) (granting a preliminary injunction requiring supplementary disclosures).

493. *MONY Group*, 853 A.2d at 673 (noting that Delaware courts are "vigilant in policing fiduciary misconduct," especially in relation to director election but also in other matters).

494. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1028–30 (Del. Ch. 2004).

495. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1120–21 (Del. 2003).

and third because it can be seen as a quintessential effort to revitalize *Blasius* beyond its questionable limits.

In *MM Companies v. Liquid Audio, Inc.*, it is important to note that defendant Liquid Audio's previously enacted bylaws provide a staggered board that was divided into three classes with only one class of directors standing for election in any given year.[496] Facing a possible contest for control from the plaintiff, MM, Liquid Audio decided to expand its board from five to seven members and to nominate two new members during August 2002.[497] Later, at its annual meeting, two MM nominees were elected as Class III directors to replace incumbents.[498] MM sought to invalidate the actions taken in August 2002, based on the claim that the decision to expand the board violated principles embedded in *Blasius* and *Unocal*.[499] Markedly, the board's action would merely dilute and not eliminate MM's presence on the board. Additionally, since the shareholders had the opportunity to elect MM's nominees to a majority of an expanded board, no facts supported the claim that the board's action precluded the shareholders from voting in favor of an actual change in control.[500] The chancery court ruled in favor of the defendants because the board expansion did not violate either *Blasius* or *Unocal*.[501] The chancery court offered the following reasons: (1) the *Blasius* claim does not apply and is therefore denied because "the addition of two new directors did not impact the shareholder vote or the shareholder choices in any significant way;" and (2) the *Unocal* claim was denied because the "plaintiff did 'not contend that the board expansion was coercive' . . . [and further] the expansion was not 'preclusive,' because the 'choices that the shareholders had before the board action was taken were the same as they had after,' and the plaintiff failed to make a showing that 'the action that the board took falls outside a range of reasonable responses.'"[502]

The chancery court's reasoning deserves additional attention. *Blasius* scrutiny was not required "because the expansion of the board was neither intended to nor did it have the effect of impeding or interfering with the shareholder franchise, or of depriving the shareholders of a full

496. *Id.* at 1122.
497. *Id.* at 1121.
498. *Id.*
499. *Id.*.
500. DiCamillo & Williford, *supra* note 90, at 3 (citing Transcript of Oral Ruling at 7, *Liquid Audio* (No. 19869)).
501. *Liquid Audio*, 813 A.2d at 1121.
502. *Id.*

and fair opportunity to vote."[503] This determination was reached despite the finding that:

> [T]he Director Defendants manipulated the size and composition of the Liquid Audio board during a contested election for directors *primarily* to interfere with and impede the success of MM's ability to gain two-of-five directorships on the Board, and, thus, to diminish the influence of MM's nominees on the Board.[504]

Thus, the court correctly draws a distinction between interfering with a possible acquirer and interfering with shareholders in their voting capacity. As further explicated by the court:

> The Shareholders had the opportunity . . . to elect MM's nominees to a majority of an expanded board or to a minority of the current smaller-sized board. The shareholders chose to elect the latter; that is, to elect two MM nominees to the current board. The expansion of the current board from five to seven on August 21st did nothing to interfere with or to change the two voting options that the shareholders had.[505]

The chancery court's opinion was largely correct in its assessment of the facts and it had a fair amount of logic to recommend it. Despite this, the Supreme Court of Delaware was not impressed.[506] Instead, the Supreme Court of Delaware held that if *Unocal* applied, it would require the compelling justification criterion to be applied to the rule mandating that "any defensive measure be proportionate and reasonable in relation to the threat posed."[507] The compelling justification criterion is implicated even though the defensive measures adopted by the board did not "actually prevent the shareholders from attaining any success in seating one or more nominees in a contested election for directors and the election contest need not involve a challenge for outright control of the board of directors."[508] The court's invocation of the compelling justification standard is particularly curious given the board's apparent primary purpose to *diminish* the influence of any nominees proposed by the hostile bidder as opposed to thwarting shareholders in their electoral capacity.[509] Thus, the *Liquid Audio* board was arguably motivated by a business purpose that could have been tested by *Unocal*.

The *Liquid Audio* holding seems contrary to both the determination in

503. DiCamillo & Williford, *supra* note 90, at 3 (citing Tr. of Oral Ruling at 6, *Liquid Audio* (No. 19869) (quotation marks omitted)).

504. *Liquid Audio*, 813 A.2d at 1121–22.

505. DiCamillo & Williford, *supra* note 90, at 3 (citing Tr. of Oral Ruling at 7, *Liquid Audio* (No. 19869)).

506. *Liquid Audio*, 813 A.2d at 1132.

507. *Id.* at 1131 (quoting Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992)).

508. *Id.* at 1132.

509. *Id.* at 1126.

