Judicial Schizophrenia in Shareholder Voting Cases

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[T]he science of the judge is to put the principles into action, to develop them, to extend them, by a wise and reasoned application, to private relations; to study the spirit of the law when the letter killeth, and not to expose himself to the risk of being alternately slave and rebel...¹

In 1932 Adolf A. Berle and Gardiner C. Means systematically identified the separation of ownership and management in public corporations.² They found that forty-four percent of the country's largest two hundred companies were under "management control."³ When stock ownership is so widely distributed that no individual or small group of shareholders has an interest large enough to control the affairs of the company, management becomes "a self-perpetuating body even though its share in the ownership is negligible."⁴ According to Berle and Means, management separated from ownership had led to conflicts-of-interest transactions, usurpation of corporate opportunities, insider trading, and misleading financial statements and news releases.⁵

Central to the Berle and Means thesis was the ineffectiveness of shareholder voting as a control device. Proxy voting in public corporations, a mechanism by which shareholders hand over their votes to individuals selected by existing management, leaves control in the hands of the board of directors, who thus "virtually dictate their own successors."⁶ Although it is possible for shareholders to solicit proxies in support of an insurgent slate of candidates, Berle and Means found proxy contests to be rare: "More often control is quietly exercised over a period of years without any active contest such as would give the stockholders an opportunity to choose between two contesting groups. For the most part the stockholder is able to play only the part of the rubber stamp."⁷

Despite Berle and Means's gloomy story of "management control," we corporate law academics have placed much hope in shareholder voting as an antidote. Our analysis of voting rights has gone through three distinct phases. First, in our "populist" phase, we believed that shareholder voting could be made into a practical (though partial) solution to the harmful effects of the ownership-management separation. We sought new legal

¹. Portalis et al., Discours preliminare, in La legislation civile, commerciale et criminelle de la France 251 (J. Locre ed., 1827) (commentary by the draftsmen of the French Civil Code of 1804), quoted in Mary A. Glendon et al., Comparative Legal Traditions: Text Materials and Cases (1985).
³. Id. at 109 (as of Dec. 31, 1929). The authors captured the problem: "The Pope selects the Cardinals and the College of Cardinals in turn select the succeeding Pope." Id. at 82 n.23.
⁴. Id. at 82.
⁵. Id. at 114. Interestingly, most of the examples of management aggrandizement and abuse noted by the authors are now illegal under one law or another.
⁶. Id. at 82. The authors further commented: "The proxy machinery has thus become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise, but by which his power is separated from him." Id. at 129.
⁷. Id. at 83.
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rules to invigorate shareholders as voters. In 1934 Congress created the Securities and Exchange Commission (SEC). The SEC put in place a federal proxy disclosure regime, mandated the contents of proxy voting cards, and later provided for shareholder access to the proxy machinery through the shareholder proposal rule.

But shareholders did not leap at the invitation to informed, empowered participation in corporate governance. During the 1950s and 1960s, proxy contests were still infrequent, and insurgents were still unsuccessful; management-sponsored initiatives won and shareholder-sponsored initiatives lost, each by wide margins. Some of us lamented as managers seemed to use state corporate law to eviscerate shareholder rights in a "race to the bottom." We lost faith in shareholder voting, and our frustration turned to resignation. By the 1970s, most of us came to accept shareholder apathy as insoluble, indeed "rational," and we disparaged shareholder voting and meetings as pointless spectacles.

Not to worry. Led by Henry Manne, a new generation of law academics told us that shareholders retained powerful latent control over managers despite the infirmity of their vote. Shareholder power came from the threat to exit (selling their shares), not from the use of voice.

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11. Rule 14a-8, 17 C.F.R. § 240.14a-8. The SEC promulgated the shareholder proposal rule in 1942 to allow shareholders to submit proposals for proxy vote on any "proper subject for action by the security holders." Exchange Act Release No. 3347, 7 Fed. Reg. 10,655, 10,656 (1942); see also Seligman, supra note 8, at 270-71 (discussing the early years of the shareholder proposal rule).


13. See John Pound, Proxy Contests and the Efficiency of Shareholder Oversight, 20 J. Fin. Econ. 227 (1988) (analyzing 100 proxy contests from 1981 to 1985 and finding most proxy contests characterized by several systematic incentive problems that make it more difficult for dissidents to win).


In this "market works" phase, we gained a new respect for shareholder voting as the linchpin for hostile stock acquisitions and takeovers. Beginning in the 1970s, dispersed shareholders began selling to one buyer, who consolidated the voting power of otherwise dispersed shares in order to replace the board and take over the company. Takeovers and the threat of takeovers, we argued, provided the discipline that atomistic voting could not. We celebrated the vigor of the 1980s takeover boom and decried managers' desperate rush to protect themselves. But the end of the 1980s saw the end of hostile tender offers. State antitakeover statutes, firm-specific poison pill defenses, and a dispirited financial market haunted by too many poorly structured, fee-driven transactions put an end to a frenzied era. All that remained was an academic epilogue on the merits of the era.

With the beginning of the 1990s, we enter the third phase in which the institutional investor has emerged as our new champion. Since large shareholders have greater incentives to become informed about proxy contests, they are more likely to vote than other shareholders. Tax rules that encourage employers and workers to contribute to pension plans, combined with a shift toward diversified individual investment through mutual funds, have put significantly more funds into the hands of

16. The terms are adapted from Albert O. Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (1970). Scholars argued that stock price, controlled by shareholders' exit choice, itself effects a sufficient constraint. Stock prices that are higher relative to industry competitors because of management misbehavior raise the firm's cost of capital, adversely affecting product price and product competitiveness. Moreover, stock price is often tied to executive compensation, and executives have a stake in their reputation as good managers. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 17, 91-92 (1991).


19. See Merger, Acquisition Activity Fell 18% in 1st Quarter, Hitting an 11 Year Low, Wall St. J., Apr. 16, 1991, at A2 ("Merger and acquisition activity plummeted to an 11 year low in the first quarter of [1991], with the number of transactions off 18 percent from a year earlier . . . continuing the decline that appeared in 1990 when potential deals fell 12 percent from 1989.").

20. State antitakeover statutes, nearly unassailable when combined with employee stock ownership plans (ESOPs) and other firm-specific defenses, supply potent tools to incumbent managers. Management can use poison pills and other entrenching devices, without antidote, to just say no to unwanted bidders. Courts ended the takeover decade of the 1980s much as they began it—with a deferential whimper. See Dale A. Oesterle, Mergers, Acquisitions and Reorganizations 414-60 (1991); see also Thomas, supra note 18, at 508-09.


Institutional investors have been successful in asserting this new power in some dramatic instances. The SEC has also jumped aboard, loosening its proxy solicitation rules to facilitate coordination among institutional investors and its shareholder proposal rule to put more questions of basic corporate structure and operations on management's proxies. The story

23. See Robert Walters, Investor Resp. Res. Ctr. (IRRC), Study Documents Rising Institutional Ownership, Corp. Gov. Bull., Sep.-Oct. 1991, at 15 (summarizing study by Carolyn Kay Brancato, Executive Director of Institutional Investor Project of Columbia University Law School's Center for Law and Economic Studies). As of 1991, institutional shareholders (private and public pension funds, mutual funds, insurance funds, bank trusts, foundations, and endowments) held 53.8% of the nation's $3.6 trillion in equity holdings. Private and public pension funds accounted for 28.2% of the nation's corporate equity, and mutual funds were next with 7.2%. By contrast, institutional investors in 1981 held 38% of the $1.5 trillion in equity holdings; pension funds held only 0.8% of corporate equity in 1950. See also Robert C. Clark, The Four Stages of Capitalism, 94 Harv. L. Rev. 561 (1981) (categorizing the history of capitalism in the United States into four stages: the age of the entrepreneur, the age of the professional business manager, the age of the portfolio manager, and the age of the savings planner ushered in by tax rules encouraging pension plans).

24. Walters, supra note 23, at 15 (summarizing Brancato study that found institutional investors own 50.1% of the stock of America's 50 largest corporations and 49.5% of America's 1,000 biggest corporations). Ms. Brancato concluded that "[c]ertain institutions now realize that their proxy vote carries with it the potential for substantial economic gain, and they are not likely to return to former periods of benign neglect when they largely ignored proxy issues or routinely voted with management." Id.; see Black, supra note 22, at 827-29.

25. For example, the decision by the Sears, Roebuck board to divest its nonretailing businesses came only after institutional investors (particularly the California Public Employees' Retirement System (CalPERS), staged a two-year campaign aimed at the Sears outside directors. See Robert Walters, Sears Saga: A Case Study for Shareholders, Corp. Gov. Bull., Sep.-Oct. 1992, at 23. As shareholders become more assertive, CEOs now have to contend with increasingly activist directors. See, e.g., Gilbert Fuchsberg, Chief Executives See Their Power Shrink, Wall St. J., Mar. 15, 1993, at B1 ("The once seemingly absolute power of the Top Banana is peeling away."). Nonetheless, the results of increased shareholder activism may be few and far between. See Stuart Mieher, Weak Force: Shareholder Activism, Despite Hoopla, Leaves Most CEOs Unscathed, Wall St. J., May 24, 1993, at A1. Corporate governance is expensive and time consuming. For example, the most active of institutional investors, CalPERS, has focused on only 25 to 50 firms in its 1300-company portfolio. Moreover, shareholder weapons against management, such as proxy voting or negative press, are not particularly powerful against smaller firms. Even for firms in difficulty, boards are reluctant to act prematurely and often view shareholder activism as a publicity stunt, not valid criticism.


2. A safe harbor from the SEC's filing and solicitation requirements facilitates communications between shareholders who do not solicit proxy authority and who do not have any material economic interest in the subject matter of the solicitation. Rule 14a-2(b), 17 C.F.R. § 240.14a-2(b)(1999).
of an invigorated shareholder voice through these new champions is still young. How will institutional shareholders use their new power: as a carrot, as a stick, or not at all? The upsurge in proxy contests in the late 1980s and early 1990s suggested a strategy of confrontation: insurgents in record numbers proposed alternative board slates and initiated proposals for structural changes.27

Lately, however, institutional investors seem to be favoring a variety of nonvoting tactics. Some involve conciliation and quiet diplomacy;28 others involve public derision and tumbrel, such as the feared "target list."29 A recent survey of CEOs from Fortune 500 companies found that eighty-two percent believe that institutional investors have made boards more critical of management performance, and seventy-three percent anticipate an increase in proxy fights.30 The effects have been no less dramatic than a

3. Unless management seeks confidential treatment, proxy materials filed in preliminary form are now treated as public documents. Rule 14a-6(e), 17 C.F.R. § 240.14a-6(e)(1993). This means shareholders can contest management disclosure before management mails its definitive proxy statement to shareholders.

4. Management must "unbundle" related matters on the proxy card so shareholders can vote on each item separately. Rule 14a-4(a), 17 C.F.R. § 240.14a-4(a)(1993).

5. Insurgents seeking minority representation on the board can seek proxies to vote for some management nominees without the nominees' permission. This enables shareholders to vote for an insurgent without having to unseat the whole management slate. Rule 14a-4(d)(4), 17 C.F.R. § 240.14a-4(d)(4)(1993).


27. Lucian A. Bebchuk & Marcel Kahan, A Framework for Analyzing Legal Policy Towards Proxy Contests, 78 Cal. L. Rev. 1071, 1075 (1990) ("Proxy contests are already an important element of the corporate structure and are likely to become even more so.").


30. Study Finds 82 Percent of CEOs Believe That Institutional Investors Will Cause Boards to be More Critical of Management Performance, PR Newswire, Apr. 12, 1993,
full-fledged victory in a proxy campaign: In 1992 the boards of directors of
General Motors, Digital Equipment, Compaq, Goodyear, Hartmarx, Im-
cera, and Tenneco unceremoniously unhorsed their CEOs in palace coups,
with institutional investors skulking in the background.31 "Relationship
investing"—establishing a long-term link between a company and one or
more of its larger shareholders—is the latest fad.32

Ultimately, the vitality of an invigorated shareholder voice depends on
our corporate legal system. To date, most reformers have looked to the

available in LEXIS, News library, Curnws file (reporting survey conducted by Korn/Ferry
International, an executive search firm, of 327 CEOs from Fortune 500 and Fortune 500
service companies). According to the report, 73% of the CEOs thought institutional investors'
"new freedom to communicate more openly with corporate boards and one another will
prompt an increase in proxy challenges"; 69% thought the new SEC shareholder-
communication rules signal a "new era of heightened communications with institutional
investors."

31. See Stewart, supra note 29, at 34.

"We own the American economy now," says Carol O'Cleireacain, New York City
finance commissioner and trustee of four city pension funds with nearly $50 billion
of assets. "We" means institutional investors—pension funds, mutual funds, insur-
ance companies—whose portfolios hold 50.3% of all the stock of all the corporations
of America.

Id. at 35.

H. Matheson & Brent A. Olson, Corporate Law and the Longterm Shareholder Model of
Corporate Governance, 76 Minn. L. Rev. 1313 (1992). Several new studies by academics and
consultants conclude that active, involved investors holding substantial minority blocks of
shares produce above-market returns for the firms in which they invest. See IRRC, New
Associates found that CalPERS' activism increased firm performance; Professors Pound and
Gordon found that buying large minority stakes in companies provided superior returns;
Professor Shulman, Kleiman, and Nathan found that strategic, large-block investments
provide strong positive returns).

Much of the support for relationship investing comes from the popular perception that
there is too much "short-termism" in the United States capital markets; investors trade stock
"like pork bellies." Dobrzynski, supra, at 68, 69. We look longingly at the German and
Japanese systems, in which bank or corporate cross-ownership makes for stolid ownership
structures. See, e.g., Bebchuk & Kahan, supra note 27; Bernard S. Black, The Value of
Institutional Investor Monitoring: The Empirical Evidence, 39 UCLA L. Rev. 895 (1992);
Ronald J. Gilson & Mark J. Roe, Understanding the Japanese Keiretsu: Overlaps Between
Corporate Governance and Industrial Organization, 102 Yale L.J. 871 (1993); Mark J. Roe,
Some Differences in Corporate Structure in Germany, Japan, and the United States, 102 Yale

Events may have softened the argument, however, as current economic conditions in Japan
and Germany have deteriorated, and some commentators now view the lack of flexibility in
their corporate structures as a liability. See, e.g., Robert Neff et al., Fixing Japan, Bus. Wk.,
Mar. 29, 1993, at 68, 73 ("[T]he Japanese financial system still resembles that of the U.S. about
50 years ago, replete with too many specialized, inflexible institutions, excess capacity, and
overregulation."); Japan's Fallible Firms, The Economist, Feb. 27-Mar. 5, 1993, at 17 (arguing
that "corporate Japan will have to restructure, and to jettison some of the luxuries of the past
five years[, such as] ... short product-development cycles, a varied product range, an emphasis
on market share rather than short-term profits, a sense of teamwork, strict quality control");
Japanese Stock Market: The Ministry's All Too-Visible Hand, The Economist, Mar. 6-12,
1993, at 81 (arguing that Japan's Ministry of Finance over-regulates Japan's trading markets
in an effort to control share prices).
federal government to liberate the institutional voice.\textsuperscript{33} Professor Black, for example, has called for the repeal or modification of various federal laws that discourage institutional investors from accumulating large single-firm holdings or from employing collective voting tactics.\textsuperscript{34} Practitioners Lipton and Rosenblum have proposed a federal law requiring open board elections every five years for public corporations.\textsuperscript{35} The California Public Employees' Retirement System (CalPERS) and other institutional groups have urged changes to the SEC proxy rules which mandate greater access by institutional shareholders to management proxy materials, confidential voting, independent inspections of elections, and reform of the director nomination process.\textsuperscript{36}

In response to these reforms, Professor Coffee has led a chorus of caution: What are the consequences of concentrating voting power in a few institutional investors?\textsuperscript{37} To whom do institutional shareholders (such as insurance companies and banks) answer?\textsuperscript{38} To whom do corporate pension


\textsuperscript{34} Black, supra note 14, at 530.


\textsuperscript{36} See, e.g., Pension Fund Petition Could Prompt Broad Changes in SEC's Proxy System, BNA Daily Report for Executives, Feb. 12, 1990, available in LEXIS, Nexis Library, OMNI File. In November 1989, CalPERS asked the SEC to act on 48 proposals to revamp the proxy system. Initially, the impact of this "little-noticed petition" remained in doubt. Within several weeks of receiving the proposals, the SEC acknowledged that the CalPERS' petition deserved serious attention. In the three years since CalPERS' assault on the SEC proxy rules, the impact of its recommendations has increased substantially.

The focus of the new SEC proxy rules is instructive. Responding to shareholder concerns, the new rules enable shareholders to express their concerns more effectively about management's performance. See, e.g., Pitt, supra note 26, at 2.

Ironically, while he is putting the fear of God into CEOs of major corporations, Dale Hanson, the head of CalPERS, is feeling heat from his own board for ill-timed investments in real estate. See George Anders, Restless Natives, Wall St. J., Jan. 29, 1993, at A1.

\textsuperscript{37} Coffee, supra note 22; see also Edward B. Rock, The Logic and (Uncertain) Significance of Institutional Shareholder Activism, 79 Geo. L.J. 445, 474 (1991) (suggesting that institutional investors may themselves replicate the agency problem). Professor Coffee is, for example, concerned with the tendency of institutional investors to index their portfolios. In this regard, Nancy A. Williams (deputy executive director and general counsel of the Public Employees' Retirement Association of Colorado) testified before Congress that since 80% of the Colorado equity portfolio is indexed the fund cannot deal with poorly performing companies by selling their stock. IRRC, Congress Again Examining Governance Issues, Corp. Gov. Bull., Mar.-Apr. 1993, at 14, 16. For an intriguing look at the behavior of institutional investors in a specific contest, see Karen Van Nuyts, Corporate Governance Through the Proxy Process, 34 J. Fin. Econ. 101 (1993) (finding banks and insurance companies are more supportive of management than public pension funds and independent investor advisors).

\textsuperscript{38} Professor Pound connects high levels of institutional ownership to a lower probability of dissident victory. See Pound, supra note 13, at 259-60 (providing data to support "strategic alignment" and "conflict-of-interest" hypotheses). Insurance companies and bank trust departments may side with management to keep the firm's insurance or banking business—a conflict of interest. Some money managers may vote with management in order to preserve
funds answer. What will be the agenda of state pension funds, frequent targets of overt political pressures? Do beneficiaries of institutional funds have meaningful control over the institutions? In short, the skeptics advance the usual agency problem: Who watches the watchers?

Missing from this inquiry into shareholder voice, somewhat surprisingly, has been an analysis of the proper role for the board of directors when it administers the company's voting machinery. In our scheme of corporate federalism, this is a question of state law. State law concerning shareholder exit rights and the board's role in tender offers attracted great, if not central, attention in the 1980s debate on takeovers. We debated whether the board should be active or passive in response to unsolicited bids, whether directors should consider the interests of management and other constituencies, and whether judges should defer to board anti-takeover strategies. We scrutinized Delaware's jurisprudence on takeover defenses—from Cheff v. Mathes1 to Unocal Corp. v. Mesa Petroleum Co.2 to Paramount Communications v. Time, Inc.3—with fanatic zest.4 We have never before or since so dissected a line of cases in corporate law.

The board's proper role is no less relevant to the current debate on shareholder voice. Managers and their lawyers have sought, and predictably will continue, to neutralize the power of the shareholder vote. Increasing activism by institutional shareholders will fuel managerial attempts to insulate themselves from the effects of the ballot box. Aggrieved beneficiaries of institutional funds have meaningful control over the institutions? In short, the skeptics advance the usual agency problem: Who watches the watchers?

39. Most corporate pension plans leave voting to their money managers, and those managers, interested in attracting additional business from corporate clients, are reluctant to anger the corporate community by voting against management. The Labor Department is considering proxy rules to address this conflict of interest. Kevin G. Salwen & Leslie Scism, Corporate Pensions Face Proxy Rules, Wall St. J., Dec. 14, 1993, at CI ("Corporate pension plans hold more than $2.43 trillion in retirement money" and have been a "virtual nonentity in the increasing shareholder activism of the past several years.").

40. In New York, Governor Mario Cuomo's proposal to link pension funds with economically targeted investments within the state is starting to bear fruit. Designed as a method to fill financing gaps, several major retirement plans have signed on, including the New York City Employees' Retirement System and the New York State and Local Retirement Systems. See, e.g., Joel Chernoff, Economically Targeted Investments: Excelsior Pool Nabs Corporate Funds, Pensions & Investments, Feb. 22, 1993, at 32. Such targeted investment/confuses retirees' roles as pension beneficiaries with their role as public citizens. Hence, the possible use of political pressure is a real danger when public agencies invest pension funds in-state to prop up sagging economies.