Unitrin that allowed directors via a repurchase program to interfere with shareholder's right to vote because "the shareholders retained sufficient voting power to challenge the incumbent board by electing new directors with a successful proxy contest,"[510] and the concession by courts that franchise rights can permissibly be diluted "where reasonably necessary to accomplish an appropriate corporate business policy."[511] Both *Liquid Audio* and *Unitrin* involve a purported business decision and some potential or actual interference with the shareholder franchise in the context of a control dispute.[512]

In *Unitrin*, Unitrin's directors, who controlled twenty-three percent of the company's outstanding shares, engaged in a stock repurchase program designed to increase their percentage ownership.[513] This, in combination with a supermajority provision in Unitrin's certificate of incorporation, "barring any business combination with a more-than-[fifteen percent] stockholder unless approved by a majority of continuing directors or by a [seventy-five percent] stockholder vote"[514] was clearly intended to, and had the effect of diminishing the influence of any stockholder who might wish to tender proxies (then or sometime in the future) in order to replace the incumbent board. It is far from clear whether the concept of diminishing influence coherently illuminates this debate. Given their contrasting determinations, *Liquid Audio* and *Unitrin* may represent the paragon of incoherence.

Thus, while the Supreme Court of Delaware confirmed in *Liquid Audio* the prevailing view that *Blasius* review "is rarely applied *either* independently or within the *Unocal* standard of review,"[515] the court contends that when it is confronted "with the ultimate defensive measure touching upon an issue of control,"[516] and where the incumbent board of directors arguably[517] acts with "the primary purpose

510. *Id.* at 1130.

511. Williams v. Geier, 671 A.2d 1368, 1387 (Del. 1996) (Hartnett & Horsey, J.J., dissenting).

512. *Liquid Audio* involved a board decision to expand the target board's size during August 2002 after MM had sought to obtain control of Liquid Audio for more than a year. *Liquid Audio*, 813 A.2d. at 1118–28. The primary purpose of the expansion of the board was to diminish the influence of any nominees of MM that might be elected. *Id.* *Unitrin* involved the "propriety of the target board's defensive measures against a tender offer coupled with a proxy contest to replace the incumbent board." Allen et al., *Function Over Form*, *supra* note 82, at 889.

513. Unitrin v. Am. Gen. Corp., 651 A.2d 1361, 1377–78 (Del. 1995).

514. *Id.* at 1377.

515. *Liquid Audio*, 813 A.2d at 1130 (emphasis added).

516. *Id.* at 1131.

517. It is not necessarily clear that the board in Liquid Audio acted with the primary purpose of interfering with the effectiveness of the shareholder franchise. *See id.* at 1126 (noting that the chancery court found the primary purpose as diminishing the influence of MM's nominees for the

[and effect] of interfering with and impeding the effectiveness of the shareholder franchise in electing successor directors,"[518] *Unocal* requires the additional, and occasional hypothetical scrutiny provided by *Blasius*. Once a court decides that *Blasius* review is mandated for whatever reason, judicial reversal of board conduct seems inevitable. Nonetheless, the pickle remains: why apply *Blasius* review at all if board conduct can be easily reversed under *Unocal*/*Unitrin*? This case attempts to supply an answer by suggesting (at least collaterally) but not directly showing that without *Blasius* review, the outcome might change.

In its totality, *Liquid Audio* can be read several ways. First, on an elementary level, the case is in stark contrast to the normal judicial reluctance towards applying *Blasius*. Consistent with the analysis in Part III exposing judicial reluctance to accept *Blasius* in a dispositive sense,[519] one observer asserts that it is likely that "[p]rior to *Liquid Audio*, there had been indications that Delaware courts might be moving away from *Blasius*. Only a few Delaware cases have ever applied the 'compelling justification' scrutiny of *Blasius*"[520] and "Delaware courts have tended to apply [primarily] *Unocal* review even with respect to defensive measures that impact the stockholder franchise."[521] Nevertheless, the Supreme Court of Delaware insisted that prior precedent "did not render *Blasius* and its progeny meaningless."[522] Perforce, *Liquid Audio's* concentration on *Blasius* can be seen as a singular focus on "inequitable purposes, contrary to established principles of corporate democracy."[523]

Second, *Liquid Audio* can be read in support of the proposition that shareholders exercise or have the right to exercise ultimate control as a general matter.[524] *Liquid Audio* declines to abandon *Blasius* because it

board).

518. *Id.* at 1131.

519. *See, e.g.*, Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996) (concluding that *Blasius* did not apply in the review of disinterested and independent director action); Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000) (noting that "Delaware courts have struggled with how broadly [*Blasius*] should be applied"); H.F. Ahmanson & Co. v. Great W. Fin. Corp., No. 15650, 1997 Del. Ch. LEXIS 84, at *28 (Del. Ch. June 3, 1997) (declining to use the *Blasius* standard); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1122 (Del. Ch. 1990) (stating that *Blasius* did not represent new law); *see also supra* Part III (discussing the *Blasius* rule).