President Clinton has also recently announced, in his State of the Union address, a new plan to seek voluntary investments from the retirement funds to help finance a program of rebuilding the nation's infrastructure. IRRC, Congress Again Examining Governance Issues, Corp. Gov. Bull., Mar.-Apr. 1993, at 14, 17.

41. 199 A.2d 548 (Del. 1964).
42. 493 A.2d 946 (Del. 1985).
43. 571 A.2d 1140 (Del. 1989).
44. See Larry E. Ribstein, Takeover Defenses and the Corporate Contract, 78 Geo. L.J. 71, 72 (1989) ("No current corporate issue has attracted more attention from legal and economic scholars than takeover defensive moves by corporate managers."). For a collection of the mentioned cases, see Oesterle, supra note 20, at ch. 4. One of the co-authors is also guilty. See, e.g., Dale A. Oesterle, The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court, 72 Cornell L. Rev. 117 (1986).
shareholders will turn to state courts, as they once did to protect their exit rights in tender offers, to ask judges to interpret state corporate codes and to enunciate the board's fiduciary duties in ways that nullify opportunistic behavior by firm managers in voting matters. As arbiters of the tension between shareholder rights and management power, judges again hold the decisive cards.

This Article explores voting in the public corporation and the role of state judges in defining and protecting the shareholder franchise. Our story begins with an exposition of the contradictory (and confounding) provisions of statutory voting law. On the one hand, state statutes uniformly guarantee shareholders basic voting rights, such as the right to annual board elections, the power to veto fundamental structural and control changes, and inspection rights to assist shareholder participation in the voting process. Yet, on the other hand, the statutes empower the board to control the process, the content, and the context of shareholder voting. The statutes grant the board discretionary powers to administer the voting machinery, to change the capital structure and thus constrict voting opportunities, to limit participation in the voting process, and even to decide whether shareholders vote at all. Faced with legislative inconsistency, we are left with a common-law answer: a case-by-case judicial response to individual pleas for relief.45

The second part of our story revolves around a line of cases that declare the inviolateness of the voting process. The cases, virtually unexplored in academic literature,46 originated in the early 1970s with *Schnell v. Chris-Craft Industries*47 and took on new vitality in the late 1980s with *Blasius Industries v. Atlas Corp.*48 and *Hubbard v. Hollywood Park Realty Enterprises*.49 The *Schnell* line of cases treats any manipulation of the voting machinery by incumbents as inequitable—a presumptive breach of fiduciary duty.50 The *Schnell* doctrine, though it avows to give content to the statutory purpose of shareholder control, is decidedly narrow. If state courts determine that the *Schnell* doctrine does not apply, they declare near indifference to the board's virtually unreviewable say over whether shareholders vote and what they vote on.

The split personality of state judges toward shareholder voting is unfortunate. Shareholder voting offers a potent means for governance change in a dynamic business environment and is a valuable part of the package of corporate rights that equity investors purchase. Lofty judicial

45. See Guido Calabresi, A Common Law for the Age of Statutes 1-7 (1982).
47. 285 A.2d 437 (Del. 1971).
48. 564 A.2d 651 (Del. Ch. 1988).
pronouncements recognize voting's centrality in the corporate agreement reflected in the corporate statutes; a stringent judicial doctrine limits the board to a ministerial role in the voting process. Nonetheless, the narrow boundaries of a heightened Schnell review and the erratic performance of judges who review management interference with shareholder voting belie a judicial inconstancy that ignores and thwarts the purposes of the voting agreement. Judges strengthen our corporate law, we assert, when they exercise the courage to match the stated theory of voting with the practice of deciding difficult cases.

In analyzing the role of state courts in voting contests, we proceed as follows: Part I describes how state corporate statutes enable and regulate voting in the modern public corporation. We describe current voting structures and practices, highlighting the tension between shareholder voting rights and management prerogatives over voting.

Part II explores the theoretical justifications for the realities of shareholder voting in the public corporation: Why do equity shareholders have voting rights? Why are these rights subject to such pervasive board oversight? We describe a theoretical framework—a basic "voting agreement"—for reconciling shareholder control and managerial administration of public shareholder voting.

Part III describes and criticizes the current split personality of state courts, particularly in Delaware, on the legality of the various techniques management has used to dilute and subvert shareholder voting rights. Current doctrine fails to distinguish between board administration of the voting machinery and board impediments to dissent and to shareholder control.

Finally, Part IV offers an explanation for judicial inconstancy in voting cases. We urge judges to return to the purposive nature of law and, in voting cases, to be true to their responsibility to interpret and enforce the basic "voting agreement."

I. SHAREHOLDER VOTING IN PUBLIC CORPORATIONS: THE STATUTORY FRAMEWORK

Shareholder voting has always been part of the American corporation. The earliest American corporate charters, granted by special acts of state legislatures, gave explicit voting rights to shareholders. State legislatures

51. Colonial proprietors, governors, and assemblies—themselves often empowered by corporate charters granted by Parliament or the Crown—exercised the right to incorporate without significant interference from British authorities. 1 Joseph S. Davis, Essays in the Earlier History of American Corporations 6-29 (1917). Colonial authorities incorporated at least seven known business corporations, though the incorporation power was seldom explicitly delegated and often unsettled. 2 Davis, supra, at 26 tbl. II. After the Declaration of Independence, the fledgling state legislatures immediately assumed the power of the colonial authorities to grant corporate charters. Between the signing of the Declaration of Independence and the ratification of the United States Constitution, the legislatures chartered over 20 business corporations.

The state legislatures were jealous of their incorporation prerogative and protected it from state executives and the federal government. Id. at 9. For example, when Governor William Livingston of New Jersey attempted to grant a charter in 1778, the legislature passed a
included shareholder voting in their first state corporate statutes in the early 1800s and later, in the mid-1800s, in their general enabling resolution vesting the incorporation power solely in it. Delegates to the federal drafting conventions, knowledgeable of English experience, believed that concentrating the incorporation power in a federal government would lead to mercantile monopolies. A weak federal government meant that the states reserved their “traditional” powers.

Under the Articles of Confederation, the federal government did not have the power to grant corporate charters. Id. at 9-12. James Madison, twice, and Charles Pinckney, once, at the constitutional convention of 1787, proposed a provision enabling the federal government to grant corporate charters, but each proposal was defeated. The final proposal, as amended, would have limited federal incorporation to canals only, but lost by a vote of eight to three. See James Madison, The Debates in the Federal Convention of 1787, at 420, 557, 563-64, 570 (Gaillard Hunt & James B. Scott eds., 1920). Rufus King of Massachusetts opposed the proposals on the ground that several states would not ratify a Constitution with such a provision. Id. at 564. He was correct. Five states, in ratifying the Constitution, recommended adding an express provision to prohibit Congress from creating companies with “exclusive advantages” or “monopolies.” Id.


By 1800, state legislatures had incorporated more than 300 business corporations. See 2 Davis, supra, at 27 tbl. III. To date, state legislatures have not relinquished their role as primary incorporators of this country’s businesses.

52. Some charters provided for a rule of one-share, one-vote. See, e.g., People ex rel. Barker v. Kip (N.Y. Sup. Ct. 1922) (reprinted at 4 Cow. 385, 384 as appendix to People ex rel. Israel v. Tibbets, 4 Cow. 358 (N.Y. Sup. Ct. 1825)) (discussing incorporation statute providing “that each stockholder shall be entitled to one vote in each share of the stock of the bank, which he shall have held in his own name at least fourteen days previous to the time of voting”); People ex rel. Israel v. Tibbets, 4 Cow. 358 (N.Y. Sup. Ct. 1825) (noting identical provision except for a sixty-day holding period).

Early bank charters had capped voting provisions. For example, the Massachusetts Bank Charter provided that no shareholder was entitled to more than ten votes. Act of March 9, 1792, 1790-91 Mass. Acts 369 (reprint 1895). The Union Bank Charter of 1792 provided that each shareholder had one vote for the first $100 contributed and one for each additional $200 contributed, with a maximum of ten votes. Act of June 25, 1792, 1792-93 Mass. Acts 14 (reprint 1895). Apparently the Massachusetts Bank abused its virtual banking monopoly and aroused substantial public resentment. See 2 Davis, supra note 51, at 67-70; see also David L. Ratner, The Government of Business Corporations: Critical Reflections on the Rule of “One Share, One Vote”, 56 Cornell L. Rev. 1, 8 (1970).

53. These statutes were industry specific, relating to canals, turnpikes, aqueducts, textiles, or banks. In 1799, for example, the Commonwealth of Massachusetts had a general incorporation statute for aqueducts. Proprietors could incorporate by registering with a Justice of the Peace for the County. Shareholders could delegate management duties to directors and officers, pass bylaws, sell their shares, and vote their shares or execute proxies. Directors could assess shareholders for needed capital funds. Creditors could sue shareholders personally if an aqueduct corporation dissolved without paying its debts. The corporation could sue those who injured corporate property for treble damages and could “enter upon, dip up and open any such parts of the Streets, Highways or Town ways” with the approval of local officials. See Dale A. Oesterle, Formative Contributions to American Corporate Law by the Massachusetts Supreme Judicial Court from 1806 to 1810, in The History of the Law in Massachusetts: The Supreme Judicial Court 1692-1992, at 127, 131-32 (Russell K. Osgood ed., 1992).
corporate statutes. The pattern established in these early general enabling statutes remains intact today.

Shareholder voting holds a position of central importance in modern enabling statutes. A large portion of every modern corporate statute devotes itself to voting in the corporation. Yet the voting structure outlined in the corporate statutes reflects a deep-seated legislative vacillation. State corporate codes contain sections detailing ostensibly mandatory voting rights: compulsory annual board elections with minimum notice and quorum requirements, shareholder inspection rights, restrictions on watered and discounted stock, prohibitions against corporate voting of treasury stock or the stock of a parent, and shareholder ratification of fundamental corporate transactions. The same codes contain, however, sections that permit (or, by omission, fail to prohibit) substantial constraints on shareholder voice: board control of the voting rights of preferred shares through blank check authorizations; opt-out provisions for such matters as one-year terms and shareholders' written consent procedures; and board domination, using corporate funds, of all proxy solicitations.

A. Who Votes?

Corporate statutes permit articles of incorporation to specify classes of equity shares and define the voting rights of each class. Under some statutes, even debt securities can have voting rights. The statutes autho-

54. The enabling statutes permitted entrepreneurs to incorporate a business without specific legislative authorization. See Henry N. Butler, Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges, 14 J. Legal Stud. 129 (1985). The earliest general incorporation statute seems to have been the Connecticut statute of 1837. Massachusetts waited until 1851, and New York until 1866, to pass such statutes. Id. at 146.

55. See, e.g., Del. Code Ann. tit. 8, § 212(a) (1991) (stating general rule that “each stockholder shall be entitled to 1 vote for each share of capital stock”); Revised Model Business Corp. Act § 7.21(a) (1991) (stating general rule that “each outstanding share, regardless of class, is entitled to one vote on each matter voted on at a shareholders’ meeting”).

In fact, by the end of the nineteenth century, all states (other than Massachusetts and New Hampshire) had ratified constitutional provisions prohibiting special incorporation and requiring incorporation under a general act. See, e.g., N.Y. Const. art X, § 1.


57. An important exception is a charter authorization of “blank check” stock. See, e.g., Del. Code Ann. tit. 8, § 151(a) (1991) (“[C]lasses or series [of stock] may have such voting powers . . . and such designations, preferences and . . . rights, and qualifications, limitations or restrictions . . . as shall be stated . . . in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.”). Under such a charter provision, the board is free to set the voting rights of the stock (usually preferred stock) it chooses to sell.


Holders of publicly traded bonds sometimes demand veto power over corporate decisions that affect the value of their debt, such as large-scale dividend distributions, mergers, and new
rize boards of directors to choose which stock they wish to sell, how much, and at what price. In theory, many nonequity constituents such as debtholders and employees—through the ownership of voting shares or classes of shares—could routinely participate in electing the board and ratifying major corporate transactions. In publicly traded corporations they rarely do. Most public corporations concentrate voting rights in a single, publicly traded class of common shares. Not surprisingly, there is strong support for this basic structure among institutional investors.

Regulatory constraints may explain the typical one-class structure. Since 1926, the New York Stock Exchange, since 1926, has refused to list debt placements. They obtain specific, explicit voting rights in a trust indenture, which are protected (ostensibly) by the Trust Indenture Act of 1940. See generally Clifford W. Smith, Jr. & Jerold B. Warner, On Financial Contracting: An Analysis of Bond Covenants, 7 J. Fin. Econ. 117 (1979). Although such bondholders could, through language in a trust indenture, opt into the procedures of a state corporate code that provides for shareholders, most bondholders seem to favor informality. In addition, when a firm is reorganized in bankruptcy, the federal bankruptcy code gives bondholders a class vote on the confirmation of the reorganization plan. See 11 U.S.C. §§ 1126(c), 1129 (1988).

59. See, e.g., Del. Code Ann. tit. 8, § 152 (1991) (consideration for the purchase of capital stock “shall be paid in such form and in such manner as the board of directors shall determine”). Once the corporation has sold equity shares, the board’s discretion is limited by statutory and common law restrictions on the sale of shares for insufficient consideration. See, e.g., Lewis v. Scotten Dillon Co., 306 A.2d 755, 757 (Del. Ch. 1973), aff’d sub nom. Iroquois Indus., Inc. v. Lewis, 318 A.2d 134 (Del. 1974) (directors’ judgment on adequacy of consideration for stock is presumptively valid and may be rebutted only by evidence of fraud or reckless indifference on the part of directors).

60. Debtholders, for example, can demand redeemable junior preferred stock when they lend to the corporation. If the stock is not redeemed on schedule, the junior preferred would vote in board elections. See, e.g., In re Bicoastal Corp., 600 A.2d 343 (Del. 1991).


62. There are some important exceptions. The most common exception to single-class voting is preferred shares. Most preferred stock gives holders the right to vote for directors if a firm has not paid preferred dividends for three years. See NYSE Listed Company Manual § 315.00(d) [hereinafter NYSE Manual] (stating that companies listed on the New York Stock Exchange must give holders of preferred stock the right to vote as a class to elect a minimum of two directors if there is a default in the payment of six consecutive quarterly dividends). Preferred shareholders also have, under state corporate codes, voting rights in charter amendment recapitalizations. See, e.g., Del. Code Ann. tit. 8, § 242(a) (1991); Revised Model Business Corp. Act § 10.04 (1991). Some state corporate codes extend voting rights for preferred stock to statutory mergers. See, e.g., N.Y. Bus. Corp. Law § 9032 (McKinney 1986); Cal. Corp. Code §§ 152, 1202 (Deering 1977 & Supp. 1992); Revised Model Business Corp. Act § 11.03 (1991).

Though unusual, a few firms have multiple classes of publicly held common shares with disparate voting power. “ABC” stock, first used by General Motors Corp. to finance corporate acquisitions, is one example, and dual class voting systems designed to deter unwanted takeover offers is another. See generally Ronald J. Gilson, Evaluating Dual Class Common Stock: The Relevance of Substitutes, 75 Va. L. Rev. 807 (1987); Jeffrey N. Gordon, Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 Cal. L. Rev. 1 (1989).

63. In an annual survey of institutional investors, the IRRC found that 67% said they would oppose a management request to authorize stock with unequal voting rights. Only 3% said they would support such a request; 30% would consider it on a case-by-case basis. Patrick S. McGurn & Leita K. Zeugner, IRRC, NYSE May Abandon ‘One-Share One-Vote,’ Corp. Gov. Bull., July-Aug. 1992, at 13, 16.
nonvoting common shares and, since 1940, has refused to list voting stock in a company that has nonvoting common shares outstanding in public hands.\(^6\) The SEC, in its aborted effort to establish a one-share/one-vote rule, indicated a strong distaste for capital reorganizations that disenfranchise common shareholders.\(^6\) Moreover, several federal statutes restrict specified types of firms from issuing nonvoting shares.\(^6\)

The presumption of equality among equity shares also finds expression in several lines of state court decisions. For example, state judges have construed general state constitutional or statutory provisions to require that public corporations entitle all shares to vote for directors, firm-specific provisions notwithstanding.\(^6\) In addition, responding to challenges of early poison pill plans, which gave contingent supervoting rights to all target shares except those held by a hostile bidder, federal district courts interpreted state corporate codes to require equal treatment of all shares of a class.\(^6\)

The court-made restriction against vote buying further limits who may vote.\(^6\) Shareholders cannot irrevocably transfer their voting power without also selling either their shares or an economic interest in the shares or the corporation.\(^7\) Recent cases, though rejecting the early judicial view that vote selling is illegal per se,\(^7\) continue to treat vote buying with suspicion: "Because vote-buying is so easily susceptible of [sic] abuse it must be viewed as a voidable transaction subject to a test for intrinsic fairness."\(^7\)

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64. NYSE Manual, supra note 62, § 313.00. Recently, however, the Exchange, worried about competitive pressures from other national exchanges and the NASDAQ, floated a plan to rescind the rule. See McGunn & Zeugner, supra note 63, at 13.


71. Macht v. Merchants Mortgage & Credit Co., 194 A. 19, 22 (Del. Ch. 1937) (holding vote selling to be "against public policy, and . . . fraud on the other stockholders" who should be able to rely on the independent judgment of fellow shareholders).

72. Schreiber v. Carney, 447 A.2d 17, 25-26 (Del. Ch. 1982) (rejecting view that modern public shareholders rely on the independent judgment of fellow shareholders). In Schreiber, Jet Capital agreed to vote for a merger after receiving a loan from one of the merging firms. The merger benefitted the firm's other shareholders, and the loan side-payment compensated Jet
The case against vote buying, deriving from a long tradition against vote buying in political contests, is not particularly strong. Just like managers who have effective control of the business without holding a significant equity interest, a variety of legal and market restraints on abusing control would control vote buyers.73 The restraints against vote buying, which preclude a low-cost method for transfers of corporate capital for its holdout power. The court held that Jet Capital's vote agreement was legal. Id. at 26. Delaware courts have also upheld vote buying in a bondholder consent process. See Kass v. Eastern Air Lines, Inc., Nos. 8700, 8701, 8711, 1986 WL 13008 (Del. Ch. Nov. 14, 1986) (written by Allen, Ch.).

73. Judge Frank Easterbrook and Professor Daniel Fischel explained vote buying impediments as a way to prevent an inefficient rift between equity ownership and equity control. See Easterbrook & Fischel, supra note 16, at 74-76. They asserted that a shareholder who faces a collective action problem would sell her virtually worthless individual votes for anything more than zero, even if the proceeds do not compensate the shareholder for the resulting potential dilution in the equity value of her stock that could result once a successful vote buyer gains control of the firm. Id. at 75. Competition among vote buyers, they argued, would not drive the price up to the value of the expected equity dilution because bidders would be buying in an all-or-nothing situation and would have to discount the price they pay for the risk of not getting control. A bidder that did not get control would have paid for worthless voting rights. Moreover, a successful bidder, without an equity stake in the firm, would “have an incentive to consume excessive leisure and perquisites and to engage in other behavior that does not maximize profits.” Id. at 74.

Easterbrook and Fischel made arguments that seem inconsistent with other parts of their book, and they did not provide us with reconciliations. We are left to wonder whether the authors have answers for the following questions: If there is a collective action problem under a vote-buying regime, won’t shareholders either discount the price of the shares they purchase or, eventually perhaps, encourage incorporators to prohibit the practice in the firm’s articles of incorporation? See id. at 1-39 (discussing the corporate contract). Why is the “specter of looting” an “all-weather bogeyman” in other control transactions and a legitimate concern in control shifts through vote buying? Id. at 129-30 (“The best remedies are based on deterrence rather than prior scrutiny. Looters, when caught, may be fined or imprisoned.”). Why can a vote buyer not make contingent offers for votes as bidders do in tender offers, thus eliminating the all-or-nothing problem as an obstacle to a fully priced competitive bidder market? Id. at 171-73. Why can’t an issuer (management) tender offer for voting rights keep third parties honest as they do with issuer tender offers for stock? Id. at 180-81 (arguing that issuer tender offer for stock protects shareholders from value-decreasing coercive tender offers). Isn’t the incidence of value-decreasing transactions in vote-buying control changes just an empirical question? Id. at 127-29 (discussing Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955)).

The main charge against vote buying—that winning bidders will recoup their investment by diverting profits from other equityholders—rings hollow. In publicly held corporations, existing managers typically have insignificant equity in the firm, yet operate under the same (or even more severe) incentive problems. The argument against vote buying assumes that vote buyers will be more adept somehow than current managements at cheating other shareholders. The same legal rules (on fiduciary duty) and market constraints (in the labor, product, and stock markets) that apply currently to existing managers and reduce agency costs would apply to successful bidders. Why do adequate rules and market forces become suddenly inadequate? The argument goes deeper. It hinges on an assessment of the value of easy control changes and whether shareholders can and should decide for themselves on the issue.

Paradoxically, Easterbrook and Fischel supported the argument by Professor Thomas Andr that vote selling is an efficient method of transferring control that avoids the necessity of target board approval and state antitakeover legislation restricting the transfer of shares. Id. at 74 n.21; see Thomas J. Andr, Jr., A Preliminary Inquiry into the Utility of Vote Buying in the Market for Corporate Control, 63 S. Cal. L. Rev. 533 (1990) (arguing that vote buying should be permitted to insurgent-bidders who engage in a two-stage strategy of a proxy contest followed by a tender offer).
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control, may do little more than provide incumbent managers in public corporations an assurance of job security. Interestingly, there may be transactional substitutes for vote buying that participants in the control market could, but do not, use.\(^74\)

**B. On What?**

State corporate codes provide for shareholder suffrage on a variety of matters: election and removal of directors;\(^75\) ratification of specified fundamental corporate transactions initiated by management such as mergers, sales of substantially all the firm’s assets, compulsory share exchanges, dissolution, recapitalizations, and charter amendments;\(^76\) approval and initiation of changes to the corporate bylaws;\(^77\) and adoption of precatory shareholder resolutions or of resolutions offered by management ratifying operational decisions on, among other things, conflict of interest transactions or executive compensation.\(^78\) The technical details of a state corporate code’s many voting provisions can lead to the false conclusion that shareholder voting rights are considerable.\(^79\) In practice, shareholder suffrage in American public corporations is limited and largely perfunctory.

Every year public shareholders elect a board of directors, but shareholders do not vote on normal operating and financial decisions unless asked by the board. State law decrees that shareholders have delegated routine management decisions to their elected representatives: the directors and the directors’ agents, the executive managers.\(^80\)

The scope of managerial discretion over operations and financial decisions is broad, stretching the definition of “routine.” For example, in American public corporations the board may decide, without any direct shareholder involvement, whether to sell stock and to whom, whether and how to distribute profits, whether the firm diversifies into new business

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74. For example, a vote buyer could buy stock the day before the record date and sell it the day after, at the same time hedging all the price risks associated with the equity by purchasing, for example, a put option at the purchase price. The price of the votes would be the one-day carrying costs of the stock and the put option. Or a vote buyer could purchase irrevocable proxies as a creditor based on a one-day, hedged position, with the proxies given as security. See Del. Code Ann. tit. 8, § 212(c) (1991). Of course, state antitakeover statutes and poison pill plans, if applicable, might defeat these strategies.

75. Id. § 211(b).

76. Id. § 242 (charter amendment), § 251 (merger or consolidation), § 271 (sale of substantially all the assets), § 275 (dissolution).

77. Id. § 109(a).


80. Del. Code Ann. tit. 8, § 141(a) (1991); see also Paramount Communications v. Time, 571 A.2d 1140, 1150 (1989) (“Delaware law imposes on a board of directors the duty to manage the business and affairs of the corporation.”).
ventures or abandons existing ones, whether the firm takes on or sheds debt, and who is to hold the most powerful executive positions in the firm.

When shareholders do seek to initiate shareholder votes on corporate matters, they face an imposing array of obstacles. Corporate bylaws often limit the ability of shareholders to place their resolutions on the agenda at a shareholders' meeting.¹ Some require that shareholder resolutions, unlike management proposals, receive the vote of an absolute majority of outstanding shares or count abstentions as “no” votes.² Even if on the agenda, shareholder proposals need not be included in the corporate-funded proxy solicitation materials unless required by Rule 14a-8, the SEC's shareholder proposal rule.³

During Rule 14a-8's fifty-year ebb and flow, the SEC (not the states) has interpreted the scope of shareholder rights to initiate corporate reforms.⁴ Recently, the SEC staff has been erratic in permitting shareholders to insert governance reform proposals in the firm's proxy solicitation materials.⁵ For example, without any change in state law, the SEC recently

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¹ In-house rules, typically in a firm's bylaws, often prohibit shareholders from introducing resolutions unless the resolution is one entrusted to shareholder action by state or federal law. Shareholders can still recommend that the board take specified action, a precatory resolution, if the shareholders do not have the power to bind the board. When a shareholder resolution is a proper subject for shareholder action, firm bylaws often require that the shareholder give management advance notice before management will put the issue on the agenda.


³ Securities Exchange Act Rule 14a-8, 17 C.F.R. § 240.14a-8 (1993). Under state law, shareholders who want to offer a competing slate of candidates or submit particular issues for shareholder vote must pay for a separate proxy solicitation. See, e.g., Rosenfeld v. Fairchild Engine & Airplane Co., 128 N.E.2d 291 (N.Y. 1955). Rule 14a-8, the so-called “shareholder proposal” rule, allows shareholders whose non-election proposals fit within the rule to communicate with other shareholders at firm expense. If shareholder action is neither sought by management nor covered by the rule, the costs of the initiative are borne by the initiating shareholder.

⁴ Rule 14a-8 purports to decide what matters are includable or excludable in management's proxy materials by reference to state law. See Rule 14a-8(c)(1), 17 C.F.R. § 240.14a-8(c)(1) (requiring that a proposal must be a “proper subject for action by security holders . . . under the laws of the registrant's domicile”). Through a no-action procedure in which the SEC reviews all shareholder proposals that management excludes, the SEC now decides the scope of shareholder rights to initiate corporate reforms.

⁵ In the last few years, SEC staff has permitted management to exclude a variety of governance reform proposals, including:

- Proposals that the firm adopt a voting scheme to give shareholders (including pass-through pension funds) one vote for each year they have held their stock, up to a maximum of five votes per share. In re Sears Roebuck & Co., 1993 SEC No-Act LEXIS 49 (Jan. 13, 1993); In re Exxon Corp., 1992 SEC No-Act LEXIS 1181 (Dec. 31, 1992); In re International Bus. Mach. Corp., 1992 SEC No-Act LEXIS 1179 (Dec. 31, 1992).
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reversed twenty years of Rule 14a-8 practice by allowing management to omit shareholder proposals dealing with social or political issues that touch on employment. In Cracker Barrel, the Commission concurred with staff views that discriminatory hiring policies, like any other employment matter within the discretion of management, constitute "ordinary business" beyond shareholder control.86

Although shareholder resolutions today face better odds of passing than ever before,87 even when a shareholder-initiated resolution passes, it usually does not bind the board. To satisfy the "proper subject" test of Rule 14a-8, most shareholders phrase their resolutions as precatory recommendations to the board, which the board can then disregard.88

Shareholder resolutions that amend a firm's bylaws are binding, but must be consistent with the firm's charter and state law. Shareholder efforts at governance reform through bylaw changes are still young, though the SEC has shown early reluctance to embrace this exercise of shareholder power. The SEC staff, for example, has accepted management arguments that shareholder bylaw proposals to create advisory shareholder committees are inconsistent with the board's statutory power to manage the firm's business and affairs.89

- A proposal to form a three-member advisory committee elected by shareholders to review the activities of the corporation and advise the board concerning shareholders' views. In re Pennzoil Corp., 1993 SEC No-Act LEXIS 503 (Mar. 22, 1993).


At the same time, the SEC staff reversed its position on what constitutes "ordinary business" under Rule 14a-8(c)(7) and when a proposal is "significantly related" to the firm's business under Rule 14a-8(c)(5). Effectively revamping shareholder governance rights, SEC staff now requires inclusion of shareholder proposals on executive compensation (though not a company's general hiring practices) and tobacco business (though not a company's policies toward smoking in the workplace). Executive Pay Proposals Can't Be Omitted: SEC Staff Reverses Longtime Policy, 7 Corp. Couns. Wkly. (BNA) No. 8, at 2 (Feb. 19, 1992); see In re Philip Morris Cos., 1990 SEC No-Act LEXIS 335 (Feb. 13, 1990) (permitting proposal that charter be amended to provide company not conduct any business in tobacco products after December 31, 1999); In re Philip Morris Cos., 1990 SEC No-Act LEXIS 333 (Feb. 22, 1990) (permitting proposal seeking report on the effect of the company's promotion activities on smoking by minors).


87. See Walters, supra note 23, at 16.

88. "Under certain states' laws, a proposal that mandates certain action by the issuer's board of directors may not be a proper subject matter for shareholder action, while a proposal recommending or requesting such action of the board may be proper under such state laws." Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, SEC Release No. 34-20091, 48 Fed. Reg. 38218, 38222 (1983) (codified at 17 C.F.R. § 240.14a-8(c)(1)).

89. The SEC staff has sent contradictory signals. While the SEC has encouraged shareholders to use their power to amend bylaws, some recent no-action letters narrowly interpret state statutes permitting such power. IRRC, Corp. Gov. Bull., Jan.-Feb. 1993, at 5. The SEC staff has been reluctant to permit bylaw changes that would effect significant governance reform. The staff recently allowed Pennzoil Corp. to exclude a shareholder proposal to amend the bylaws to create a shareholder committee that would review board
Shareholder voting on firm matters is extremely limited and, when it
happens, purely reactive. The statutes generally limit voting on extraordi-
nary matters to charter amendments, statutory mergers, assets sales, and
dissolution. The scope of this voting right, fixed by history, includes
such minor events as changing the corporate name or the address of the
registered office, yet excludes such major events as changing the firm's
dividend policies, incurring substantial new debt, entering new lines of
business, and appointing a new CEO. Under the “equal dignity” doctrine,
managers can even restructure a transaction to avoid statutory voting
requirements.

In addition, shareholders cannot initiate fundamental changes. The
board must initiate and propose amendments to the firm's charter, merg-
ers, and sales of assets; shareholders can only ratify board initiatives. When
the board submits a proposal to shareholder vote, shareholders cannot sua
sponte amend the initiative—they must take it or leave it. The board retains
control over the transaction even if the shareholders approve it. A favorable
vote is not binding on the board, which can, without a second shareholder
activities and advise the board of shareholder views. In re Pennzoil Corp., 1993 SEC No-Act
LEXIS 503 (Mar. 22, 1993). The proposal, submitted by CalPERS, would have created a three-
member committee elected by shareholders and paid fees equal to half the fees paid to the
company's outside directors. Pennzoil submitted a letter from Delaware counsel that argued
the bylaw change would be inconsistent with Section 141(a) of Delaware's statute which
provides the board is responsible for managing the firm's affairs. See Proposal for Shareholder
Committee via Bylaw Amendment May Be Omitted, 8 Corp. Couns. Wkly. (BNA) No. 12, at 1
(Mar. 24, 1993). Even when CalPERS resubmitted the proposal as a precatory recommenda-
tion for the board to amend the bylaws to effect the new structure, SEC staff concluded
"there is a substantial question as to whether, under Delaware law, the directors may adopt a
by-law provision that specifies that it may be amended only by shareholders." In re Pennzoil
Corp., 1993 SEC No-Act LEXIS 503 (Mar. 22, 1993); see Charles F. Richards, Jr. & Anne C.
Foster, Exxon Revisited: The SEC Allows Pennzoil to Exclude Both Mandatory and Precatory
Proposals Seeking to Create a Shareholder Advisory Committee, 48 Bus. Law. 1509 (1993)
(describing SEC response to Pennzoil's arguments based on state law). The SEC staff's position
is remarkable in view of Delaware's statute, which provides "the power to adopt, amend or
repeal bylaws shall be in the stockholders entitled to vote." Del. Code Ann. tit. 8, § 109(a)

Yet in another recent no-action letter, the SEC staff permitted the New York State Common
Retirement Fund to propose a bylaw amendment at A&P that would allow shareholders with a
.5% stake for three years to submit a 300-word statement on how they intend to vote for
directors and their opinion of the ability of the incumbent board to achieve long-term
corporate growth and shareholder gain. In re Great Atlantic & Pac. Tea Co., 1993 SEC No-Act

90. See, e.g., Del. Code Ann. tit. 8, § 242 (charter amendment), § 251 (merger or
consolidation), § 271 (sale of substantially all the assets), § 275 (dissolution)(1991).

91. The common law required that shareholders unanimously assent to changes in the
corporate charter, changes that included amendments, mergers, and dissolution. E.g., Voeller
v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941). Sales of all or substantially all of a
firm's assets also required unanimous approval. E.g., Geddes v. Anaconda Copper Mining
Co., 254 U.S. 590, 595-98 (1921). These "organic" changes were said to be beyond the
ordinary business matters delegated to the board. Corporate codes came to include sections
that reduced the unanimity rule to, first, a two-thirds, and, later, a straight, majority vote.
Modern corporate codes have added no new matters to the list of fundamental transactions.
The New York Stock Exchange Listed Company Manual, however, does include additional
subjects. See NYSE Manual, supra note 62.

92. See infra text accompanying note 205.
In theory, shareholders can initiate structural reforms in the bylaws. The statutes by their terms contemplate coterminous control over the bylaws and permit both the board and shareholders to initiate and approve bylaw amendments. Some statutes even make shareholder-approved bylaws superior, explicitly prohibiting the board from modifying or sabotage them. In practice, however, the board makes almost all bylaw changes without a shareholder vote. Until recently, public shareholders have rarely sought to use their shared power over the bylaws.

Shareholders who seek bylaw changes face daunting barriers. Most firms have in-house rules requiring shareholders to give advance notice of proposed bylaw changes. These rules give managers time to rally support against the change, or to challenge its legality. Although state courts have not addressed the extent of shareholder power over the substantive content of bylaws, corporate law practitioners have questioned whether shareholders can use the bylaws for governance reforms. Moreover, many firm charters require a supermajority shareholder vote to amend bylaws. Finally, under Rule 14a-8, management may exclude from management's proxy materials shareholder proposals that seek bylaw changes if they are inconsistent with the charter or state law, and, in particular, if they intrude on management prerogatives.

Even on the one issue that statutes do give shareholders an unequivocal, periodic right to vote—the election of directors—incumbent managers dominate the outcomes through their control of the firm's proxy solicitation machinery. Professors Berle and Means chronicled this con-
trol in 1932, and since then it has not changed significantly. Incumbents' success in American public corporations rivals that of former Soviet politicians. Of the 1500 public corporations tracked by the Investor Responsibility Research Center, insurgents displaced only eight boards.

Management retains control over board membership in a number of ways. The board sets the time and record date for the annual meeting, thus deciding who votes and when. Moreover, incumbent managers have significant control over board composition between elections. State statutes empower the board to add or eliminate directorships and to fill vacancies. The board can thus decide (without shareholder approval) to change its size, the number of directors up for election, and even its composition, subject only to specific (and rare) limits in the corporate charter. Shareholders have the power to remove directors mid-term, but their inability to call special shareholder meetings effectively nullifies this authority.

The board is divided into no more than three classes of directors, each class coming up for election no less than every three years. By staggering the board, the normal one-year cycle of board elections becomes a two-year cycle, and an insurgent must assemble a shareholder majority in two elections before obtaining absolute board control. Although the greater continuity of a staggered board arguably benefits shareholders—the usual justification for such a restructuring—event studies indicate a loss in share value because of the change, suggesting that shareholders perceive the loss of control over the board to exceed the gains in board stability. E.g., Greg A. Jarrell & Annette B. Poulsen, Shark Repellents and Stock Prices: The Effects of Antitakeover Amendments Since 1980, 19 J. Fin. Econ. 127 (1987).

See supra notes 2-7 and accompanying text.

Thomas J. Andre, Jr., The Corporate Governance Reform Act of 1995, 17 J. Corp. L. 87, 120-24 (1991) (describing Lockheed board's decision in 1990 to add four new directors' seats and fill them with institutional shareholders to stop those shareholders from voting their shares in favor of an insurgent, who was the firm's largest shareholder).

Del. Code Ann. tit. 8, § 141(b) (1991) (permitting the number of directors to be fixed in the certificate of incorporation); id. § 223(a)(1) (requiring the number of directors to be fixed by the certificate of incorporation, the bylaws, or in a manner provided for in the bylaws).

The board can amend the bylaws, unless the charter withdraws this power, to add or subtract directors. Id. § 142(a). Using this power, the board can add or subtract director seats without a shareholder vote. Moreover, the board can fill vacancies or newly created directorships. Id. §§ 142(e), 223. An incumbent board can use this power to defend itself in proxy contests. When AT&T succeeded in defeating the reelection of NCR's CEO and President in a proxy contest, the NCR board increased the board by two seats and reinstated the defeated officials. Michael Peltz, AT&T Reaches Out and Clutches NCR, Institutional Investor, Jan. 1992, at 64.

Some statutes do, however, circumscribe the board's power to fill vacancies in mid-term. In Delaware, for example, any shareholder (or group) holding 10% or more of a corporation's outstanding shares can petition the Chancery Court to order a special election to fill vacancies or new director seats, if they would otherwise be filled by a minority of incumbent directors. Del. Code Ann. tit. 8, § 223(c) (1991).


In practice the removal power is limited. Shareholders cannot call mid-term special meetings on their own, unless permitted in the charter or bylaws. Such provisions are unusual. On rare
C. How?

Shareholder suffrage is tied to a historical anachronism—the shareholder meeting.¹⁰³ According to the corporate statutes, shareholders vote in person or through an agent at a designated location and time.¹⁰⁴ When shareholders are numerous and dispersed, few travel to the meeting; most who vote use an agent empowered by a written proxy. Most absentee shareholders select the proxy agent identified by the firm’s managers on a form proxy card mailed to all the firm’s shareholders. A shareholder need only check boxes, sign the card, and mail it back.

Although a proxy solicitation looks like a mail-in absentee ballot used in multiparty political elections, it is not. In a mail ballot, citizens have choices among various candidates. In a proxy solicitation, the proxy empowers an agent to vote in the manner chosen by the proxy solicitors.¹⁰⁵

occasions, if the certificate of incorporation does not prohibit the practice, shareholders have used their power to act by written consent. See infra note 103. For example, in NYCAL Corp. v. Angelichio, No. 13053, 1993 Del. Ch. LEXIS 226 (Del. Ch. Aug. 31, 1993), the board majority declared the firm’s insolvency and authorized the filing of a bankruptcy petition. In bankruptcy, shareholders tendered written consents representing a majority of the shares to remove the entire board and replace it with their designates. The Chancery Court upheld the shareholder action, though it noted that the majority shareholder may have violated a contractual governance agreement requiring a specified number of independent directors.

103. Del. Code Ann. tit. 8, § 211(a) (1991). The modern exception, made optional in many states, is the “written consent” procedure. Statutes in many states, including Delaware, authorize shareholders to act without a formal shareholders’ meeting by giving written “consents” to elect directors and take other corporate action. See id. § 228. Corporations can opt in or, in other states, opt out of the procedure in their charters. In Delaware, action by consent is available unless the firm has opted out by charter amendment. In Delaware, shareholders holding enough voting shares to take an action at “a meeting at which all shares entitled to vote thereon were present and voted” must sign consents. Id. § 228(a). Many state corporate codes do not follow Delaware and permit action by written consent only if all the shareholders consent. See, e.g., Revised Model Business Corp. Act § 7.05(a) (1991).

During the 1980s, insurgents in control fights discovered that they could exploit the consent procedure to obtain access to the voting mechanism without waiting for an annual meeting. See, e.g., Empire of Carolina, Inc., v. Deltona Corp., 514 A.2d 1091 (Del. 1986); Datapoint Corp. v. Plaza Sec. Co., 496 A.2d 1031 (Del. 1985). In a consent solicitation, the insurgent, not the board, controls the timing of the vote. In fact, in a consent solicitation governed only by the statute, management may have no more than a few days to respond with its own solicitation. Under Delaware’s statute the record date in a consent solicitation is the date the insurgent delivers the first consent, unless the board has established a procedure for setting another date.

104. Corporate codes require a shareholders’ meeting at least every 13 months, but leave the specific timing and mechanics of the meeting to the board. Del. Code Ann. tit. 8, § 211(a) (1991) (consistent with the firm’s bylaws). The state statutes do provide minimal protections. The board cannot call a shareholders’ meeting without notice or choose a stale record date. Id. § 222 (notice), § 213(a) (record date). Delaware’s statute specifies that the meeting date must fall within a window of at least 10 days, but no more than 60 days, after the record date. Many statutes also prohibit the board from back dating the record date to a date before the record date resolution. Id. § 213(b); see also Fisch, supra note 26, at 1134-42 (describing the evolution of the proxy system).

This means that shareholders cannot bind the proxy to vote against the management's slate of candidates or for particular nonmanagement candidates.