520. DiCamillo & Williford, *supra* note 90, at 4.

521. *Id.*

522. *Liquid Audio*, 813 A.2d at 1130.

523. *Id.* at 1132 (quoting Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)).

524. *Id.* at 1130. "A board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.'" *Id.* (quoting Stroud v.

accepts the claim that corporate governance requires a determination that shareholders are principals, implying shareholder control, and that directors are agents so that the decision to interfere with the franchise cannot be left to the good-faith business judgment of the firms' alleged agents even though the board acted consistently with bylaw amendments enacted pursuant to both Delaware law and the firm's charter.[525] To be sure, the board's answer to the pre-trial interrogatory was problematic. It questionably asserted that it "was concerned that the potentially 'acrimonious' relationship between MM's board members and Liquid Audio's incumbents would lead one or more of the incumbent directors to resign, thereby causing a board deadlock or transferring control to MM."[526] This answer admits that Liquid Audio "had expanded the board to dilute MM's,"[527] but not the shareholders' influence. It is possible that the board's answer may reflect a primary purpose to "interfere with and impede the effective exercise of the stockholder franchise in a contested election for directors,"[528] or alternatively the answer might evidence—however poorly worded—an entirely defensible conduct within the meaning of a robust conception of the business judgment rule. Nonetheless, the court's holding sustaining MM's objections may supply a basis for concluding that *Liquid Audio* constitutes a judicial effort to revitalize shareholder governance or, alternatively, simply that poor answers to interrogatories deserve judicial rebuke.

Indeed, one narrative argues that "*Liquid Audio* . . . expanded the reach of *Blasius* beyond [the issue of] a reduction or expansion in board size that in and of itself thwarts a change in board control."[529] First, although one may interpret *Liquid Audio* to only apply in cases involving an immediate change in board control,[530] it is equally possible that *Liquid Audio* can be interpreted to apply in circumstances where immediate board conduct (however tangential) reduces the likelihood that a *future* proxy vote or board election will result in the expulsion of current board members or a substantial change in the composition of the board.

Grace, 606 A.2d 75, 92 n.3 (Del. 1992)).

525. *Id.* at 1128–29.

526. Kahan & Rock, *supra* note 14, at 512.

527. *Id.*

528. *Id.* (quoting *Liquid Audio*, 813 A.2d at 1132).

529. DiCamillo & Williford, *supra* note 90, at 4.

530. *See, e.g.*, *id.* at 4–5 ("If Liquid Audio is interpreted to involve a potential immediate change in board control, *Blasius* might expand only to include cases in which a shareholder vote, in conjunction with some other foreseen or foreseeable circumstance, would result in a change of control. Such factual circumstances may be uncommon.").

Second, an alternative view suggests that endeavors aimed at reducing the influence of hostile firms (by reducing the influence of the hostile firm's board nominees for instance) that minimally implicate voting rights may be subject to *Blasius* review. The *Liquid Audio* court bluntly states that *Blasius* may apply to a "contested election for directors and the election contest need not involve a challenge for outright control of the board of directors."[531] This may implicate *Blasius* analysis, when and if the target board acts to prevent the hostile firm from gaining a "substantial presence" on the target board[532] and thus expanding the reach of *Blasius* to pure contests for control (particularly when, and if, there is some tangential impact on the electoral process). These two possibilities indicate that shareholders, not directors, ought to be in charge of setting corporate business policy.

Third, *Liquid Audio* can be read as an argument for enhanced fiduciary duty analysis that has its origin in and is simply collateral with *Unocal* and its concern for entrenchment. Thus, at least one set of observers validates *Liquid Audio* because the board's bylaw amendments exceeded the degree of entrenchment opted for in the charter and the firm's governance structure.[533] If true, it is possible that all entrenchment efforts that are not validated by the firm's governance scheme should suffer the same fate and be tested under the same criterion calculated to be sufficient to deal with this kind of entrenchment concern: the *Unocal/Revlon/Unitrin* framework. Consistent with language in prior cases stating that *Blasius* is designed to catch even unintended violations of the duty of loyalty,[534] *Liquid Audio* adheres to a matrix suggesting that an "inequitable action does not become permissible simply because it is legally possible."[535] This interpretation suggests that *Blasius* is simply a species of *Unocal*, meaning that where directors act to impede or impair the franchise, the conduct cannot be seen as either proportionate or reasonable in relation

531. *Liquid Audio*, 813 A.2d at 1132.

532. DiCamillo & Williford, *supra* note 90, at 5. The Court of Chancery distinguished *Liquid Audio* from IBS Fin. Corp. v. Seidman & Assocs., L.L.C, 136 F.3d 940 (3d Cir. 1918). *Id.* In *IBS*, the Third Circuit applied *Blasius* "to a board reduction that prevented a plaintiff shareholder from gaining a 'substantial presence'" on the board. *Id.*

533. Kahan & Rock, *supra* note 14, at 514.

534. *See, e.g.*, Blasius Indus. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988) (finding an unintended violation of the duty of loyalty even though the action was taken in good faith). The *Blasius* proposition continues to be restated and reaffirmed by the Supreme Court of Delaware. *See, e.g.*, Stroud v. Grace, 606 A.2d 75, 91–92 (Del. 1992) (accepting the "basic legal tenets" of *Blasius*).