To vote against the management's candidates, a shareholder must either hope someone else sends her a proxy solicitation with competing candidates, find a personal representative willing to go to the meeting with her personal proxy, or go to the meeting herself. The latter two alternatives are too expensive, and insurgent proxy solicitations are rare. So her only viable option, short of selling her stock, is to check the "abstain" box on the firm's proxy or refuse to mail it at all. Lately, institutional investors have begun to experiment with a "just vote no" strategy in which they return their proxy cards and expressly abstain, withholding votes from the board nominees. The institutions hope that enough abstentions will register as a protest vote with a firm's managers. The legal effect of an abstention or nonvote, however, is surprising. In some states such as New York and Pennsylvania, blank proxies and proxies marked "abstain," although counted for the purposes of a quorum, do not count as votes or in the computation of voting results. In Delaware, however, abstentions count as votes cast against nonelection initiatives, but no-votes have no impact since they are not present or represented and not entitled to vote at the meeting. The SEC follows the Delaware rule for proxies submitted on executive and director compensation plans under Rule 16b-3.

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106. See IRRC, Funds Experiment with Withholding of Votes, Corp. Gov. Bull., May-June 1992, at 12 (discussing several large institutional investors who withheld votes from management slate at companies identified as "underperformers"). Of twelve companies subject to "just vote no" campaigns, one had 16.3% of the shares voted at the company's annual meeting withheld, others 9.3%, 5.8% and 5.6%, and the rest all under 5% with one as low as 1.3%. Id. The data show that these campaigns are waged largely for their public relations effect.

107. SRO rules bar broker-dealers from exercising discretionary authority to vote on nonroutine or controversial matters. SROs are self-regulatory organizations, national exchanges and national associations of securities dealers. See, e.g., NYSE Rule 452, 2 NYSE Guide (CCH) § 2452 (1991). Broker-dealers cast nonvotes on such proposals when they have not received voting instructions from their customers. Broker-dealers, however, exercise their authority on routine matters and either cross out or leave blank nonroutine matters on the proxy.


109. In matters other than the election of directors, the Delaware statute requires "the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote." Del. Code Ann. tit. 8, § 216(2) (1993).

110. SEC Release No. 34-30849, 57 Fed. Reg. 29,564 (1992) (concluding that shares voted as abstaining on a Rule 16b-3 proposal should be counted as present and entitled to vote, thus having the effect of a no-vote on the proposal; nonvotes are not shares present or represented and entitled to vote).
The proxy procedure survives because incumbent managers support it and reformers have not been able to coalesce around a satisfactory alternative. There is no corporate equivalent to a political primary to limit the number of eligible candidates. Some have suggested that a shareholder or group of shareholders controlling a set block of stock (say, ten percent) ought to be able by law to slate candidates on the proxy card. But the proposal is fraught with pragmatic difficulties, and policymakers seem happy not to address the quagmire. Others argue that firms could always provide for such procedures in their charter, but since firms have not done so, their shareholders must not want them. When the board asks shareholders to ratify transactions, either because required (in fundamental transactions) or because ratification insulates the board from personal liability for fiduciary breach (in conflict-of-interest cases), the firm's proxy must provide for a "no" vote. But the information that accompanies the proxy form is carefully written advocacy, drafted by public relations specialists working in conjunction with lawyers. The lawyers ensure that the advocacy satisfies the federal proxy regulations, and the public relations specialists present the firm's position in the most acceptable light. There is no room for the comments of dissenting shareholders in these materials. Only Rule 14a-8 resolutions entitle shareholders to "free write," subject to space limits and some management censorship.

For most public firms, the shareholders' meeting is an annual rite of spring following the closing of the company's end-of-year books. In the vast majority of cases, there is no serious challenge to management at the shareholders' meeting, and the meeting itself offers few surprises.

The usual annual meeting is not legislative; the shareholders rarely do more than ratify through proxies the board's slate of directors and any actions presented for shareholder approval. At most, the usual meeting is informational. The chair of the meeting orchestrates management reports and entertains shareholder questions from the floor on such matters as earnings, dividends, salaries, pensions, and pending suits. More realistically, the meeting is a grand public relations event. Management, with the

112. The proposal would be, in effect, constituency representation. Critics argue that board members should have a fiduciary responsibility to all shareholders and not a discrete class. Edward Regan, New York State's Comptroller and sole trustee of its public employee pension fund, has said: "It's an idea I don't like. I think the board ought to be compatible. I really don't care . . . if the board is all the CEO's brother-in-law and family. My beneficiaries don't give a damn . . . . They want to know their pension is safe, period." Id. at 12.
113. Firms do have bylaw requirements for "independent" directors on boards and on board nominating committees. Criteria for independence are based on various definitions, including one used by the New York Stock Exchange. NYSE Manual, supra note 62. Several shareholder resolutions in 1992—such as New York City Employee's Retirement System's submission to Reebok—called for increased proportions of independent directors. See In re Reebok Int'l Ltd., 1992 SEC No-Act LEXIS 376 (Mar. 16, 1992). Even directors nominated by an independent nominating committee, however, are approved by company chairs and CEOs before they are nominated.
help of its lawyers, often spends long hours crafting and refining answers in anticipation of difficult questions. There are lavish special effects and product displays, unless the management is portraying austerity. At worst, the annual meeting is a charade to foster the illusion of shareholder democracy.  

During a meeting, the board—through its representative, the chair of the meeting—has nearly absolute control. The formal procedural or parliamentary rules that govern the meeting are skimpy, and the chair has discretion to cut off proposals, shareholder questioning, or the meeting itself.  

Management control over the meeting (and the proxy mechanism) extends to proxy tabulation. The board can choose whether proxy voting is confidential. In most public corporations, it is not. This allows management to examine and tabulate proxies before the meeting and, if necessary, pressure large shareholders (such as banks or insurance companies that may do business with the firm) to vote, if they have not yet, or to change their vote, if unfavorable. The board chooses an election inspector to tally proxies and to determine their validity. State courts accord broad deference to these officials in accepting or rejecting proxy votes.  

The leaky dam of proxy tabulation burst in the 1993 proxy season when various institutional investors blew the whistle on Automatic Data Processing (ADP), a tabulation firm that handles over seventy percent of all corporate proxy solicitations. Several investors claimed ADP had not tallied their proxies in a “just vote no” campaign against Paramount Communications. The Paramount miscount was only the tip of the iceberg. During the solicitation period before the 1993 spring annual meetings, ADP had experienced significant difficulties: Proxy materials were sent out late or not at all; ADP received proxy tabulations late or not at all.
at all, causing several firms to struggle to meet quorum requirements or to postpone meetings; electronic tabulation systems failed to function; and proxy solicitors had to solicit proxies several times. Institutional investors have urged the SEC to review the role of firms that distribute proxy materials for public companies. No doubt, the weak standard under which courts review board oversight of the proxy solicitation and tabulation process has contributed to the problem.

In theory, any shareholder (or even nonshareholder) can upset management's control over the voting mechanism by soliciting her own proxies. However, a number of obstacles, created by management and permitted by state law, stand in the way.

The board uses the bylaws to control proxy solicitations. Most firms have advance-notice requirements, applicable to nonmanagement director nominees. More importantly, the board has broad discretion to decide whose soliciting expenses the corporation will reimburse. Generally, the incumbent board chooses to reimburse its own expenses; as a practical matter, the corporation reimburses dissidents only if they win.

An insurgent must commit significant time, money, and effort to overcome shareholder apathy. The insurgent must organize an insurgent group, underwrite a mass mailing, and conduct a public relations campaign in the media. The insurgent must hire proxy solicitors, public relations advisors, investment bankers, financial printers, lead and local counsel, and even private investigators. The insurgent must prepare to initiate and defend lawsuits alleging violations of the federal proxy rules and state or firm-specific voting requirements. Expenses for an insurgent in a contested election can range between $5 million and $10 million.


121. Courts treat the report of election inspectors as ministerial and presume it to be correct. See, e.g., Berlin v. Emerald Partners, 552 A.2d 482, 491 (Del. 1989); see also Del. Code Ann. tit. 8, § 141(e) (1991) (board may rely on books and records). A court could, under existing law, find that boards which were put on notice by the 1993 problems can no longer rely on ADP and other similar organizations without further monitoring or safeguards.

122. In general, the proxy contest expenses of the insurgent are borne by the insurgent; the expenses of incumbents are borne by the corporation. If management can frame the proxy contest as one involving “policy” and not “control” the corporation can reimburse expenses to fend off an insurgency. Even incumbents who lose can claim indemnification for their expenses in an unsuccessful campaign. Del. Code Ann. tit. 8, § 145 (1991); Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 344 (Del. 1983) (permitting reimbursement of the legal expenses of the losing management group under § 145).

123. If the insurgent forms an insurgent group, the group must agree on who controls the proxy contest, who names the dissident slate, how expenses are to be shared, how profits and losses will be shared on stock disposition, and who indemnifies whom.

If an insurgent loses, she absorbs the full costs of the contest; she cannot compel contribution from other shareholders or the firm. If she wins, the firm will reimburse the costs of the contest, but she must share in the gains created with all other shareholders. The percentage of her shareholding in the firm, which is usually quite small, determines her portion of the gains. She risks a substantial sum to create gains in which other shareholders share, even though the other shareholders risk nothing. Known as a “free rider” problem, the phenomenon encourages shareholders to do nothing to correct firm management problems; each shareholder waits for someone else to incur the costs in hopes of a “free ride.”

The “rational apathy” of most small shareholders confronted with competing proxy solicitations compounds an insurgent’s problems. If a shareholder holds a small stake in a firm as part of a diversified portfolio, the shareholder has minimal incentive to spend time educating herself in a meaningful way about the merits of any given proxy contest. She may rationally perceive that the time spent becoming familiar with the contestants and the issues will not be worth any potential gains to her portfolio, even if she votes correctly. The uninitiated shareholder often has difficulty determining, even after significant study, which of the contestants is better for the future of the firm. Given the informational disadvantage of most small shareholders, most act on this general rule of thumb: vote for or with incumbent managers.

D. A Glimpse at Recent Shareholder Voting

Shareholder voting activism has lately been on the upswing. The number of insurgencies for board control nearly tripled in the 1980s, compared to the previous two decades. The average number of proxy contests for control each year has increased from 5.6 during the 1960s and 1970s to 15.7 during the early 1980s, to 30.0 during the late 1980s. Million to Defray Cost of Coniston Fight, Boston Globe, July 23, 1988, at C12.

125. Gordon, supra note 14, at 1571.
126. Clark, supra note 23, at 571.
127. In a study of proxy contests between 1962 and 1978, Peter Dodd and Jerold Warner identified 96 proxy contests for board control or representation, an average of 5.5 per year. Peter Dodd & Jerold B. Warner, On Corporate Governance: A Study of Proxy Contests, 11 J. Fin. Econ. 401, 409 (1983). According to their study, there were slightly more contests in the 1960s (6.6 per year) than in the 1970s (5.4 per year). Id. at 410.

Ronald Schrager compiled data from the SEC annual reports on proxy contests from 1957 to 1977. Ronald E. Schrager, Corporate Conflicts: Proxy Fights in the 1980s 9-10 (1986). The SEC data showed 540 proxy contests for full or partial board control, an average of 25.7 contests per year—a number far higher than Dodd and Warner found in their study. The SEC data on insurgent success, however, was consistent with the Dodd and Warner study. It showed that insurgents won majority control in 55 (10.2%) of the contests, but obtained some representation in 180 (33.3%) of the contests. Id. at 9.

128. Between 1981 and 1984, Ronald Schrager reported 63 proxy contests for full or partial board control, an average of 15.7 per year. Schrager, supra note 127, at 9-10. Dissidents were successful in 38.7% of all contests, both for board control and on particular issues. Id. at 11.

129. For the period from 1981-1990, the IRRC reported an annual average of 24.0 contests for board seats, with an average of 30.0 such contests during the 1988-1990 period. IRRC letter to Jeff Bolster; Ina McGuiness, IRRC, Proxy Fights in 1990: A Season of Shareholder
Insurgents have also been increasingly successful. In the 1960s and 1970s, insurgents won a majority of board seats in 18.7% of the election contests and obtained minority representation on the board 39.6% of the time.\textsuperscript{130} While the number of contests nearly tripled in the early 1980s, success rates remained relatively constant. From 1981 to 1984, insurgents were successful in 38.7% of all contests, both for board control and on particular issues.\textsuperscript{131} The success rates improved during the late 1980s. Of the 165 proxy contests for board membership between 1984 and 1990, insurgents won or negotiated for control in 34.5% of the contests and gained minority representation in another 15.9% of the contests; management retained full control in only 40.0% of the contests.\textsuperscript{132} For 1990, insurgents seeking full board control enjoyed a remarkable success rate of 41.0%.\textsuperscript{133}

Although recent studies suggest a downturn in the frequency of proxy contests in the 1990s, they nonetheless report continued improvement in success rates. For example, although there were only twenty-one contests for board seats in 1991, insurgents won a remarkable eight of the ten contests for full board control.\textsuperscript{134}

Likewise, shareholder resolutions on particular issues are more likely to succeed than ever, and management often negotiates settlements or makes policy changes rather than face the embarrassment of a shareholder rebuff.\textsuperscript{135} In 1991, shareholder proposals against poison pill plans on average received 44.8% support, and proposals to reduce supermajority voting requirements received 47.2% support. Proponents withdrew a record forty-six proposals following negotiated settlements.\textsuperscript{136} The trend

\begin{quote}

130. Dodd & Warner, supra note 127, at 409. The data from the SEC annual reports on success rates in proxy contests from 1957 to 1977 is consistent with the Dodd & Warner study. Schrager, supra note 127, at 9-10 (showing that from 1957-1977 insurgents won majority control in 55 (10.2%) of the contests, but obtained some representation in 180 (33.3%) of the contests).

131. Schrager, supra note 127, at 11.


Data gathered by the IRRC confirms these results. The IRRC reported that insurgents won proxy contests from 1981-1990 about 28% of the time and posted a remarkable 41% success rate in 1990. McGuiness, supra note 129, at 9. The IRRC figures do not include cases in which insurgents and managers settled short of a vote.

133. See McGuiness, supra note 129, at 9.


136. Walters, supra note 23, at 16. The 1993 proxy solicitation season saw a "record number of negotiated settlements between companies and shareholders." IRRC, Shareholder
continued in 1993 when shareholders voted on over 400 corporate governance proposals at 225 of the 1500 companies tracked by the Investor Responsibility Research Center, and eleven proposals received a majority vote. Shareholder proposals against poison pill plans received an average 46.2% of the votes cast (with four receiving a majority), and shareholders in five companies rejected management proposals.

Despite the evidence of a rise in shareholder voting activism, there continue to be startling examples of shareholder passivity, as shareholders overwhelmingly vote against their own self-interest. In 1992, shareholders at Alexander & Alexander eliminated bylaw provisions that required a board report of any changes it made in the bylaws and increased the vote needed to overturn board bylaw changes. Shareholders at MIPS Computer Systems (after five years of underperformance) added 2.5 million shares to its stock option plan for their executives, diluting existing shares by 30.3%. The plan, which offered no performance standards upon which to base the option awards, permitted the board to set any price for nonqualified options and to replace any underwater options.

II. A Theory of Shareholder Voting

For years, we academics accepted shareholder voting as a self-evident proposition: shareholders are owners, and owners appoint and control managers. Left unexplored were a number of questions whose answers are far from self-evident: Why do equity shareholders (and only common equity holders) vote, but other corporate constituencies do not? Why do shareholders vote for the board and on certain major corporate transactions, but not on more? Why is equity voting by majority rule with one vote per share not more (or less) concentrated? Why are some voting provisions optional and others mandatory?

Legal economic academics, beginning in 1982 with Professors Easterbrook and Fischel's seminal article on shareholder voting, have begun to address these questions with positive economics. They begin by asserting that a firm is a complex multiparty contract among various corporate constituencies.
constituencies: management, equity investors, creditors, and labor. The parties cannot foresee the future with enough specificity to account for all operational contingencies, and contract terms must, of necessity, leave much to the managers’ discretion. Other members of the firm monitor managers’ exercise of discretion ex post in periodic elections and ex ante in votes to ratify board decisions on fundamental transactions. At issue, however, is which firm constituency should monitor the managers through the voting process.

Easterbrook and Fischel identify equity holders as the obvious choice because of the equity holders’ residual claims to the firm’s income stream. Equity holders take what is left over, if anything, after the firm pays all the other expenses. As a consequence, equity holders, the leveraged investors in the firm, absorb the most risk in return for a chance at the highest returns.

As the residual claimants, shareholders have appropriate incentives to make discretionary decisions. According to classical economics, the firm should produce new products, build new plants, offer new services, and so forth, until the firm’s gains and costs are identical at the margin. Yet the firm’s constituents, except shareholders, lack the appropriate incentives to pursue optimal undertakings. Those with fixed claims on the income stream receive, at best, only a tiny benefit in increased security from a new project. “The shareholders receive most of the marginal gains and incur most of the marginal costs.” Through voting, shareholders are best suited to “fill in the details” in the corporate contract.

The legal economists’ theory holds together as far as it goes, but is undeveloped at a number of levels. For one, it fails to explain why shareholders are the only corporate constituency able to negotiate successfully for voting rights. Voting rights are valuable in theory to all constituencies. Why don’t other constituencies demand them? Why does management concede them to shareholders exclusively? Moreover, the theory does not explain with precision how corporate law regulates shareholder voting. Why is shareholder voting prohibited by law in some matters, required in others, and optional in yet others?

Finally, and more importantly for discerning the appropriate role for the board in shareholder voting, the theory does not address explicitly the reality of voting in public corporations. Why are control rights in public corporations largely toothless? Why do shareholders accept suffrage rights

144. Easterbrook & Fischel, supra note 16, at 68.
145. Professor Thomas, for example, assumed that voting rights warrant judicial protection because they provide the means for beneficial control changes despite the incumbents’ opposition. Thomas, supra note 18, at 526-32. Why this power should be in the hands of equity shareholders, however, he did not explain. Rather, he argued that the free exercise of the shareholder franchise in change-of-control situations is important. But why should it be?
that are usually inconsequential? Why do shareholders accede to a system in which the board largely dominates the voting process?

A. The Relative Value of Voting Rights to Various Corporate Constituencies

The contract metaphor offers an explanation on why shareholders vote and other corporate constituencies (employees and bondholders) normally do not. If we condense in place and time the hypothetical negotiation involved in the multiparty arrangements among the firm's constituencies, we can postulate entrepreneur-managers, debtholders, employees, and equityholders assigning various values to a division of the firm's income stream in exchange for their inputs. The managers value discretion in operating the firm; passive investors demand high returns for absorbing the increased risk of manager misbehavior; and employees demand high wages for the risks of job instability. The solution? Managers cede some control in the form of voting rights to the other constituencies. For managers, the gain in lower capital costs or wages exceeds the value lost in management prerogative.

Who among the other constituencies gets the right to vote? All of them? Each constituency places some positive value on the right to choose the managers and the right to vote on firm decisions. Yet the constituents do not value control rights equally. Shareholders value control rights more than the other constituencies for three interrelated reasons. First, shareholders have the most at stake at the margin from managers' discretionary operating decisions. Second, other constituencies have less expensive means to obtain the control over managers they desire. Third, shareholder monitoring benefits other claimants more than the reverse. Common shareholders are the dominant residual risk-bearers in a healthy firm; they take whatever is left of a firm's income stream after the company has paid all other creditors (including employees, debt holders, and preferred shareholders).

As the dominant residual claimants, common shareholders gain or suffer the most if managers perform well or poorly at the margin. This gives shareholders, as compared to other firm constituents, the greatest stake in overseeing managers' business decisions, ordinary as well as

146. Bondholders do negotiate for the right to vote on major transactions. See Smith & Warner, supra note 58.

147. See Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 Stetson L. Rev. 23 (1991) (applying a similar analysis to allocate fiduciary duties among the various corporate constituencies).


149. As insolvency nears, the residual risk-bearers become the unsecured debtholders.

150. Labor's most effective claim here is that, although wages may be less volatile at the margin, the undiversified nature of labor's investment makes changes at the margin more subjectively valuable. See Katherine Van Wezel Stone, Employees as Stakeholders Under State Nonshareholder Constituency Statutes, 21 Stetson L. Rev. 45 (1991).
extraordinary, and shareholders will pay the firm (and thus other firm constituencies) to acquire monitoring power. Other firm constituents value control less and are willing to sacrifice control rights in exchange for other forms of compensation.

What happens if these hypothetical negotiations fail and shareholders are unable to obtain control rights? Consider a corporation whose employees select the board, and the board's maximizing incentives and duties run exclusively to the employees. Equity investors (and, perhaps, long-term creditors) will discount the price they are willing to pay for their residual rights to the firm's income stream. They will pay less for stock, anticipating that the employee-controlled board, over time, will consistently sacrifice shareholder gain to maximize wages. If the value to the firm produced by employee control is greater than the equity investor's discount, the firm will be a more efficient competitor and the control structure will survive. If not, the additional cost of capital will make the firm a less successful competitor in the product markets. A poor competitor in the product markets will eventually pay lower wages, if it is to survive at all, and employees will wish they had not taken voting control away from shareholders.

A similar story results if bondholders vote and shareholders do not. A board controlled by bondholders will protect the security of the debt with conservative operating policies, sacrificing the expected returns to the shareholders. Shareholders will pay less for stock, but bondholders will loan money at lower interest rates. Will the bondholders forgo enough interest to offset fully the shareholders' discount on the stock? The position of shareholders as residual claimants, with the most to lose if the firm does not take advantage of opportunities with positive expected values, suggests not.

Shareholders also attach a higher value to voting than other corporate constituencies because other constituencies have more cost-effective substitutes for voting rights. Debtholders and employees can contract specifically for many of their most valued protections and do not need voting control of the board to enforce those contracts. Debtholders can protect the security behind their obligations with an array of specific covenants and security interests, and employees can protect their job security with labor contracts. Severance packages, for example, prevent firm takings of employees' human capital investment. Although these contracts do not provide perfect protection, they still mitigate the loss of control when employees cede rights to shareholders. In contrast, shareholders cannot easily contract ahead of time for specific limitations on manager discretion in the general operation of the firm.

Finally, shareholder monitoring—on average and over time—is more likely to benefit other claimants than the reverse. Equity control creates an incentive for management to maximize equity's residual claims, and this more often works to the benefit of employees and creditors (whose claims stand ahead of equity's) than the reverse.

Voting rights are an essential complement to the other mechanisms that bond management to shareholders. The two primary alternative control devices—the law of fiduciary duty and contractual devices such as compensation incentives—are each of limited utility.

Under modern case law, fiduciary duties in the public corporation protect shareholders principally against management diversion of income, not management shirking. The judiciary's institutional limitations and the perverse incentives inherent in shareholder litigation constrain the law of fiduciary duty. Judges, who are often unsophisticated in finance and business, may look for simplifying guideposts or allow the actual effects of business decisions to influence the outcome, thus failing to understand the legitimacy of risky decisions when made. The business judgment rule admonishes judges to resist these tendencies.

Moreover, management bonding through contract devices (such as stock option plans and other incentive programs tied to stock price) will inevitably be subject to management opportunism. Studies of stock option plans have found that managers benefit from industry or market-wide price increases that may have nothing to do with the managers' success at an individual firm. Plans do not distinguish the trends in a firm's stock price from industry-wide or market-wide trends. Moreover, price decreases cause boards to lower exercise prices on outstanding options, giving executives a one-way ratchet upward. In other words, stock option plans are only minimally effective in tying a manager's performance to the welfare of shareholders.

Voting rights provide a structural self-help mechanism for shareholder intervention, an inevitable piece of any management-shareholder relationship. Shareholders can take measures into their own hands when managers begin to stray from their maximizing mandate.

The hypothesis is borne out in practice. Current voting structures suggest that equity investors value voting more highly than other constituencies. That is, the extra that equity pays for voting rights exceeds what employees would pay in wage and benefit concessions or what bondholders would forgo in interest to acquire the same rights. Moreover, as this more robust theory of voting suggests should happen, other nonequity claimants acquire control rights, by contract or operation of law, when the firm's sinking fortunes causes them to become residual claimants. Preferred shareholders generally acquire voting rights when the firm fails to make dividend payments over a specified period. Debtholders increasingly negotiate for contingent voting rights, or acquire them by virtue of bankruptcy rules, when the equity cushion disappears. Even employees can obtain

control rights in bankruptcy. These phenomena support the hypothesis that residual claimants—equity and nonequity—value control more than nonresidual claimants.

Some scholars argue that the evidence does not necessarily support this model. Focusing on the negotiation implicit in the model's contract metaphor, some claim that current corporate structures merely reflect inequities in, for example, employees' starting position, and thus their bargaining power. That is, employees may value voting control over the firm more than shareholders, but shareholders wrest control away through greater social, political, and market power.

No doubt some bargaining inequity exists, but the evidence on the value of voting to nonequity constituencies is still to the contrary. For example, firms under employee ownership in the United States and firms without voting shareholders (mutual banks, for example) do not compete well over time with more traditionally structured firms. In any event, the argument does not claim that employee contractual protections are perfect or even adequate, but simply that nonvoting contractual protections for shareholders are less perfect or less adequate than voting. Shareholders value voting rights and are willing to pay more than are employees or other corporate constituencies.

B. The Value of Voting as a Control or Monitoring Device

Applying the contract metaphor to the details of shareholder voting is a troublesome endeavor. If public shareholders value control and negotiate for suffrage, why have they "agreed" to a system in which the firm's managers so dominate the voting process? The pat, though simplistic, answer is that shareholders understand the benefits of not meddling excessively in the operations of the firm. Except perhaps for the SEC's mandatory proxy regime, the voting system represents a finely tuned

157. See, e.g., Stone, supra note 150.
158. See, e.g., Hansmann, supra note 61.
159. See Maureen O'Hara, Property Rights and the Financial Firm, 24 J.L. & Econ. 317 (1981) (showing that mutual banks, in which voting power depends on deposits rather than share ownership, do not perform as well as other banks).
160. According to Easterbrook and Fischel, the SEC's federal proxy rules are not part of the contract metaphor package. See Easterbrook & Fischel, supra note 16, at 81-89. Firms have flexibility in drafting the corporate contract by choosing their state of incorporation and by drafting firm-specific charters and bylaws. The federal proxy system, mandating rules for all firms, allows no deviations; firms cannot choose to opt out. The federal rules, therefore, are less influenced by the desires of the participants in the corporate contract and, indeed, override and displace results that the participants would otherwise prefer. Id. at 82.

The criticism is a bit harsh and overly broad. The primary function of the SEC under the proxy regulations is the prohibition of fraudulent proxy solicitations. Any sensible corporate contract implicitly includes such an understanding. Toward this end, the SEC has formalized solicitation documents to ease oversight and reduce fraud. To the extent that the SEC goes beyond this basic function, its rules are subject to challenge in the federal courts. See, e.g., Business Roundtable v. SEC, 905 F.2d 406, 411 (D.C. Cir. 1990) (discussing Rule 14a-4(b)(2), requiring a proxy to provide a mechanism for each security holder to withhold authority to vote for each board nominee individually, and noting that it "may lie in a murky area between substance and procedure"). Congress decided that a national proxy solicitation regime was
balance, adjustable with time, that allows just the right amount of oversight: neither too much nor too little. Voting rights come into play only when management misbehavior is obvious or imminent.

For example, the statutory grant of a veto power over fundamental transactions, though often artfully and loosely crafted, arises in specific transactions in which shareholder and management interests predictably will deviate, and as to which the disciplining pressures from the markets, fiduciary review, and even annual replacement are relatively weak. The statute's definition of fundamental transactions roughly describe: (1) instances in which the door is open to management opportunism; (2) one-time events that are unlikely to recur; (3) end-period situations that cut off possible ongoing management discipline; and (4) significant mid stream changes to the nature of the investment. As one would expect, shareholders have veto power when other bonding mechanisms—most importantly, controls triggered by low stock prices—diminish in potency. 161

The argument justifying the timidity of voting rights under normal circumstances, specifically concerning the power of shareholders to select the board, recently has lost much of its luster. In the 1980s, Easterbrook and Fischel argued that the right to elect directors was an essential adjunct to hostile takeovers and the market in corporate control. Shareholders sold their voting power to a buyer willing to speculate in the gains she could produce from replacing incumbent management. Acknowledging the collective action and free rider problems of voting in publicly held firms, Easterbrook and Fischel wondered whether voting rights in public corporations serve primarily as a mechanism to effectuate tender offers, the control market's ultimate disciplining tool. 162 The bubble burst in the late 1980s and early 1990s, however, as a combination of circumstances effectively stopped hostile tender offers. 163

Perhaps we should accept that shareholders bargained for and are happy with voting rights that are largely ineffective in board elections or as a veto over management initiatives. Arguably, tender offers were a fleeting and mistaken shift toward shareholder control, and proxy contests currently under attack by state statute and firm-specific defenses may again become as anemic as they have been historically. 164 That is, shareholder voting may not be worth much.

necessary because publicly held firms make national offerings, making policing and enforcement by individual states problematic. See Pound, supra note 33 (arguing that proxy rules have increased the costs of shareholder communications and coordinated action, deterring shareholder initiatives and inhibiting the development of a private market for information about voting issues).

161. See Oesterle, supra note 20, at 126-28 (identifying three situations in which we would expect shareholder voting: in situations of manager exit behavior; of efforts by managers to denude market control mechanisms; and in major one-time changes in firm structure).


163. See Oesterle, supra note 20, at 414-59.

But studies document that shareholders pay a premium for the right to vote. Shareholders must believe that the threat of disapproval through the ballot has a residuum of value. The threat that an outside actor will concentrate shareholder displeasure in a tender offer or proxy contest still constrains managers. Shareholders have paid for meaningful voting rights to keep this threat alive.

C. Mandatory Voting Rules: A Contradiction of the Contract Model?

The contract metaphor implies that the parties to the corporate form have the freedom to negotiate for whatever firm-specific rules they agree on. So why do state corporate codes contain a system of mandatory voting rights? Why must directors put themselves up for election each year? Why do all charter amendments require shareholder approval? Why does the law not allow the parties to agree in the charter to quinquennial board elections or even board power to change the charter unilaterally to authorize new shares and voting rights? The answer to these questions suggests the mandatory role of corporate law in shareholder voting.

Easterbrook and Fischel, uncharacteristically trying to outguess the time-worn wisdom of state corporate codes, would tolerate complete freedom for the parties to specify voting rights and limitations in the charter. A regime of open-contracting for public corporations—where drafting costs are relatively inconsequential—has not developed. Why not?

There are two possible answers consistent with the contractual model of the firm. First, a legal economist might argue that mandatory voting rights embody the optimal corporate contract developed over time by firms that choose the corporate form over other competing forms and migrate to those states with optimal corporate codes. States such as Delaware provide mandatory rules rather than a system of perfect contracting freedom on shareholder voting because the parties prefer the mandatory provisions. Mandatory voting rules, unlike opt-in or opt-out voting rules, are immutable and thus “lock in” the basic bargain over time. Mandatory rules offer the parties a long-term contract with a largely fixed shareholder-manager relationship, something that would be difficult to provide effec-

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165. See Haim Levy, Economic Evaluation of Voting Power of Common Stock, 38 J. Fin. 79, 88 (1983) (the voting premium is 45.5%); see also Ronald C. Lease et al., The Market Value of Control in Publicly-Traded Corporations, 11 J. Fin. Econ. 139 (1983) (the voting premium is 5.44%). These studies pre-date the era of hostile tender offers and, in this regard, are still perhaps indicative of the 1990s, in which hostile tender offers are more unusual.

166. They do intimate, however, that perhaps management should not have carte blance to make later, midstream changes to the right. See Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416, 1442-45 (1989).


tively in a system of open contracting. The mandatory rules constitute the core of the basic "voting agreement."

This argument does not overlook the possibility that parties in an open-contract system could mandate similar constraints on changes to fixed voting rights. The parties, for example, could establish supermajority or even unanimous voting requirements for any amendments to established voting rules. Given the complexity of contracting to protect the initial bargain against all the clever and unforeseeable ways future lawyers might devise to avoid it, mandatory voting rules serve to state a purpose that management may not intrude into certain voting matters and to provide assured protection against future managerial opportunism. For an illustration of the drafting problems inherent in protecting an established pattern of shareholder voting, consider the clever techniques used by firms to create two classes of voting stock out of one, while avoiding a shareholder vote. Mandatory voting rules embody the parties' basic agreement and minimize the possibility of cheating.

Second, in response to the apparent conflict between the contractual model of the firm and mandatory voting rules, a legal "realist" might argue that the "mandatory" debate misses the point. As we have seen, voting rights in all their facets are far from mandatory. They can be done away with or limited at the firm's creation, such as by a dual class structure or by a voting structure in which public investors receive participating preferred shares entitling them to vote only on major corporate transactions while management receives full-voting common shares. Moreover, irregular voting structures are possible even after the firm's constituents have chosen a traditional voting structure. Managers (with shareholder consent) can extinguish voting rights in midstream through either a dual-class recapitalization or an exchange offer in which shareholders exchange voting shares for nonvoting equity or debt. Less complete disenfranchisement is possible, and prevalent: staggered boards, voting bylaws, employee stock ownership plans (ESOPs), and poison pills aimed at election contests. Voting rights in public corporations, it turns out, behave much like any other optional corporate default term.

169. See Lucian A. Bebchuk, The Debate on Contractual Freedom in Corporate Law, 89 Colum. L. Rev. 1395 (1989) (arguing that midstream changes to the corporate contract ought to be treated differently than the formation of the initial corporate contract); see also Lucian A. Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 Harv. L. Rev. 1820 (1989) [hereinafter Bebchuk, Limiting Contractual Freedom].


171. See Roberta Romano, Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws, 89 Colum. L. Rev. 1599, 1599 (1989) (stating that mandatory rules are easily "side stepped, or they pose nonbinding constraints because there is no burning demand to deviate from them").

172. One could speculate on an agreement in which shareholders were content to vote on major corporate transactions and willing to cede the power of selecting board members to another corporate constituency—even the board itself.
Both views contain elements of truth. We academics tend to overestimate the scope of the mandatory voting rules in state corporate codes and, at the same time, to underestimatethe ability of firms to contract around them. State corporate codes do contain an essential core of meaning. Their mandatory terms give corporate interpreters important persuasive meaning and embody a purpose that any tinkering with voting rights not be done lightly. These core provisions limit managerial opportunism once shareholders invest funds based on a basic understanding of their rights. There exists a fundamental “voting agreement” both under the terms andintendment of the statute and by tradition. In other words, state corporatecodes lock in certain patterns of shareholder suffrage, and the pricing ofshares in the investment markets reflects this value.

D. The Role of State Courts: Enforcing the Basic Agreement

A voting system requires an administrative mechanism. The corporate system must empower someone to handle the details of determining and notifying shareholders of record, organizing the meeting place and time, certifying voters, setting the agenda and running the shareholder meeting, and counting and announcing results. In a public corporation with dispersed equity ownership, the logical institution is the shareholders' fiduciary agent, the board of directors. But as we have seen, the authority to shape voting rights and administer the voting mechanism subsumes a power to dilute those rights and stifle voting opportunities. From the beginning of American corporate law, state courts have taken upon themselves the institutional responsibility to discern the difference—that is, to interpret the voting provisions of the statute and the firm's constitutive documents. State courts, from their ex post perspective, determine if managers have taken opportunistic advantage of their oversight of the voting mechanisms and breached the basic voting agreement.

Political voting offers us an illustration of the tension between administration and opportunism, mediated by judicial views of basic voting rights. The Supreme Court has interpreted the Constitution's implicit guarantee of representative government to embrace fundamental voting rights, including a right of “one person, one vote.” Certain constitutional provisions address voting specifically. Article I, Section 2, declares that Representatives are to be chosen “by the People of the several States.” The

173. Early corporate law cases involved challenges to opportunistic behavior by directors toward voting. See, e.g., People ex rel. Barker v. Kip (N.Y. Sup. Ct. 1822) (reprinted at 4 Cow. 382 as appendix to People ex rel. Israel v. Tibbets, 4 Cow. 358 (N.Y. Sup. Ct. 1825)) (inspector refused to count votes of legal owners, changing the outcome of the election, on the ground that third persons had equitable interests in the shares); Ex parte Holmes, 5 Cow. 426 (N.Y. Sup. Ct. 1826) (directors voted shares of treasury stock, registered in their names as trustees, to reelect themselves); Stow v. Wyse, 7 Conn. 214 (1828) (directors did not give notice of shareholders' meeting because neither the charter nor bylaws provided for it).

174. The Supreme Court has found fundamental voting rights in various aspects of the Constitution. Equal protection requires that "all who participate in the election are to have an equal vote [and] the conception of equality ... can mean only one thing—one person, one vote." Gray v. Sanders, 372 U.S. 368, 374 (1963) (invalidating Georgia's "primary unit system" for statewide primaries because it gave counties with smaller populations a disproportionate say in selection of candidates).
Fifteenth Amendment states that “[t]he right of citizens of the United States to vote shall not be denied . . . on account of race, color, or previous condition of servitude.”

Of necessity, federal and state legislatures must delineate the content of voting rights and administer the voting system. The Supreme Court has accepted legislative authority to define voting rights, such as when the legislature specifies a supermajority vote on certain referenda,\(^1\) estable

ishes at-large, winner-take-all elections for multimember political bodies,\(^2\) and even creates voting systems of “one-acre, one-vote.”\(^3\) Further, legislatures must administer the voting process. The Court has upheld legislative power to delineate voting districts,\(^4\) administer a system of voter registration,\(^5\) supervise the voting process,\(^6\) and ensure that ballots are timely cast.\(^7\)

Yet legislative administration of voting has its limits, and the Supreme Court has used “exacting judicial scrutiny of statutes distributing the franchise.”\(^8\) Legislatures may not engage in purposeful partisan gerrymandering,\(^9\) may not deny voting rights to a sector of the population

\(^{175}\) Gordon v. Lance, 403 U.S. 1 (1971) (upholding West Virginia’s rule that local political subdivisions obtain 60% approval before incurring bond indebtedness or increasing tax rates).

\(^{176}\) “The Equal Protection Clause of the Fourteenth Amendment does not require proportional representation . . . .” City of Mobile v. Bolden, 446 U.S. 55, 75-76 (1980) (upholding for the city commission at-large, winner-take-all elections in which minority groups have no assurance of representation). But an at-large election system can violate equal protection if “maintained for a discriminatory purpose.” Rogers v. Lodge, 458 U.S. 613, 628 (1982) (Powell, J., dissenting on other grounds) (invalidating a Georgia county’s system for electing a Board of Commissioners).

\(^{177}\) Ball v. James, 451 U.S. 355, 359 (1981) (upholding Arizona water district’s limitation of voting to landowners on a “one acre, one vote” basis, even though the district was a significant hydroelectric supplier and much of its water went to urban areas for nonagricultural uses).

\(^{178}\) See, e.g., Mahan v. Howell, 410 U.S. 315 (1973) (upholding Virginia’s apportionment of state representatives to legislative districts, even though some districts had a larger population (6.8% more) and some smaller (9.6% less) than the average); Burns v. Richardson, 384 U.S. 73 (1966) (upholding Hawaii’s use of registered voters to determine voting districts, thus excluding nonvoter residents).

\(^{179}\) Rosario v. Rockefeller, 410 U.S. 752 (1973) (upholding New York’s requirement that voters must enroll in a party of their choice eight to eleven months prior to voting in the next party primary).

\(^{180}\) Burson v. Freeman, 112 S. Ct. 1846 (1992) (upholding Tennessee statute that prohibited solicitation of votes and display of campaign materials within 100 feet of polling place on election day).


\(^{182}\) Kramer v. Union Free Sch. Dist., 395 U.S. 621, 628 (1969) (invalidating exclusion from school district elections of persons who did not own or lease taxable real property or who were not parents of children enrolled in the public schools).

SHAREHOLDER VOTING

because of how they may vote, may not impose poll taxes, and may not set filing deadlines and fees as to impede independent candidacies. The judicial function is to interpret the constitutional guarantee of republican democracy and to balance individual voting rights against effective public administration.

State courts in corporate voting cases face a similar task to draw a line between voting oversight and voting interference. Just like legislators beguiled by the opportunities to abuse political voting rights, directors have powerful incentives to overstep their authority and alter opportunistically and unilaterally the basic voting agreement.

In the public corporation, what is the voting agreement? Corporate codes and the firm's constitutive documents cannot anticipate and prohibit explicitly all inappropriate board maneuvers. These sources can realistically contain only a broad outline of the shareholders' right to vote and a notion of the board's good faith obligation to respect that right and facilitate its exercise. Courts nonetheless have an institutional responsibility to determine ex post whether acts of the board violate arrangements upon which shareholders relied when they invested. The contract metaphor assumes a judicial role to enforce voting rights. In our corporate federalism, it is a role undertaken by state courts. William T. Allen, Chancellor of the Delaware Chancery Court, captured the point: "As long as there have been elections there have been those who seek to gain unfair advantage in them (and those, who like some lawyers today, can suggest and guide that effort). Courts must remain sensitive to this risk and alert to act when they can to thwart it."

Moreover, the corporate statutes (Delaware's in particular) have a number of provisions that contemplate significant judicial involvement in shareholder voting. In Delaware, any shareholder may petition the Chancery Court to determine the validity of an election, or to order an election.