535. *Liquid Audio*, 813 A.2d at 1132 (quoting Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)).

to the threat posed unless the firm is confronted with an extremely coercive threat. Such a reading adds little to the already well-established *Unocal* framework. This point may be somewhat speculative, since the "Supreme Court of Delaware described the Court of Chancery's analysis under *Unocal*, but refrained from adopting (or rejecting) it."[536]

V. SHAREHOLDER VOTING RIGHTS AND THE ACCOUNTABILITY/AUTHORITY PARADIGM

Prior to the *Liquid Audio* decision, cases brought outside of takeover contests, bidding contests, or situations where a change of control became inevitable often returned to the familiar contention that defendant directors inequitably and in breach of their fiduciary duties interfered with and manipulated shareholder voting rights or otherwise undertook bylaw changes adversely affecting shareholders in order to accomplish an improper purpose.[537] Such a claim seems to implicate the duty of loyalty, but tangentially implicates the ideological underpinning of directorial power that accepts the view that shareholders are both principals and owners.[538] If accepted, this paradigm often leads to a failure by the court to apply deferential business judgment review and possibly a decision to decline to deploy[539] unless, of course, the evidence shows that the board's action was for the primary purpose and effect of interfering with the franchise.[540] Alternatively, if the challenged board action involves a business transaction, the court can simply decline to apply *Blasius* even if the transaction "had the effect of diluting or interfering with voting rights."[541]

Despite the difficulty in proving primary purpose connected to a business transaction that has two equally plausible purposes, *Blasius* and its progeny demonstrate that a primary purpose to interfere can be

536. DiCamillo & Williford, *supra* note 90, at 7 n.29.

537. *See, e.g.*, BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 12, at 45 (discussing Coalition to Advocate Public Utility Responsibility, Inc. v. Engels, 364 F. Supp. 1202 (D. Minn. 1973); Allen v. Prime Computer, Inc., 540 A.2d 417 (Del. 1988); *In re* Osteopathic Hospital Ass'n of Del. 191 A.2d 333 (Del. Ch. 1963).

538. *See, e.g.*, *Blasius*, 564 A.2d at 657 (demonstrating that a primary purpose of interfere can be found even where the board's action is undertaken in good faith after a reasonable investigation and without self-interest leading to a breach of the fiduciary duty of loyalty).

539. Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *26–27 (Del. Ch. Dec. 4, 2000).

540. *See, e.g.*, *id.* at *40–41 (finding that evidence that board action, even if done without any indication of bad faith, demonstrates a primary purpose to interfere with a shareholder vote).

541. McBride & Gibbs, *supra* note 326, at 939.

found, even where the board action is undertaken in good faith after a reasonable investigation and without self-interest leading to a breach of the fiduciary duty of loyalty.[542] *Peerless*, a non-control case, and *Blasius* itself intimate that the absence of self-interest fails to preclude a successful duty of loyalty claim.[543] Chancellor Allen states "even though defendants here acted on their view of the corporation's interest and not selfishly, their . . . action constituted an offense to the relationship between corporate directors and shareholders that has traditionally been protected in courts of equity."[544] Conceding that an "unintended breach of the duty of loyalty is unusual," and "finding the action taken was taken in good faith," the Chancellor nonetheless found that the board's action "constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."[545]

Before the *Liquid Audio* decision, cases decided within a takeover setting as part of the *Unocal* framework demonstrate that ambivalence has continued to surround important policy-laden questions involving the ability of directors to deploy defensive measures.[546] Although "Delaware has not explicitly embraced director primacy,"[547] the relevant statutory provisions and the *Unocal/Revlon/Unitrin* paradigm have largely intimated that directors retain authority and need not passively allow either exogenous events or shareholder action to determine corporate decision-making. While the "DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation [it is apparent that the] capacious grant of power is policed in large part by the common law of equity, in the form of fiduciary duty principles."[548] It seems clear that the Delaware General Assembly has left it to the courts to shape the appropriate legal rules in the merger and acquisition marketplace during the past thirty years.[549]

As part of this framework, the burden of proof may be placed on the board to comply with its own initial two-part burden under certain circumstances, or face the possibility that fiduciary duty analysis may

542. *See, e.g.*, *Blasius*, 564 A.2d at 663 (Del. Ch. 1988) ("[E]ven finding the action taken was in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."); *see also Peerless*, 2000 Del. Ch. LEXIS 170, at *41 (noting that *Blasius* found an unintended violation of the duty of loyalty).

543. *Blasius*, 564 A.2d at 663; *Peerless*, 2000 Del. Ch. LEXIS 170, at *41.

544. *Blasius*, 564 A.2d at 652.