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186. Anderson v. Celebrezze, 460 U.S. 780 (1983) (invalidating Ohio's rule that independent candidates for President file at least seven months before the November general elections); Lubin v. Panish, 415 U.S. 709 (1974) (invalidating California's filing fee of 2% of the annual salary for the state office to get on the ballot).
187. See Thomas, supra note 18, at 527 (pointing out that courts have relied on the "shareholder democracy model" for deciding corporate voting cases).
190. Del. Code Ann. tit. 8, § 225(a) (1991) provides:
Upon application of any stockholder the Court of Chancery may hear and determine the validity of any election of any director and, in case any such office is claimed by more than 1 person, may determine the person entitled thereto; and to that end make such order or decree in any such case as may be just and proper.
if the board fails to call an annual meeting.\textsuperscript{191} Delaware courts have readily compelled compliance.\textsuperscript{192} The statutes evince a legislative concern not only for the integrity of the voting process, but for the vitality of voting rights as well.

In the end, the job falls on state courts to interpret the basic "voting agreement" and to protect shareholders from particular avoidance schemes carried out in the name of voting administration. Unfortunately, state judges exhibit a split personality in such cases; they border on the self-righteous in some settings and hide timidly in others.

### III. JUDICIAL SCHIZOPHRENIA TOWARD SHAREHOLDER VOTING

State corporate statutes, on their face, give managers broad prerogatives over shareholder voting. Without formal shareholder approval, the board can unilaterally alter voting procedures, dilute majority voting blocks, and structure transactions to avoid shareholder veto rights.\textsuperscript{193} The statutes also permit the board to enlist shareholders in their own disenfranchisement by initiating charter amendments that change the voting structure or by buying shareholder voting rights in dual class recapitalizations and exchange offers. In each situation, state courts must address, first, whether the open-ended statutes grant managers such power and, second, if they do, whether managers have used the power properly in a given case.

A legal economist might argue that the voting agreement contemplates this managerial prerogative over voting, and judicial respect merely recognizes that each situation involves a degree of shareholder consent. Investors who choose to buy stock accept the board's authority over the voting machinery. When shareholders approve board initiatives for new voting structures, no matter how disenfranchising, they merely (and willingly) cede additional voting prerogatives to the board.

Under this view, shareholders who claim not to have consented, whether because they invested with a different view of the board's power or voted against diminished voting rights, can expect little solace. By their investment, modern shareholders have accepted a package of rights and disabilities implicit in their share ownership and have consented to majority rule. A theory of vested rights no longer protects shareholders from

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\textsuperscript{191} Id. § 211(c); Coaxial Communications v. CNA Fin. Corp., 367 A.2d 994, 998 (Del. 1976) ("Given the importance of an annual meeting of stockholders in the administration of corporate affairs, 'prompt' relief is essential under § 211."); see also Speiser v. Baker, 525 A.2d 1001, 1006 (Del. Ch. 1987) (granting shareholder's petition under § 211(c) even though shareholder had sought to prevent earlier meeting).

\textsuperscript{192} For cases enforcing § 211(c), see, e.g., Tweedy, Browne & Knapp v. Cambridge Fund, 318 A.2d 635 (Del. Ch. 1974); Prickett v. American Steel & Pump Corp., 251 A.2d 576 (Del. Ch. 1969). For cases enforcing what is currently § 225(a), see, e.g., Grossman v. Liberty Leasing Co., 295 A.2d 749 (Del. Ch. 1972); In re Chelsea Exch. Corp., 159 A. 492 (Del. Ch. 1932); McWhirter v. Washington Royalties Co., 152 A. 220 (Del. Ch. 1930).

\textsuperscript{193} See supra notes 57, 80, 92, 100-01, infra notes 204-05 and accompanying text.
majority passivity, ignorance, and folly. Arguably, the spice of shareholder consent ought to flavor all judicial interpretations of the voting agreement.

Yet state judges apply corporate fiduciary principles to reject a wide-open theory of shareholder assent. Since at least the 1920s, Delaware courts have held that a board may not use even lawfully delegated power for an improper purpose. Judges interpret the basic voting agreement to reach beyond the explicit terms of the statute and to restrain the board from unbridled opportunism. The courts, however, have not yet clearly defined the standards for judicial intervention. Should courts infer an inherent good faith obligation from contract doctrine, a higher fiduciary duty from trust law, the business judgment rule from corporate law, or a hypothetical voting bargain? Should the standard vary depending on the facts of the case—such as when shareholders claim voting rights in an election contest coupled with a tender offer?

This Part of the Article explores the nature of judicial review of board actions affecting the shareholder franchise. We find a rich and polar body of decisional law in which judges vacillate between zealous condemnation of board intervention and callous disregard for shareholder surprise and vulnerability. Curiously, the existent literature largely ignores this fascinating dichotomy. The judicial vacillation is unpredictable, often illogical,

194. Bove v. Community Hotel, 249 A.2d 89, 93-95 (R.I. 1969) (upholding statutory merger whose effect was to cancel the right of holders of cumulative preferred stock to dividend arrearage; when the firm was incorporated, state law reserved the power of repeal or amendment of corporate charter); cf. Faunce v. Boost Co., 83 A.2d 649, 652 (N.J. Super. Ct. Ch. Div. 1951) ("The right to vote was a basic contractual right. It was an incident to membership or of the property in the stock, of which the stockholder or member cannot be deprived . . . . No specific section of [the New Jersey Statutes] permits a majority to disenfranchise the minority."). See generally Coffee, supra note 188, at 1635-42 (describing the demise of the vested rights theory of corporate law).

195. E.g., State ex rel. Cochran v. Penn-Beaver Oil Co., 143 A. 257, 259-60 (Del. 1926) (holding that charter provision giving board discretion over shareholder inspection rights permits only reasonable restrictions).


198. Easterbrook and Fischel, for example, argued that a court ought to hypothesize what arrangement the parties would have adopted ex ante if they, as rational wealth-maximizers, had addressed the disputed issue on a fully informed basis. Frank H. Easterbrook & Daniel R. Fischel, Corporate Control Transactions, 91 Yale L.J. 698, 702-704 (1982). But see Coffee, supra note 188, at 1679-80 (criticizing this approach because it leads to indeterminacy and confusion, and repeals the principle of stare decis).

and full of surprises. In short, it is schizophrenic.

A. Strict Judicial Scrutiny When the Board Interferes with the Voting Process: Schnell Review

More than twenty years ago in Schnell v. Chris-Craft Industries,200 the Delaware Supreme Court invalidated a board's eleventh-hour bylaw change that sought to advance the date for a shareholders' meeting and thus thwart an insurgent's proxy fight.201 Even though the board had complied with the literal terms of the statute, the court held it had acted illegally:

[M]anagement has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office . . . [and] for . . . obstructing the legitimate efforts of dissident stockholders in their exercise of their rights to undertake a proxy contest against management. These are inequitable purposes, contrary to established principles of corporate democracy.202

Schnell is remarkable at a number of levels. First, the court left no doubt that there is a distinction between the validity of a board's power over a firm's voting processes and the propriety of the use of that power in a given case.203 In Schnell, the court held that the statutory power of the board to control the timing of shareholders' meetings did not restrain the court from looking beyond the form of the board's action to its improper effects.

Second, in so doing, the court took shareholder rights in board elections down a path very different from that for shareholder rights in other control transactions—namely, negotiated acquisitions and tender offers. Since 1963, the Delaware Supreme Court had rejected a robust de

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200. 285 A.2d 437 (Del. 1971). The decision followed several earlier decisions in which the Delaware courts had held that actions within the scope of a board's authority were nevertheless illegal if the board was entrenching itself in office. See Bennett v. Propp, 187 A.2d 405, 408 (Del. 1962); Condec Corp. v. Lunkenheimer Co., 230 A.2d 769, 775 (Del. Ch. 1967) (stating that "corporate machinery may not be manipulated so as to injure minority stockholders").


203. In the recent case of Farahpour v. DCX, Inc., 635 A.2d 894 (Del. 1994), the Delaware Supreme Court stated that the Delaware corporate statute allowed a nonstock corporation, in converting to a stock corporation, to eliminate two classes of nonvoting members, without preserving their rights to assets on dissolution. Responding to a certification of questions of law from the District of Columbia Court of Appeals, the court took pains to note that [s]trict adherence to the procedures authorized by particular provisions of the GCL does not insure that the result will receive judicial approval in litigation at the behest of disgruntled members of shareholders. The use of the corporate machinery, even in full compliance with Delaware law, does not insulate corporate management or directors from claims of inequitable conduct.

Id. at 900-01 (citing Schnell).
facto merger doctrine in negotiated acquisition cases. The court used an interpretative sleight of hand known as the "equal dignity" doctrine to permit a board to avoid shareholder voting and appraisal rights in an acquisition having the effect of a statutory merger if clever lawyers structured the deal as an asset sale. In *Cheff v. Mathes*, the Delaware Supreme Court planted the seeds of Delaware's tolerance of tender offer defenses. In *Cheff*, a shareholder who challenged a board's payment of greenmail bore the heavy burden of showing that the board's true motive was "primarily" to entrench itself. By contrast, under *Schnell*, if the board manipulates the voting process, the statutory validity of the board's action is irrelevant and the challenging shareholder need not show improper motives.

Third, the Delaware Supreme Court, always politically sensitive to corporate federalism, used *Schnell* to answer federal activism in shareholder proxy voting and ensure Delaware a continuing role. At about the same time that federal courts were fashioning broad disclosure-based shareholder rights in corporate transactions requiring shareholder approval, the Delaware Supreme Court took the initiative in *Schnell* to oversee the voting process in board elections.

1. The Schnell Standard of Review

At its core, *Schnell* represents a clear invitation to aggrieved shareholders to seek judicial relief. The court stands ready to provide redress when a board interferes with an anticipated or ongoing proxy fight. Only

204. See *Hariton v. Arco Elecs.*, Inc., 188 A.2d 123, 125 (Del. 1963) ("[T]he sale-of-assets statute and the merger statute are independent of each other [and] . . . of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end."); *Warner Communications Inc. v. Chris-Craft Indus.*, 583 A.2d 962 (Del. Ch. 1989) (approving the use of a triangular merger using a shell subsidiary corporation rather than a charter amendment to eliminate the class voting rights of convertible preferred stock).

205. In *Hariton*, two firms combined by having one firm sell all its assets and transfer all its liabilities to the other in exchange for stock in the buying firm and by having the selling firm dissolve, effecting the same result as a traditional stock-for-stock statutory merger. Under the appraisal section of the statute, however, shareholders of the selling company had no appraisal rights, as they would have under a statutory merger. *Hariton*, 188 A.2d at 125.

206. 199 A.2d 548 (Del. 1964).

207. Id. at 554.


"ministerial" board actions or actions with a "compelling justification" survive court scrutiny. Under Schnell and its progeny, the courts have declared:

The board cannot advance the annual meeting date if doing so would burden insurgents in a pending proxy contest;\textsuperscript{211}

The board cannot postpone the annual meeting date if opposing proxies already gathered by an insurgent would expire by the time of the meeting;\textsuperscript{212}

The board cannot require advance notice of director nominations if doing so would prevent an insurgent from nominating a slate of candidates;\textsuperscript{213}

The board cannot require advance notice of shareholder proposals during an ongoing election contest if doing so would chill shareholders from voting for the insurgent's nominees;\textsuperscript{214}

The board cannot change the method for electing directors from a simple plurality to an absolute majority after a shareholder has compelled the convening of an annual shareholders' meeting;\textsuperscript{215}

The board cannot impose requirements that unnecessarily delay the effect of shareholder action by written consent;\textsuperscript{216}

\textsuperscript{211} ER Holdings, 735 F. Supp. at 1100-01; Lerman, 421 A.2d at 914; Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

\textsuperscript{212} ER Holdings, 735 F. Supp. at 1101; Aprahamian, 531 A.2d at 1208-09 (invalidating five-month postponement of annual meeting when proxies solicited for dissident slate would have been void).


\textsuperscript{214} Mesa Petroleum Co., 1985 WL 44692 at *4-6, (temporarily restraining advance-notice bylaw that required 30-day notice of shareholder proposals because shareholders solicited by the insurgent might erroneously believe that the bylaw would prevent shareholder proposals at an adjourned meeting sought by the insurgent).


\textsuperscript{216} Allen v. Prime Computer, Inc., 540 A.2d 417 (Del. 1988); Datapoint Corp. v. Plaza Sec. Co., 496 A.2d 1031 (Del. 1985); see also Edelman v. Authorized Distrib'n Network, Inc., No. 11,104, 1989 Del. Ch. LEXIS 156 (Nov. 3, 1989) (bylaws require shareholders intent on soliciting written consents to request the board to fix a record date).
The board cannot use a thirty-day advance-notice bylaw to prevent a dissident shareholder from submitting proposals at the reconvening of an adjourned meeting.\(^{217}\)

The board cannot in response to a consent solicitation to oust the board sell twenty percent of the firm's stock and pledge a board seat to the purchaser under a contract that prohibits the purchaser from voting in opposition to the board's wishes.\(^{218}\)

For the first two decades, despite the potential breadth of its language and its underlying principle, *Schnell's* effect was limited. The Delaware courts applied the case only to board action concerning the mechanics of shareholder voting. Two recent decisions, however, *Blasius Indus. v. Atlas Corp.*\(^{219}\) and *Hubbard v. Hollywood Park Realty Enter.*\(^{220}\) have added new dimensions to *Schnell* review.

In *Blasius*, Chancellor Allen invalidated an incumbent board's attempt to nullify a pending two-step consent solicitation-restructuring proposal by increasing the board's size and filling the vacancies.\(^{221}\) Allen pushed the *Schnell* doctrine beyond its traditional application by applying it to any board action that adversely affected shareholder voting.\(^{222}\) *Blasius* involved board interference with the opportunity for shareholder voting, not board manipulation of the voting process. According to Chancellor Allen, any interference with the voting process or its effects imposes on the board "the heavy burden of demonstrating a compelling justification" for its action.\(^{223}\) Allen applied this rigorous standard of review even though the board had "acted . . . in a good faith effort to protect its incumbency, not selfishly, but in order to thwart implementation of the recapitalization that it feared, . . . ."

In *Datapoint*, incumbent directors adopted a bylaw in anticipation of a consent solicitation that (1) delayed for fifteen days the setting of the record date from the time a shareholder gave notice of intent to solicit consents, (2) delayed implementation of the action by consent for 45 days after the record date was fixed, and (3) further delayed the consent action until the conclusion of any legal proceedings brought to determine the consents' validity. *Datapoint*, 496 A.2d at 1031.

In *Allen*, the board adopted a bylaw amendment during a pending consent solicitation that imposed a minimum 20-day delay for the effectiveness of consent action. *Allen*, 540 A.2d at 418.

\(^{217}\) *Mesa Petroleum Co.*, 1985 WL 44692. The court upheld, however, the overall validity of the advance-notice bylaws, as long as they did not apply to the adjourned meeting.


\(^{219}\) 564 A.2d 651 (Del. Ch. 1988).


\(^{221}\) *Blasius*, 564 A.2d at 664-66. The Atlas board sought to amend the bylaws to increase the board size from seven to nine directors. The effect was to undermine a consent solicitation by Blasius Corporation to increase the board size from seven to fifteen and to elect eight Blasius-named directors to fill the new slots. Blasius proposed a leveraged recapitalization under which shareholders would receive a special cash dividend. Goldman Sachs, Atlas's investment banker, opined that the firm after the restructuring would be unable to meet its heavier debt burden and would eventually become bankrupt.

\(^{222}\) Cf. Vaurigard v. Tubbs, 903 F.2d 825 (5th Cir. 1990) (staying advance-notice bylaw because shareholders had not been told of recent expansion of board in a more traditional application of the *Schnell* doctrine).

\(^{223}\) *Blasius*, 564 A.2d at 661.
reasonably, would cause great injury to the Company."\textsuperscript{224}

In both \textit{Schnell} and \textit{Blasius}, the board reacted to an earnest shareholder insurgency by changing its normal procedures or rules. In \textit{Hubbard}, the Chancery Court went one step further, requiring a board in the face of a voting contest to undo impediments installed well before the contest arose.\textsuperscript{225} The court compelled the board to waive a preexisting advance-notice bylaw to facilitate a pending proxy insurgency otherwise precluded by the bylaw.\textsuperscript{226} Vice Chancellor Jacobs found encompassed in the shareholders' right to vote a right to nominate a contesting slate and a concomitant board duty to facilitate that nomination. Analogizing shareholder voting to political voting, Jacobs noted the political distinction between a citizen's right to vote and a citizen's opportunity to vote: "[T]he unadorned right to cast a ballot in a contest for office, a vehicle for participatory decisionmaking and the exercise of choice, is meaningless without the right to participate in selecting the contestants."\textsuperscript{227} Totalitarian socialism comes to mind as an example of a system in which the electorate is empowered to vote, but without a meaningful choice.

Hollywood Park's bylaw required would-be insurgents (but not management) to present their slate of nominees within seven days after receiving notice of an annual meeting. When an insurgent, Hubbard, gave timely notice of his slate, management sought an amicable resolution. After several weeks of negotiations, the two sides settled their differences: Hubbard joined the board and withdrew his slate, and the parties agreed on a nominating committee to designate management's slate. When the nominating committee chose the slate, several sitting directors discovered the nominating committee had not renominated them and the new board would likely displace current management. These incumbents mounted a belated proxy fight and brought suit to compel the board to waive the advance-notice bylaw.

The court concluded that unforeseeable changed circumstances—namely, the Hubbard palace coup—made enforcement of the bylaw inequitable, even though the bylaw's original adoption was not. The court extended the board's noninterference duty to an affirmative duty to act: "[C]onsiderations of fairness and the fundamental importance of the shareholder franchise" placed on the board a duty to waive the advance-notice requirement so shareholders could consider "arguments on both sides."\textsuperscript{228} Hubbard blurs the action/inaction distinction of the \textit{Schnell-Blasius}

\textsuperscript{224} Id. at 658.
\textsuperscript{226} Id. at *39-40.
\textsuperscript{227} Id. at *18 (quoting Durkin v. National Bank of Olyphant, 772 F.2d 55, 59 (3d Cir. 1985)). The court analogized shareholder choice to "access to the candidate selection process," which in civic elections is a component of constitutionally mandated voting rights. Id. ("To allow for voting while maintaining a closed candidate selection process thus renders the former an empty exercise." (quoting Durkin, 772 F.2d at 59)).
\textsuperscript{228} Id. at *40.
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anti-manipulation rule. A duty to facilitate the voting process, through a logical extension of the Schnell theory, goes well beyond the general reluctance of courts to compel particular board actions.

Judicial language throughout the Schnell-Blasius-Hubbard line of cases is broad and rhetorical. The Delaware judiciary waxes about the "high" or "fundamental" value of shareholder voting rights. In Schnell, the Delaware Supreme Court explained powerfully that obstructing a proxy contest contravenes "established principles of corporate democracy." For Chancellor Allen in Blasius, "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."

Other cases draw their vitality from the historical tradition against self-perpetuating directors: "Incumbent directors do not have any preemptory right to continue to serve as directors."

In much quoted language, Chancellor Allen in Blasius articulated a broad theory of shareholder control:

Action designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and a shareholder majority. Judicial 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.

Distinguishing between normal business decision-making and board action touching on voting, Allen construed the basic voting agreement to forbid the board from using the voting machinery to impede a shareholder majority. He elevated the allocation of power in the firm's voting mechanism to a special protected status:

229. In Hubbard the court stated:

From a semantic and even legal viewpoint, "inaction" and "action" may be substantive equivalents, different only in form. Moreover, occasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably. Certainly a board cannot be heard to argue that it has no obligation even to consider whether or not to redeem a poison pill rights plan in the face of a noncoercive tender offer, simply because its refusal amounts to "inaction" rather than affirmative board "action."

Id. at *31-32 & n.12 (citing Moran v. Household Int'l, Inc., 500 A.2d 1346, 1354 (Del. 1985)).

230. Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1122 (Del. Ch. 1990) (noting that the Blasius "compelling justification" exception reflects "the high value that the prior cases had placed upon the exercise of voting rights").


234. Blasius, 564 A.2d at 660.
A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of the corporation's power over its property, or with respect to its rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.235 Delaware judges in other cases echo this language.236

Shareholders entrust the voting machinery to the board as a matter of expedition, not because of any specified competence. Shareholders ask the board to administer their voting: to set necessary dates, to hire facilities, to provide shareholder lists to interested shareholders, to certify individuals as voters, to count and announce votes—and no more. In Datapoint Corp. v. Plaza Sec. Co., for example, the Delaware Supreme Court made clear that bylaws on written consent procedures will survive judicial scrutiny only if they impose “minimal essential provisions for ministerial review of the validity of the action taken by shareholder consent.”237 Whenever the shareholder majority has a view contrary to the board's on a substantive matter within their competence, the board must accede. In essence, the Delaware courts have declared that a robust shareholder voice is a cornerstone of corporate legitimacy. When the board toys with the mechanics of shareholder voting, Chancellor Allen is adamant:

The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors.238

Under this view—confirmed by the results in the Schnell-Blasius-Hubbard line of cases—the board can act only to operate the voting machinery. Courts widely accept the board's ministerial authority to set meeting dates, establish voting procedures and bylaws, and take other facially neutral

235. Id.
236. Vice Chancellor Hartnett offered a similar explanation in Aprahamian:
   In the interests of corporate democracy, those in charge of the election machinery of a corporation must be held to the highest standards in providing for and conducting corporate elections. The business judgment rule therefore does not confer any presumption of propriety on the acts of the directors in postponing the annual meeting.