545. *Id.* at 663.

546. Allen et al., *The Great Takeover Debate*, *supra* note 120, at 1068–69.

547. Bainbridge, *Director Primacy in Corporate Takeovers*, *supra* note 23, at 814.

548. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004).

549. Allen et al., *The Great Takeover Debate*, *supra* note 120, at 1068.

prevent board action.[550] Nonetheless, the underlying assumptions and the prevailing perspective preserve the business judgment rule as a vehicle for board prerogatives, particularly when managing the continuing operations of the firm as well as when deciding extraordinary activities including the adoption of appropriate defensive measures in the face of a threat to corporate policy.[551] The ultimate responsibility for managing the business and affairs of a corporation falls on its board of directors and is consistent with the doctrine of private ordering, so long as they comply with the requisite duties of care and loyalty due to the corporation and its shareholders.[552] It is probable that *Unocal* allows the board to retain the power of fiat in takeovers, subject to *Unocal's* parameters aimed at diminishing conflicts of interest.[553] The developments in *Omnicare*, however, weaken this

550. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995). *Unocal* reaffirmed the application of the business judgment rule in the context of hostile takeovers by requiring that as a predicate to placing the burden on the plaintiff the board must carry its own initial two-part burden mandating compliance with both the reasonableness test and the proportionality test. *Id.*

551. There is apparently

> a distinction between the business judgment rule, which insulates directors and management from personal liability for their business decisions, and the business judgment doctrine, which protects the decision itself from attack. The principles upon which the rule and doctrine operate are identical, while the objects of their protection are different. In the transactional justification cases, where the doctrine is said to apply, our decisions have not observed the distinction in such terminology.

Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (1985) (citations omitted).

552. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The existence and exercise of [directors' power to manage the business and affairs of the corporation] carries with it certain fundamental fiduciary obligations to the corporation and its shareholders."); Guth v. Loft, Inc., 5 A.2d 503, 510 (1939) ("[Directors] stand in a fiduciary relation to the corporation and its stockholders."). The directors must also comply with the duties of care and loyalty in a corporate merger context. Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (stating that directors continue to have fiduciary duties when considering a corporate merger). Moreover, directors have fiduciary duties when considering corporate takeover issues. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985) (stating that a board continues to have fiduciary duties when addressing a pending takeover bid); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) ("In the board's exercise of corporate power to forestall a takeover bid our analysis begins with the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."); Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) (stating that a board has fiduciary duties in a takeover context).

553. When *Unocal* is properly understood, the decision invokes a conditional formulation of the traditional business judgment rule during contested proceedings involving the plaintiff's motion for a preliminary injunction. The board can defeat the plaintiff's burden to demonstrate a reasonable probability of success after trial if the board withstands *Unocal's* reasonableness and proportionality review. If the board meets its burden, the traditional business judgment rule is invoked which generally precludes the plaintiff from succeeding on the merits of its claims. *Unitrin*, 651 A. 2d at 1375.

conclusion.[554]

Omnicare's dissenting opinions illuminate the obvious difficulties with the majority opinion. The initial dissenting opinion deserves to be quoted at length because it concentrates on the actual business choices faced by the board as opposed to the majority opinion's focus on the deal protection measures in isolation:

> The process by which this merger agreement came about involved a joint decision by the controlling stockholders and the board of directors to secure what appeared to be the only value-enhancing transaction available for a company on the brink of bankruptcy. The Majority adopts a new rule of law that imposes a prohibition on the NCS board's ability to act in concert with controlling stockholders to lock up this merger. The Majority reaches this conclusion by analyzing the challenged deal protection measures as isolated board actions.[555]

According to the dissent, the majority opinion clearly precludes an extraordinary enterprise decision aimed at salvaging some economic return for all shareholders premised on the court's after-the-fact conclusion that the Omnicare transaction, as opposed to the Genesis transaction, offered a superior economic return for all shareholders including minority shareholders.[556] If the dissent's understanding of the majority opinion is correct, and if the majority view is allowed to stand, then one may logically conclude that the courts rather than boards ought to manage the business, and that the courts rather than directors can accurately assess beneficial risk taking.[557] If deal protection measures are a condition precedent for the agreed upon merger between NCS and Genesis, such protective measures appear reasonable in light of the circumstances.[558] In essence, a process that evidently reflects a disinterested and informed board decision reached in good faith fails to

554. *See supra* Part III (discussing Omnicare, especially the dissent).

555. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 940 (Del. 2003) (Veasey, C.J. & Steele, J., dissenting).

556. *See id.* (Veasey, C. J. & Steele, J., dissenting) (noting that hindsight revealed that the Genesis bid would have yielded a higher economic return for shareholders rather than the Omnicare bid).

> It is now known, of course, after the case is over, that the stockholders of NCS will receive substantially more by tendering their shares into the topping bid of Omnicare than they would have received in the Genesis merger, as a result of the post-agreement Omnicare bid and the injunctive relief ordered by the Majority of this Court.

Id.

557. *See id.* at 928 (noting that there are 'certain circumstances' where a court will oversee the decisions and actions of directors).

558. *See id.* at 934–35 (stating that deal protection devices need to be within a "range of reasonable responses" to the threat perceived) .

receive the protection of the business judgment rule.[559]

By contrast, "the rationale of the business judgment rule was rooted in the concept that, in managing or overseeing the management of a business, directors must have wide discretion to delegate, to take risks and not be second-guessed by courts."[560] Even if enhanced scrutiny is grounded in *Unocal* and its progeny and even if totally independent of *Blasius*, this has the capacity to change everything. While this approach intensifies doubts about whether *Blasius* should have independent significance, one view of heightened scrutiny demands that the court shift its analysis beyond the level required by a deferential conception of business judgment toward the modern version of the business judgment rule.[561] This implies that the business judgment rule, which requires care, good faith, and loyalty, is a substantive standard of liability.[562] The rule, as "so conceived, entails some objective review of the quality of the [board's] decision, however limited."[563] However, another possibility exists. Enhanced scrutiny may signify an even more intense judicial review than that envisioned by the modern version of the business judgment rule, which may lead to a substantive and highly skeptical examination of the merits of the board's decision by the courts, even if no evidence of director self-interest or any other indication of actual or potential breaches of the triads of fiduciary duty can be found.

Whether motivated by the contemporary whiff of scandal, the current growth in and demand for more government regulation of corporate entities, or the court's own version of shareholder primacy, the majority

559. *Id.* at 940 (Veasey, C.J. & Steele, J., dissenting); *id.* at 947 (Steele, J., dissenting).

560. Veasey, *The Business Judgment Rule*, *supra* note 59, at 576.

561. *See, e.g.*, Bainbridge, *The Business Judgment Rule as Abstention*, *supra* note 151, at 85–87 (arguing that the business judgment rule is designed to effect a compromise between two competing values: authority and accountability).

562. S*ee id.* at 87–88 (stating that the modern trend treats the business judgment rule as a substantive doctrine expressing the scope of director liability and permitting courts some room to examine the substantive merits of the board's decision as opposed to the traditional business judgment rule which is best understood as a doctrine of abstention pursuant to which courts in fact refrain from reviewing board decisions unless exacting preconditions for review are satisfied). Bainbridge asserts:

> The business judgment rule commonly is understood today as a standard of liability by which courts review the decisions of the board of directors . . . the rule is better understood as a doctrine of abstention pursuant to which courts in fact refrain from reviewing board decisions unless exacting preconditions [i.e., failure to comply with one of the triad of fiduciary duties: care, good faith, and loyalty] for review are satisfied.

Id. at 87.

563. *Id.* at 91 (quotation marks omitted).

opinion in *Omnicare* invalidating lock-ups and other deal protection devices implies that the Supreme Court of Delaware has been increasingly drawn to the claims that: (1) shareholders are both the true owners of the firm as well as being true principals; (2) enterprise issues, however complex, can and must be seen as absolutely separable from ownership decisions to enjoy the protection of the business judgment rule; (3) shareholders (including minority shareholders) have a contract right to receive takeover bids; and (4) the *Unocal*/*Revlon*/*Unitrin* approach that allows directors authority to act upon a reasonable investigation, in good faith, and without self-interest to protect the corporation must now be altered to accommodate (if not encourage) rather capacious judicial review that allows the court to substitute its judgment for that of directors.[564] In sum, *Omnicare* seems to shift the balance and focus toward an expansive conception of accountability, which may provide a basis and an invitation to incorporate a more robust version of *Blasius* within *Unocal's* now expanded borders.[565]

While a principled concern for fiat, discretion, and directors' prerogatives suggests this invitation should be rejected, *Liquid Audio*

564. *See Omnicare*, 818 A.2d at 930–37, 939 n.88 (noting that deal protection devices were held to require enhanced scrutiny in Paramount Communications, Inc. v. Time, Inc., even though an original merger agreement did not constitute a "change in control" (citing Paramount v Time, 571 A.2d at 1150)). The court then cited *Paramount Communications, Inc. v. QVC Network, Inc.* for the proposition that two key features emerge when the facts require enhanced judicial scrutiny: (1) a "judicial determination regarding the adequacy of the decision-making process employed by the directors;" and (2) a "judicial examination of the reasonableness of the directors' action in light of" the existing circumstances. *Id.* at 931 (citing Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1993)). Both of these features are coupled with the placement on the directors of the "burden of proving that they were adequately informed and acted reasonably." *Id* (citing *QVC*, 637 A.2d at 45). Next, the court concluded that since Genesis gave a one day ultimatum attached to a Section 251(c) clause mandating the submission of the merger agreement for a stockholder vote even if the board's recommendation was withdrawn, coupled with the absence of any fiduciary out clause, coupled with a personally signed voting agreement from two stockholders who combined to control a majority of stockholder voting power results in an unenforceable agreement results which requires not only special scrutiny, but also invalidation, because the agreements taken together were not reasonable and proportionate to the threat that NCS perceived from the potential loss of the Genesis transaction. *Id*. at 934–36. From an analytical perspective then, the *Omnicare* majority opinion substituted its judgment for that of directors facing a deadline. Failing to meet this deadline may have led to a failure to secure any financial consideration for the shareholders given that Omnicare faced imminent insolvency. *See also id.* at 940 (Veasey, C.J. & Steele, J., dissenting) ("The Majority concludes that the board owed a duty to the NCS minority stockholders to refrain from acceding to the Genesis demand for an irrevocable lock-up notwithstanding the compelling circumstances confronting the board and the board's disinterested, informed, good faith exercise of its business judgment.").