531 A.2d at 1206-07.

In the course of the Time-Warner merger dispute, Chancellor Allen stated: “[Board] action, even if taken in the good faith belief that it was necessary to protect the corporate enterprise from likely harm from the untenable business plan espoused by the shareholders initiating the consent, involved the basic allocation of power between shareholders and directors . . . .” Paramount Communications, Inc. v. Time, Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) 95,514 (July 14, 1989), aff'd sub nom. Literary Partners, L.P. v. Time Inc., 565 A.2d 280 (Del. 1989).

237. 496 A.2d 1031, 1036 (Del. 1985).
238. Blasius, 564 A.2d at 663.
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actions regarding voting mechanics. Such ministerial oversight receives deferential business judgment review if the actions are for “the orderly and efficient administration of the [voting] process” and not in response to a specific voting contest. In Blasius, for example, Chancellor Allen was quick to point out:

If the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, which merely had an incidental impact upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification . . . . The board, as a general matter, is under no fiduciary obligation to suspend its active management of the firm while the consent solicitation process goes forward.

Within its realm, Schnell review is perhaps the most exacting in corporate law. It unequivocally reverses the business judgment presumption. Director action that interferes with the voting process is presumptively inequitable. Board motives to affect the voting process, even if wholesome and well-informed, do not matter if a court determines that the action was “taken for the sole or primary purpose of impeding the effectiveness of the shareholder vote.” A board, for example, may not justify a new stock issue to a friendly party that dilutes the voting power of outstanding shares on the ground that an insurgent is a likely looter or asset


240. Edelman v. Authorized Distrib’ns Network, Inc., No. 11104, 1989 Del. Ch. LEXIS 156, at *11 (Nov. 3, 1989) (deeming sufficient board’s purpose “to create a procedure for determining which stockholders will be able to take part in a written consent action”).

241. Allen v. Prime Computer, Inc., 540 A.2d 417 (Del. 1988). Datapoint, 496 A.2d at 1036. In Allen, the court suggested that the board could have acted ministerially to assure validity of consents, even if the board adopted the procedure during a consent solicitation. 540 A.2d at 420.

242. Blasius, 564 A.2d at 655 (emphasis added). The ministerial function rule is not unlike the rule applied to the vote count activities of election inspectors in proxy and consent contests. If an election inspector’s function is “ministerial,” the courts will give the action substantial, if not complete deference. If the inspector has committed an error of law which has led to the disenfranchisement of a stockholder whose vote should have been counted, the courts will review the matter de novo and correct the error. See Williams v. Sterling Oil of Okla., Inc., 273 A.2d 264 (Del. 1971).

243. The business judgment rule protects executive and directorial decisions regarding company actions from attack by dissatisfied shareholders when the manager can demonstrate due care and good faith in taking such corporate action. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

244. To be “inequitable,” such conduct does not necessarily require a dishonest, selfish, or evil motive. Stahl v. Apple Bancorp, Inc. (Stahl I), 579 A.2d 1115, 1122 (Del. Ch. 1990); Lerman v. Diagnostic Data, Inc., 421 A.2d 906, 912 (Del. Ch. 1980); see also Warren & Abrams, supra note 46, at 652-53 (commenting on strictness of Schnell-Blasius test).

Whether the board is well-intentioned or carefully reviews the action, courts readily infer an inequitable purpose from the obstructive effects of a challenged board action. Further, *Schnell* places no stock in disinterested director approval. The courts presume that all directors (whether management, affiliated, or independent) are interested in their incumbency. Board composition and the process of approval—so important to *Unocal* and loyalty-fairness review—are notably missing elements in *Schnell*.

In word and spirit, *Schnell* goes well beyond the *Unocal* proportionality standard for takeover defenses, at least as the courts have come to apply that test. Under *Schnell* review, paternalism toward shareholder ignorance or folly is not a compelling justification. The board cannot evaluate the soundness of the insurgent's future plans and decide, based on the infeasability of the plans or the unsavory character of the insurgent, to alter the voting process or otherwise interfere with the vote. The board's only option is to communicate its beliefs to the shareholders and seek to convince them that the insurgency is misguided. Contrast this with *Unocal* proportionality review and Delaware jurisprudence on tender offers. A board can block a tender offer, that is, take from individual shareholders their power to tender, based on the offer's "fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the risk of non-consummation; the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on shareholder interests." A board responding to a tender offer need not persuade shareholders not to tender; it can block the offer itself. The suggestion made in some opinions and by some commentators that

246. Cf. id.


248. Under the *Unocal* test, the board is protected if it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the acts chosen were "reasonable in relation to the threat posed." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

249. Many commentators have perceived the factual similarities between cases decided under *Schnell-Blasius* on the one hand and those decided under *Unocal* on the other. Professor Loewenstein, for example, has decried the failure of the courts to apply *Schnell* to the "equivalent fact pattern" of defensive maneuvers in response to a hostile tender offer. Mark J. Loewenstein, *Toward an Auction Market for Corporate Control and the Demise of the Business Judgment Rule*, 63 S. Cal. L. Rev. 65, 98 (1989); see also *Ribstein*, supra note 44, at 128 ("There is, indeed, little difference between [a voting process] case and the shareholder disenfranchisement inherent in such devices as lockups and poison pills.").


Schnell and Unocal review are equivalent finds support only in the area of two-step proxy contest/tender offer cases.  

Further, Schnell is far more demanding than traditional loyalty-fairness review. Although some cases have implied that the two standards are functionally equivalent, the characterization is neither apt nor particularly useful. Under extant law, fiduciary self-dealing is valid if approved by disinterested directors or shareholders, or if fair as measured against comparable market transactions; some transactions, such as minority squeezeouts, must meet both tests. Neither procedural nor substantive fairness, however, is relevant to Schnell review of voting manipulation. Schnell does not compare internal manipulation of the voting process to an arm's-length transaction. By its nature, board action affecting shareholder voting has no market analogue. Only the board controls the voting mechanism, and Schnell measures the challenged board action against that of a board seeking to comply with the basic agreement on shareholder voting.

2. The Definition of “Ministerial” Action

Schnell does envision a board role in administering the voting process. Delaware cases on the board's role in written consent contests illustrate the judicial line drawn between voting manipulation and administration—a line that, regrettably, leaves substantial room for anticipatory planning.

Many boards have unilaterally acted to delay and burden action by written consents with bylaw amendments that create waiting-period, advance-notice, inspection, and record-date procedures. The courts have not hesitated to use Schnell to strike down such provisions when adopted...
during a threatened or pending consent solicitation. However, when the board adopts a delay provision as a ministerial measure in advance of a control contest and unrelated to the "legal sufficiency of the consents obtained," the courts have been more forgiving. When the board implements the delay provisions as a charter amendment, their validity is on firmer ground still.

The Delaware Supreme Court's 1988 opinion in Allen v. Prime Computer, Inc. delineates the scope of the board's "ministerial" powers over the consent procedure. In Allen, the board made last-minute changes to the bylaws that imposed a twenty-day waiting period and twenty-day inspection procedure for a pending consent solicitation/tender offer. The court held that the minimum twenty-day delay provision, "the reasonableness of which is not explained, did more than 'defer consummation of shareholder action until a ministerial review of the validity of the consents' had occurred."

The court offered guidelines for determining whether a bylaw is ministerial, and thus valid:

In evaluating the reasonableness of a bylaw, which purports to establish ministerial review of the validity of consents, several factors are relevant. First, a court must determine the purpose sought to be served. A bylaw whose real purpose is delay of shareholder action is per se unreasonable. Second, the court should consider the impact of the bylaw upon the effective exercise of the power conferred under § 228. Finally, the bylaw should contain only the minimal requisites for a reliable and prompt ministerial review to ensure the orderly function of corporate democracy. Such ministerial review must not be unduly elaborate, should contain reasonable time periods only necessary to the circumstances, and should be ... administered in good faith. The court further commented that the company's inspection bylaw, "were it not coupled with the twenty day period, would probably be reasonable."

The Delaware courts have read Prime Computer narrowly, applying it robustly only to board action after an insurgent has delivered an executed


261. 540 A.2d 417 (Del. 1988).

262. Id. at 420 (quoting Datapoint, 496 A.2d at 1036).

263. Id.

264. Id. at 421.
The harshness of the judicial limitation is evident in *Empire of Carolina, Inc. v. Deltona Corp.*, where the Delaware Supreme Court upheld a record date set by a board that effectively delayed a written consent contest.266 In the case, an insurgent shareholder demanded to inspect the corporate shareholder list in order "to communicate with its fellow Company stockholders respecting the solicitation of consent for the removal of the company's current directors, the election in their stead of Holder's nominees and the approval of certain amendments to the Company's By-Laws."267 The insurgent did not, however, deliver an executed written consent, which would have fixed the record date for all other shareholders under Delaware law. The board, using its statutory power to fix the record date within sixty days of the date of the board's record-date resolution,268 fixed the record date six weeks away, during which time it closed a previously announced stock issuance that put half the corporation's stock in the hands of a friendly white knight.

A second case invites managers and their lawyers to, in effect, sabotage the holding of *Prime Computer*. In *Edelman v. Authorized Distribution Network, Inc.*, the Delaware Chancery Court upheld a preexisting bylaw that required any consent solicitor to request the board to fix a record date.269 Under the bylaw, the board then had up to ten days to meet to fix the date, which it could set up to ten days after the directors met. The bylaw bought the board twenty days that it otherwise would not have had. The solicitor argued that his delivery of consents disempowered the board and automatically fixed the record date as contemplated in the statute. The court distinguished the earlier record-date cases as involving postdelivery bylaw changes, not the preemptive bylaw crafted by the board. It pointed out that the statute contemplated a board procedure,270 and that the solicitor knew about the record-date bylaw beforehand. These regrettable opinions treat shareholder action by written consent much like many other areas of corporate law. Even though the courts block some obstructionist paths to the board, other paths of "equal dignity" are available to accomplish the same result—whatever the intendment of the voting agreement. *Prime Computer*, while effectively prohibiting waiting-period bylaws and casting a

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265. One wonders what happened to the language of Vice Chancellor Jacobs in *Hubbard*: If, in order to establish the movant's *Blasius* or inequitable manipulation claims it becomes necessary to imply judicially a duty not previously recognized, should not that fact counsel against extending those doctrines to situations not involving any overt manipulation of or tampering with the election machinery? . . . [T]he case-by-case development of the law governing fiduciary obligations—a process that is integral to our common law tradition—cannot be constrained by so facile a distinction.


266. 514 A.2d 1091 (Del. 1986).

267. Id. at 1094.

268. The Delaware legislature has since amended the statute to reduce the period to 10 days. Del. Code Ann. tit. 8, § 213(b) (1991).


dark shadow over advance-notice bylaws, invites the board to burden unwanted consent solicitations with inspection procedures. In short, if one tactic fails the "ministerial" test, another with a different label (but the same effect) may well pass it. In the context of consent-procedure bylaws, at least, the Delaware courts have conceded to ingenious planners.\textsuperscript{271} Schnell, daunting within its boundaries, turns out to be avoidable.

3. The "Compelling Justifications" Exception for "Extreme Action"

Chancellor Allen's "compelling justification" exception in \textit{Blasius} permits the board to go beyond its "ministerial" role in an election contest. Rejecting a passivity thesis and a \textit{per se} rule barring any board manipulation of the voting process, Allen decided there may be "some set of facts [that] would justify such extreme action."\textsuperscript{272} Vice Chancellor Jacobs in \textit{Hubbard} later stated the test as follows:

Because of the fundamental importance of shareholder voting rights to our system of corporate governance, \textit{Blasius} may be viewed as holding that director conduct intended to interfere with or frustrate shareholder voting rights is presumptively inequitable and will be invalidated, unless the directors are able to rebut that presumption by showing a compelling justification for their

\textsuperscript{271} "It now appears that the element of surprise may be neutralized through the adoption of certain by-laws, and the timing of the record date for any consent solicitation may likewise by controlled." Veasey et al., supra note 46, at 1148.

\textsuperscript{272} Blasius Indus. v. Atlas Corp., 564 A.2d 651, 652 (Del. Ch. 1988); \textit{see also} id. at 660-61 (concluding that a \textit{per se} rule would "sweep too broadly," and rejecting a \textit{per se} rule even when the board action was "done for the primary purpose of impeding the exercise of stockholder voting power" (citing Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987)); Phillips v. Insituforn of N. Am., Inc., No. 9175, 1987 WL 16285 (Del. Ch. Aug. 27, 1987).

In \textit{Aprahamian}, the court had enjoined the postponement of an annual stockholders' meeting, stating:

The business judgment rule therefore does not confer any presumption of propriety on the acts of the directors in postponing the annual meeting. Quite to the contrary. When the election machinery appears, at least facially, to have been manipulated, those in charge of the election have the burden of persuasion to justify their actions.

531 A.2d at 1207.

To some this language in \textit{Aprahamian} had suggested a revival of a \textit{per se} rule against changing the meeting date, as articulated in Gries v. Eversharp, Inc., 69 A.2d 922, 926 (Del. 1949). \textit{See} Robert R. Ambler, Jr., Comment, Postponing the Delaware Corporation's Annual Meeting, 38 Emory L.J. 207, 230-35 (1989) (arguing that a no-change rule is inappropriate under the revised § 211). \textit{Blasius} and other courts have rejected this reading of \textit{Aprahamian}. \textit{Blasius}, 564 A.2d at 662; Henley Group, Inc. v. Santa Fe S. Pac. Corp., No. 9569, 1988 Del. Ch. LEXIS 32, at *35 (Mar. 11, 1988) (reading \textit{Aprahamian} only as prohibiting director action that defeats an "apparently successful dissident slate"); Stroud v. Milliken Enters., Inc., 585 A.2d 1506 (Del. Ch. 1988), \textit{appeal dismissed}, 552 A.2d 476 (Del. 1989) (reading \textit{Aprahamian} to require only that board election must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate). In fact, \textit{Aprahamian} itself sought to harmonize its result with other cases, including Huffington v. Ensar Corp., No. 7543, 1984 WL 8299 (Del. Ch. Apr. 25, 1984), which had allowed for meeting postponements when warranted by the circumstances. \textit{Aprahamian}, 531 A.2d at 1207-08.
actions.\textsuperscript{273}

In \textit{Blasius}, Allen offered as a compelling justification a board that responds to a two-step proxy contest/tender offer by approving, on the eve of the election, a stock lockup to a second bidder offering a higher price. The \textit{Unocal} standard then governs the propriety of the stock lockup, which standard replaces the \textit{Schnell} test for control contests that combine a tender offer with a proxy contest.

With Chancellor Allen’s example, the logic of \textit{Unocal} has come full circle. In \textit{Unocal} and cases applying the \textit{Unocal} standard, judges explicitly justified deference to board decisions in control contests on the ultimate power of shareholders to elect the board.\textsuperscript{274} The court relied on the election power as a residual safeguard against insular managers when it approved board discretion in erecting tender offer defenses. In \textit{Moran v. Household Int’l, Inc.}, for example, the Delaware Supreme Court rested its approval of poison pill plans on “the Vice-Chancellor’s finding that the effect upon proxy contests will be minimal.”\textsuperscript{275}

These cases suggest that when insurgents join proxy contests for control of the board of directors with tender offers, \textit{Schnell} review should trump \textit{Unocal} review.\textsuperscript{277} In \textit{Blasius}, Chancellor Allen reached out in dicta to declare the reverse. The Delaware Supreme Court’s recent decision in \textit{Paramount Communications Inc. v. QVC Network Inc.}\textsuperscript{278} highlights the oddity of \textit{Unocal} review in two-step proxy contest/tender offers. The Delaware

\begin{itemize}
\item \textsuperscript{274} Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).
\item \textsuperscript{275} Id. at 959 (describing shareholder voting rights as the final fallback remedy for management failures).
\item \textsuperscript{276} Moran v. Household Int’l, Inc., 500 A.2d 1346, 1354 (Del. 1985) (“One could also form a group of up to 19.9% and solicit proxies for consents to remove the Board and redeem the Rights.”).
\item \textsuperscript{277} One Delaware court has classified \textit{Schnell}-style review as a “heavy burden” and a “specific expression of the proportionality test” in \textit{Unocal}. The \textit{Blasius} court “performed exactly the sort of balancing contemplated . . . [indicating that \textit{Schnell} was not a new standard apart from \textit{Unocal}.” Shamrock Holding, Inc. v. Polaroid Corp., 559 A.2d 278, 285-86 (Del. Ch. 1989). Even so classified, however, the Delaware courts acknowledge that when \textit{Schnell} review applies, the burden of justification is greater. See \textit{Stahl v. Apple Bancorp Inc. (Stahl II)} [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) 95,412 (Del. Ch. Aug. 9, 1990). If so, should not the heavier burden of justification trump the lighter burden when both apply? In an odd footnote, the Delaware Supreme Court explained that \textit{Unocal} trumps \textit{Schnell} whenever the issue is a defensive measure to a control change, but that \textit{Unocal} will lead to a closer review if defensive measures affect voting:
\begin{quote}
This does not render \textit{Blasius} and its progeny meaningless. In certain circumstances, a court must recognize the special import of protecting the shareholders’ franchise within \textit{Unocal}’s requirement that any defensive measure be proportionate and “reasonable” in relation to the threat posed. A board’s unilateral decision to adopt a defensive measure touching “upon issues of control” that purposefully disenfranchises its shareholders is strongly suspect under \textit{Unocal}, and cannot be sustained without a “compelling justification.”
\end{quote}
\textit{Stroud v. Grace}, 606 A.2d 75, 92 n.3 (Del. 1992). The standard is right out of \textit{Schnell}! The court’s compulsion to make such a hash out of the issue remains a mystery.
\item \textsuperscript{278} 637 A.2d 34 (Del. 1994).
\end{itemize}
Supreme Court, applying the Unocal test to board favoritism of one third-party tender offer over another, showed unprecedented concern about the eventual voting position of target shareholders, who would end up as minority shareholders in the newly combined entity. Under the court's logic, the resulting voting powerlessness of target shareholders in a straight tender offer justifies enhanced scrutiny under Unocal. Arguably, the immediate voting powerlessness of target shareholders when a target board blocks a two-step proxy contest/tender offer warrants even greater judicial scrutiny.

B. Board Action Beyond Schnell Review

Taken at face value, the theoretical underpinnings of Schnell cast a heavy burden on any board action that undermines voting rights. According to the court's broad holding, it should make little difference whether voting interference affects an election contest or an issue contest, whether it occurs by manipulating the voting process or through gutting voting opportunities, whether it is carried out through a preemptive measure or during an ongoing contest, or whether it is a sin of commission or of omission. In practice, theory and reality diverge. Delaware courts have bounded the Schnell doctrine, refusing to apply it to a wide variety of board actions that undermine shareholder voting.

1. The Action-Inaction Distinction

Schnell forecloses boards from inequitable deeds in the face of a voting contest. The doctrine by its terms does not compel special board action that aids the insurgents, such as by adjourning a shareholders' meeting to give a dissident more time to solicit proxies.279 Before Vice Chancellor Jacobs's opinion in Hubbard,280 it seemed well-established that the board had no duty to adjust the voting machinery to facilitate an insurgency. Hubbard suggests an important rethinking of Schnell. In the case, Vice Chancellor Jacobs applied Schnell to compel the board to rescind an advance-notice bylaw based on events that occurred after the deadline had passed. A facilitative duty fits squarely within a voting agreement in which the board acts only as a voting administrator, no more and no less. Once an insurgent has shown a willingness to bear the costs and risks of an insurgency—a de facto certification the insurgent is not simply exploiting shareholder passivity—the board becomes a mere facilitator.

Perhaps this makes too much of Hubbard. Any optimism that the case signifies a new trend to extend Schnell seems, at the least, premature. Hubbard itself is easily confined to its unique setting of "incumbent insurgents" with significant shareholdings who seek to retain current management after a pre-election coup. Moreover, Hubbard may be merely


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part of a line of cases revealing a judicial hostility toward advance-notice bylaws. Jacobs illustrated the court's facilitative rule by suggesting the board would be duty-bound to waive an advance-notice bylaw if the board had approved a radical change in business direction just before an annual meeting, but after the deadline for nominations.281

Nonetheless, other cases suggest that Hubbard may represent another fissure in the action-inaction distinction. For example, the Delaware courts have said management must share control over corporate-funded proxy mailings when it seeks to remove dissident directors for cause.282 In some circumstances, the board must also delay a vote on shark repellent amendments so a challenger may document a potentially unfair proxy contest.283

The action-inaction dichotomy, however, may serve a valuable purpose to distinguish between legitimate and opportunistic insurgents. A comparison of an insurgent shareholder's access to shareholder lists and her access to the corporate treasury to fund her voting contest illustrates this point.