565. *See Omnicare*, 818 A.2d at 947 (Steele, J., dissenting) ("The Majority's conclusion substantially departs from both a common sense appraisal of the contextual landscape of this case and Delaware case law applying the *Unocal* standard.").

accepts this invitation in the context of shareholder voting as part of the dispute over the election of directors within a setting, thus suggesting a potential control contest.[566] It is doubtful that this approach can be successfully limited to the circumstances of this case. Indeed, *Liquid Audio* and *Omnicare* taken together provide a platform that is capable of transmuting the business judgment rule. As traditionally understood, the business judgment rule confirmed that directors retain substantial discretion subject to well known limits.[567]

It has been argued that to prevent erosion of this business judgment principle, we should be wary of allowing courts "to determine the 'reasonableness' of actions of business people or to substitute [their] judgment for that of the directors."[568] Nonetheless, an unconstrained view of *Unocal* rather than *Blasius* provides the court with just such an opportunity. In fact, the jurisprudence of *Unocal* has taken on a life of its own, with the *Omnicare* decision evidencing its expansion beyond the formerly compartmentalized limits in a takeover setting.[569] Expansive interpretations of *Blasius* foretold this event despite evidence of some initial judicial reluctance in applying *Blasius*.[570] Hence, one should not be surprised that *Liquid Audio* represents an effort to revitalize shareholder governance by protecting shareholders' influence from even incidental dilution even where the defensive measure does not actually prevent the putatively hostile stockholders from attaining success in seating one or more of its nominees on the board of directors.[571] This decision, which can be understood as contrary to *Unitrin*, may materialize as a branch of an increasingly unruly tree and

566. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003).

> To invoke the *Blasius* compelling justification standard of review *within* an application of the *Unocal* standard of review, the defensive actions of the board only need to be taken for the primary purpose of interfering with or impeding the effectiveness of the stockholder vote in a contested election for directors.

Id.

567. For example:

> The only real limitations on that discretion [were]: (1) the directors should not enjoy the presumption of the business judgment rule if they were not making a business decision or if they were interested, not independent, not acting in good faith or grossly negligent in their decision-making [sic] process; and (2) to be sustainable, their decision may not be shown to have been devoid of any rational business purpose or to be so irrational that no person of ordinary prudence would have believed the decision to have been in the best interests of the corporation.

Veasey, *The Business Judgment Rule*, *supra* note 59, at 576–77.

568. *Id.* at 577.

569. *See Omnicare*, 818 A.2d at 932 (applying *Unocal's* enhanced judicial scrutiny to defensive measures designed to protect a merger agreement).

570. *See supra* Part III.B.2 (discussing *Blasius* and its progeny).

571. *Liquid Audio*, 813 A.2d at 1132.

provide a basis to expand "the *Unocal* doctrine to other traditional business judgment rule applications such as statutory directorial prerogatives, purely enterprise decisions . . . [and allow judicial] review of decisions by disinterested and independent directors," no matter what the context.[572] Although it can be persuasively argued that the business judgment rule is designed to effect a compromise between the two competing values of authority and accountability,[573] the *Omnicare/Liquid Audio* framework as a dangerously expansive interpretive hermeneutic indicates that this compromise increasingly concentrates on vindicating accountability fears at the expense of authority. To the extent that directors adopt defensive measures that incorporate provisions adversely affecting voting rights, courts committed to shareholder primacy and principal-agent rhetoric can be expected to now find support for their views within the *Omnicare/Liquid Audio* paradigm, which represents the predictable outcome of an unconstrained conception of the *Unocal/Blasius* framework.

The acceptance of the *Omnicare/Liquid Audio* paradigm by courts and commentators, particularly in an era of scandal, may constitute a strikingly attractive skeleton on which to construct a basis for future incremental judicial review couched in the language of undistorted shareholder choice, corporate social responsibility, the protection of the shareholder franchise, and the protection of ownership as opposed to enterprise decisions. This scaffold may have ominous implications for private ordering grounded in pre-commitments by stakeholders, including shareholders. In the long-run, one might anticipate that beneficial risk-taking will be further restrained as boards become overly concerned about either the risk of personal liability or the likelihood that their decisions will be reversed, *ex post*, by judges who fail to adequately understand the proper scope of the *ex ante* risk calculus. If economic returns can be correlated with whether the decision maker accepts risk neutrality, risk aversion or risk taking, and then if economic returns eventually fall within the constraints of this scheme, shareholders may wish to look to the judiciary for an explanation. I fear that the *Omnicare/Liquid Audio* cases may be a forerunner of a future where the pertinent job description of judges includes their corporate management capability.

572. Veasey, *The Business Judgment Rule*, *supra* note 59, at 577–78.

573. *See supra* notes 561–64 and accompanying text (arguing that the business judgment rule is a substantive standard of liability and requires enhanced scrutiny).

VI. CONCLUSION

Let us go then, you and I,
When the evening is spread out against the sky
Like a patient etherised upon a table;[574]

We are the hollow men
We are the stuffed men . . . .
Shape without form, shade without colour,
Paralysed force, gesture without motion;[575]

The capability of shareholders (as a disparate group) to manage relatively large corporations is hindered by collective action problems tied to disparate preferences, different persuasive abilities, different time horizons, as well as differing capacities to digest pertinent financial, microeconomic and macroeconomic information (even when widely available). Directors are generally seen as being less likely to be blinkered by such collective action problems. Additionally, judges have rightly been seen as having their own difficulties in the exercise of day-to-day or long-run management. Thus, the various contracting parties who form a corporation agree in advance to empower directors as hierarchs to embody and to manage the business, including extraordinary events such as mergers, the adoption of defensive measures, and the creation of deal protection devices.

Such private ordering is consistent with and operates as an extension of the Ellulian idea of the living law (*le droit vivant*) that "is born at the same time as human relationships. Law arises with contact between two people for it is made for people. It arises with spontaneity."[576] This idea leads in the corporate context to the empowerment of directors. Corporations come with a series of pre-existing gap-filling rules that indicate that directors should be empowered "to decide what as the enterprise proceeds" to solve various contingencies.[577] Traditionally, courts and the statutes have concurred in this empowerment largely via the business judgment rule. Empowerment has a cost—it risks entrenchment and self-interested behavior, which may reduce shareholder wealth. Hence, courts and shareholders are

574. T.S. ELIOT, *The Love Song of J. Alfred Prufrock, in* COLLECTED POEMS 1909–1962, at 3 (1963).

575. T.S. ELIOT, *The Hollow Men, in* SELECTED POEMS 77 (1964).

576. *See, e.g.*, GODDARD, *supra* note 167, at 200–01 (discussing Jacques Ellul's conception of the living law).

577. Blair, *supra* note 22, at 43.

properly concerned about accountability. This concern escalates when and if various possible transactions are vetoed or otherwise precluded by board action, particularly when the board's conduct impinges on shareholder voting rights.

Board action in this context today provides an opportunity for various entities, constituencies (including shareholders), and courts to enter into an increasingly intense, contemporary conversation about corporate democracy, agency, principals, the proper allocation of power, entrenchment, unintentional but nonetheless fatal breaches of the duty of loyalty and the proper contours, as well as the necessity of reforming corporate governance. At issue are various conceptions of accountability and contestable conceptions of authority. Against this framework, it is possible to be drawn to the advantages of contractarian approaches that imply director primacy as the appropriate governance model. This position appears consistent with the determination that the ultimate responsibility for managing the business and affairs of a corporation falls on its board of directors grounded in the doctrine of private ordering (the firm's charter as permitted by the governing law), so long as the chosen hierarchs comply with the requisite duties of good-faith, care and loyalty. It is impossible to draw the corporate governance line precisely, but wherever the line is drawn along the accountability/authority continuum, it is conceivable that accountability unease will etherize necessary and desirable board discretion.

Unocal and its early progeny seemed to suggest an adequate framework in which to exercise the courts' legitimate concern that entrenchment might serve as a vehicle to reduce shareholder wealth. Then came *Blasius* and with it a potentially powerful device for sheltering judicial intervention: shareholder voting as a sacred plinth. While the early cases displayed examples of judicial reluctance to deploy *Blasius*, such reluctance—as *Liquid Audio* illustrates—can be overcome. Recent court decisions suggests that the expansive, if not explosive, implications of *Blasius* seeded within *Unocal* under the rubric of an assiduous concern for the franchise can lead to the diminution of board discretion and thus capture shareholder voting rights within the accountability/authority paradigm. Equally clear, recent court decisions refreshed by the pungent aroma of scandal and indefensible management malpractice imply that concern for shareholder voting rights provides a platform that can devour necessary board discretion. Future cases may be required to fully determine whether this development can be seen empirically as best serving shareholder interest. When the final chapter on corporate governance is written, it is probable that the *Omnicare/Liquid Audio* framework will be viewed as an ominous metaphor for the ascendant movement that defines shareholders and contemporary judges as sacred governors worthy of directorship and the actual directors as hollow wardens of corporate decision-making.