Access to Shareholder Lists. Corporate statutes give shareholders the right, upon request, to inspect and copy a list of shareholders—an indispensable tool for an insurgent seeking access to the proxy machinery. The statutes, however, provide limited guidance on the extent of this right. Statutes modeled on the Revised Model Business Corporation Act (RMBCA) call for a list of shareholders of record and beneficial owners who have on file with the corporation a nominee certificate.284 Other statutes, including Delaware's, specify only the “stock ledger” of record shareholders.285 Yet others merely specify a “list of shareholders” without describing its contents.286 The content of the inspection right thus arises largely from judicial interpretation, which has been mixed.

The most important judicial gloss, codified in many modern statutes, is the requirement that the requesting shareholder have a “proper purpose” for the list.287 Although courts universally recognize communicating

281. Id.
284. See Revised Model Business Corp. Act §§ 1.40(22), 7.20(a) (1991). The RMBCA requires that the list be arranged by voting group and show the “address of and number of shares held by each shareholder.” Revised Model Business Corp. Act § 7.20.
285. See, e.g., Cal. Corp. Code § 1600(a) (Deering Supp. 1993); Del. Code Ann. tit. 8, § 219(a) (1991) (requiring list to be “arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder”).
287. Delaware’s statute essentially codifies the common law. Del. Code Ann. tit. 8, § 220(b) (1991) (permitting a stockholder of record to inspect “for any proper purpose . . . a list of stockholders”; id. (defining a “proper purpose” as one “reasonably related to such person’s interest as a stockholder”). For an application of the section, see In re Wal-Mart Stores, Inc., 1993 SEC No-Act LEXIS 584 (Mar. 26, 1993) (soliciting proxies in support of a resolution proposed solely for moral or political reasons constitutes a proper purpose).
with other shareholders to wage a proxy contest as a proper purpose, the vagueness of the requirement invites managers to stonewall and to force the insurgent to litigate the request, adding delay and costs.\textsuperscript{288} Although some statutes (including Delaware's and those modeled on the 1969 version of the Model Business Corporation Act) make ineligible for election any officer who refuses or willfully neglects to produce the list, courts do not enforce the penalty and many statutes have abandoned it.\textsuperscript{289}

Courts have also had to define what shareholders can inspect and copy. With the increase in beneficial share ownership, the "stock ledger" list of record shareholders is relatively useless for a targeted proxy campaign. Institutional intermediaries hold legal title to most shares in their "street names" on behalf of their customers, who as beneficiaries are identified as entries in the computers of the intermediaries. There are often several layers of financial institutions between the beneficiary and the institution with legal title. Yet the beneficiaries retain the power to direct the intermediaries on how to vote.\textsuperscript{290}

Naturally, proxy contestants try to cut out as many intermediaries as possible so that the proxy materials will reach the beneficial owner and the beneficial owner's voting instructions will make it back up the chain of record ownership. For this reason, the computer-readable information on street name ownership, contained either in a "Cede & Co. list"\textsuperscript{291} or "NOBO/COBO list," is far more valuable to potential dissidents mounting a voting contest than the firm's record books.\textsuperscript{292} Under SEC rules, both documents are available to management, but not to shareholders.\textsuperscript{293}

Some statutes, though not Delaware's, dispense with a "proper purpose" requirement for shareholders that hold a specified percentage of the company's shares, sometimes for a specified minimum period. \textit{See}, e.g., Cal. Corp. Code § 1600 (Deering 1977) (5%); N.Y. Bus. Corp. Law § 624(b) (McKinney 1986) (5% for at least 6 months).

\textsuperscript{288} \textit{See} Robert A. G. Monks, My Run for the Sears Board, Legal Times, Aug. 12, 1991, at 20 (noting that the cost of a lawsuit is enough to preclude access to a shareholder list).

\textsuperscript{289} Such provisions were once common, many imposing liability on officers who unjustifiably refused access to the list. \textit{See} Model Business Corp. Act § 52 (1969) (imposing liability for 10% of the value of the requesting shareholder's stock). The RMBCA drafters dropped the provision as ineffective and seldom enforced. Revised Model Business Corp. Act § 16.04 cmt. (1991).


\textsuperscript{291} The Cede & Co. list, sometimes known as the "depositories list," contains the names and holdings of brokerage houses and banks whose shares are held as of record by stock depositories. The Cede list looks through Cede & Co. and other depositories, and through intermediate banks and brokers, to the first-tier bank or broker that has direct contact with the beneficial owner.

\textsuperscript{292} The "NOBO/COBO list" contains the names, addresses, and holdings of nonobjecting beneficial owners whose stock is held in street name. Most brokerage house customers—70%—are NOBOs. Roger D. Blanc & Barry J. Quinn, The Right of Access to Recordholder and Other Shareholder Listings, Shareholder Activism—The Emerging Role of Institutional Investors in Shareowner Activism: The Emerging Role of Institutional Investors at 151, 175 (PLI Corp. L. & Practice Course Handbook Series No. B4-6810, 1987).

\textsuperscript{293} The Cede & Co. list is available to management under the depository agreement, which requires the depository to disclose the identity and holdings of beneficial owners whose
To date, Delaware cases have interpreted the state's inspection statute to require access only to shareholder information already in existence that managers themselves use to communicate with the firm's shareholders. The interpretation, explicitly derived from the *Schnell* action-inaction boundary, entitles insurgents to the same channels of communication used by management, but no more. Delaware courts have not required management to compile shareholder information, such as NOBO lists, not already in the firm's hands. As a consequence, management often refuses to ask the firm's nominee holders for the readily available NOBO list. Recently, however, the Second Circuit broke ranks with Delaware when it construed New York's inspection statute to compel management to facilitate an insurgency. In AT&T's well publicized two-step proxy contest/tender offer for NCR, the Second Circuit required NCR management to compile and provide a NOBO list not then in management's hands. The language of the statute did not compel the court's decision; the New York statute calls only for a "record of shareholders" and nowhere suggests a management duty to compile new information.

Yet the Second Circuit inferred a compilation duty on a number of grounds. The broader inspection right compensated for an NCR shark repellent that required an eighty percent supermajority to replace the classified board at a special shareholders' meeting. A "heightened stan-

shares it holds as of record. Regulation of Security Communications, Release No. 34-29315, 1991 SEC LEXIS 1204 (June 17, 1991). The increasingly used NOBO list is available to management from broker-dealers under Rule 14b-1(c), which requires brokers and other record holders of stock in street name to compile a NOBO/COBO list at management's request. Nominee holdings in existence on December 28, 1986, are disclosed if the beneficial holder consents to disclosure—COBOs; nominee holdings established after that date are disclosed unless the beneficial holder objects to disclosure—NOBOs. See 17 CFR §§ 240.14a-13, 240.14b-2 (1993).


296. *See* Gillette, 1988 Del. Ch. LEXIS 40; *see also* Cynergy, 662 F. Supp. at 1148.


298. The case had other novel elements. The court applied the New York statute to a Maryland corporation, a rare deviation from the lionized internal affairs doctrine, which requires an application of the law of the place of incorporation. The New York statute enables New York residents who have been record holders for six months to gain access to a "record" of the shareholders of any corporation, wherever incorporated. *See* N.Y. Bus. Corp. Law § 624(b) (McKinney 1986). The court, however, did not address the propriety of this aspect of the provision. The case also reeked of transparent and champertous forum-shopping by AT&T. Two long-time individual NCR shareholders, residents of New York, sought the list under an agreement that AT&T would pay their expenses and control their request and litigation.
The court reasoned, should apply because every uncast share would count as a "no" vote, thus aggravating the effect of the supermajority rule. The court also noted that denying the list to insurgent AT&T would have placed NCR management in an advantageous position in the proxy fight, a result at odds with the rationale behind the SEC rule that enables management to obtain the NOBO information from brokers.

Delaware courts may choose not to follow the lead of the Second Circuit, although they should. The "proper purpose" filter effectively addresses whatever concern Delaware courts might have about insurgent opportunism. The SEC's recent decision not to expand shareholder inspection rights only increases the importance of state rules that give non-opportunistic insurgents access to the proxy machinery.

Reimbursement of insurgent expenses. As Berle and Means observed more than half a century ago, management control over the voting machinery rests largely on the board's control of the corporate purse strings. The governing maxim on the reimbursement of voting-related expenses in election contests is easily stated: The corporate treasury will pay incumbent managers their expenses in election contests, win or lose; an insurgent can count on reimbursement only by winning. This "principle" powerfully reflects an attitude of judicial inertia that assumes those who hold corporate power deserve their position and merit judicial consideration.

Although few in number, the cases on proxy solicitation expenses uniformly grant the incumbent board wide discretion to pay management's expenses. The expenses need only relate to corporate "policy," as opposed to a "purely personal" quest for control. Since any decent lawyer can characterize any control fight or issue contest as a question of how the corporation should be managed, not who should do it, all incumbent expenses are payable—and, in practice, are paid—by the corporation.

No reported decision has denied incumbents less than complete payment of their solicitation-related expenses.
The board, on the other hand, has equally ample discretion to refuse to reimburse the solicitation expenses of outsiders. In practice, dissidents and insurgents rarely receive payment. Only if an insurgent wins an election contest, replaces the incumbent board, and successfully solicits shareholder ratification of repayment can it count on reimbursement from the new board.

Commentators have widely criticized the prevailing reimbursement rule, which began with a bare court majority in *Rosenfeld*. Nonetheless, the rule is consistent with even a robust theory of shareholder control. Normally, shareholder voting is a wasteful formality—a ritual assurance to shareholders of their control rights. Anything besides the full-discretion rule would be contrary to shareholder interests. Under a flat no-payment rule, incumbents would insist on additional compensation to fund their participation in a wasteful formality. An equal-payment rule, such as one reimbursing challengers the same dollar amount per vote received as incumbents, would introduce uncertainty and opportunism. Like derivative suit plaintiffs, numerous insurgents would aim for losing causes.

The current rule, by forcing a voting challenger to bear the full risk of an unsuccessful contest, gives the board a powerful tool for distinguishing between the well-meaning suitor and the opportunistic striker. No other test is as functional or efficient. Although the full-discretion rule appears initially at odds with the board's limited role of ministerial administrator, it actually bolsters the theory. To prevent exploitation of shareholder passivity by minority groups—a recurring theme in the statutory voting structure and a logical element of the basic voting agreement—the reimbursement of corporate funds for services of special counsel, public relations firm, and proxy solicitation firm).

The IRS has also been unsuccessful in denying deductibility of incumbents' solicitation expenses. *See* *Locke Mfg. Cos. v. United States*, 237 F. Supp. 80 (D. Conn. 1964) (rejecting IRS argument that only legal fees and part of public relation fees were deductible). Expenses of dissidents and insurgents, however, stand on shakier tax ground. *See* *Dyer v. Commissioner*, 352 F.2d 948 (8th Cir. 1965) (disallowing individual shareholder's deduction of expenses in connection with unsuccessful shareholder proposal).

306. The rare instances of reimbursement often involve unusual situations. For example, in the Penn Central bankruptcy, the trustee reimbursed dissidents who successfully blocked a merger. In addition, incumbent directors and officers, who have fallen out of favor with management, have successfully sought reimbursement under the mandatory indemnification provisions of Delaware's statute.

For issue-contest dissidents, as opposed to election-contest insurgents, the path is even harder. Even if the dissident succeeds in blocking a management initiative or in having a shareholder proposal adopted, the incumbent board continues to have discretion whether to reimburse the dissident's expenses, shareholder ratification notwithstanding.

307. The cases thus treat successful insurgents in the same way as incumbents. Steinberg v. Adams, 90 F. Supp. 604, 607 (S.D.N.Y. 1950) ("[t]here is no distinction between 'ins' and the successful 'outs'"). According to the cases, shareholders must also ratify the retroactive ratification of payment, a formality in a successful insurgency, and the insurgency must have benefitted the corporation, presumably shown by the shareholder vote and an absence of looting.

308. *See* Bebchuk & Kahan, supra note 27, at 1089-95 (arguing that state law tends to systematically favor incumbents and discourage control challenges relative to socially desirable rules).
rule acts as a filter, weeding out frivolous insurgencies.\textsuperscript{309}

2. The Requirement of a Pending Voting Contest

A factual theme running through the \textit{Schnell} cases is the existence of an ongoing voting contest. In the cases, an insurgent had appeared and was planning or engaging in a proxy or consent solicitation to elect a new board or otherwise contest an incumbent board’s policies. In marked contrast, when board action does not threaten a pending control contest, judges shy away from \textit{Schnell}.

\textit{Stroud v. Grace} best illustrates this boundary.\textsuperscript{310} In \textit{Stroud}, a minority shareholder challenged the adoption of new bylaws that required shareholders to submit advance notice of their candidates to the board, specifying their qualifications. The bylaws empowered the board to disqualify a shareholder’s nominee at any time, even during the annual meeting. The Delaware Supreme Court upheld summary judgment against the challenger, noting that the board did not face a pending proxy contest. The court wrote, “it cannot be said that the ‘primary purpose’ of the board’s action was to interfere with or impede exercise of the shareholder franchise.”\textsuperscript{311} This temporal boundary turns out to be decisive in two important areas: dilutive stock issuances and poison pill plans aimed at proxy contests.

\textit{Dilutive Stock Issuances}. Cases dating from the 1950s invalidate a board’s issuance of new stock meant to dilute a control block threatening a proxy fight.\textsuperscript{312} Delaware courts have since expanded their analysis to encompass dilutive issues aimed at any insurgent regardless of ownership level, weaving this line of cases into the \textit{Schnell} doctrine.\textsuperscript{313}

The dilutive issue cases are all cut from the same pattern: an insurgent starts or threatens a proxy contest; the incumbent board responds by issuing new voting (sometimes supervoting) stock to management or a management-friendly “white squire”; the new issue dilutes the insurgent’s vote and concentrates voting power in management hands, killing what

\textsuperscript{309} Easterbrook & Fischel, supra note 16, at 77-78.

\textsuperscript{310} 606 A.2d 75 (Del. 1992).

\textsuperscript{311} Id. at 99. The line the court draws is extraordinary because, on the facts, there was a clear and long-running challenge to the board by a minority shareholder, who (among other things) had sued on a prior set of bylaws and charter amendments and forced the firm to withdraw them. The board, given its problems with a vocal dissident minority shareholder, was anticipating a voting contest.


looked to be a successful insurgency. True to \textit{Schnell}, the business judgment presumption does not apply, and it is no justification that the board acted in good faith or after "due investigation," that the new issue was meant to raise capital, or that the supervoting terms were a necessary condition for the investment.\footnote{In \textit{Packer v. Yampol}, No. 8432, 1986 WL 4748 (Del. Ch. Apr. 18, 1986), the court invalidated the board's issuance of two new series of supervoting preferred in the face of a pending insurgency. The new preferred, issued to the company's CEO and an Italian investor, represented approximately 27\% voting control. The court found that there was a "strong possibility" the new investor would vote with management and that the new preferred would have left the CEO and the investor with a nearly insurmountable 44\% voting bloc, forcing the insurgent to carry the remaining public shareholders by a margin of seven to one.}

Typical of the \textit{Schnell} line of cases, the language of the antidilution cases is wide-ranging, but the Delaware courts seem to limit board prerogatives only when the board is about to lose control in a proxy or consent solicitation. If there is no pending control contest, or if the control contest involves a threatened stock acquisition, the courts use the looser \textit{Unocal} standard of review. Under this standard, courts have upheld a variety of defenses that dilute the voting power of existing shareholders—the sale of voting stock to ESOPs or other white knights, the issuance of supervoting preferred, and the erection of low-voting stock in various forms of dual-class recapitalizations.\footnote{Unlike the standard of \textit{Cheff v. Mathes}, which required a showing of entrenching motives, the voting dilution cases do not inquire into the board's subjective good faith. \textit{Condec}, 290 A.2d at 769; \textit{Manabi}, 96 A.2d at 810; see \textit{Packer}, 1986 WL 4748, at \#14.}

But the temporal edifice is showing some cracks—at least in federal court. In \textit{Gregory v. Correction Connection, Inc.},\footnote{No. 88-7990, 1991 U.S. Dist. LEXIS 3659 (E.D. Pa. May 21, 1991).} a stock issuance would have passed working control from a majority shareholder to a minority shareholder. The federal district court in Pennsylvania applied Delaware law to invalidate this dilutive stock issue even though no proxy contest was pending. Judge McGlynn, however, had some difficulty determining the appropriate standard of review. Predicting that the Delaware courts would apply \textit{Blasius},\footnote{Id. at \#60 (relying on \textit{Phillips v. Instiufom of N. Am., Inc., No. 9173, 1987 WL 16285 (Del. Ch. Aug. 27, 1987)) (written by Allen, Ch.). In \textit{Instiufom}, there was no pending voting contest, but one was brewing. A board issued shares to its CEO to deprive dissident shareholders of the ability to act by written consent to remove the board.} Judge McGlynn nonetheless used \textit{Unocal} review because "board action designed principally to interfere with the exercise of shareholder voting rights inherently involves a conflict of interest between the board and the shareholder majority."\footnote{\textit{Gregory}, 1991 U.S. Dist. LEXIS 3659, at \#59.} The court went on to note:

> Although there is sufficient evidence in the record to suggest that defendants made the October issuance for the proper and compelling corporate purpose of raising capital for a financially strapped CCI, ... there is an absence of evidence showing that defendants acted in good faith or conducted a reasonable investigation to determine that the October 1988 issuance was the least
restrictive means of raising needed capital for CCI.\textsuperscript{320}

Even without a pending voting contest, the questionable motives of the board (apparently as measured by a heightened proportionality standard) warranted judicial intervention to assure the integrity of voting opportunities.

The modern version of the dilutive stock issue defense is the creation and financing of an ESOP. Board members believe that employees, more invested in their employment than their stock position with the firm, will vote with management against insurgents, whom the board can classify as bust-up artists and job-cutters. Judges have given defensive ESOPs mixed reviews.

In the recent NCR-AT&T takeover fight, a federal district judge in Ohio applied Maryland law to invalidate the NCR board's defensive use of a newly created ESOP.\textsuperscript{321} The NCR board, acting on the eve of the record date for a special board election, issued $500 million of new NCR shares (about eight percent of the NCR shares outstanding) in response to an AT&T two-step proxy contest/all-cash tender offer.\textsuperscript{322} In an opinion redolent of the rhetoric of corporate democracy, Judge Rice's approach was eclectic, to say the least. Mentioning Schnell process concerns and finding that management entrenchment was a "primary purpose" for the ESOP, the court eventually held that the NCR board violated its "duty of due care."\textsuperscript{323} Rice noted that the board "surely... [has] some obligation to at least ensure that principals [sic] of corporate democracy are not unduly submerged in an attempt by management to entrench itself."\textsuperscript{324}

While other federal courts have generally invalidated last-gasp dilutive ESOPs on varying grounds,\textsuperscript{325} Delaware courts have shown increasing

\textsuperscript{320} Id. at *86-87.


\textsuperscript{322} AT&T had forced a special shareholders' meeting and structured its acquisition in two steps because its banks had conditioned financing on a friendly takeover. See AT&T Sues Over NCR ESOP, Chi. Trib., Mar. 6, 1991, § 3, at 1; Jack Lesar, AT&T Seeks to Void NCR ESOP, UPI, Mar. 5, 1991, available in LEXIS, News library, Wires file.

\textsuperscript{323} NCR, 761 F. Supp. at 496.

\textsuperscript{324} Id. at 494-95.

\textsuperscript{325} See Klaus v. Hi-Shear Corp., 528 F.2d 225, 234 (9th Cir. 1975) (invalidating ESOP created in a proxy fight because it lacked a "sufficiently compelling business" purpose); Podesto v. Calument Indus., [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,433, at 93,557 (N.D. Ill. May 9, 1978) (invalidating ESOP whose primary, if not sole, purpose was to entrench control).

A glaring exception is *Shoen v. Shoen*, 804 P.2d 787 (Ariz. Ct. App. 1990), where the court upheld a last-ditch ESOP dilution defense under the business judgment rule. Unlike other dilutive issue cases, *Shoen* involved a closely held family corporation (U-Haul truck rentals). The dissident group, which included the company's founder, held approximately 49.7% of the stock and proposed to sell the business. The management group, including three of the founder's sons, owned approximately 45.8% of the stock. A family trustee, who held the swing votes, was prepared to vote with the dissidents. The court accepted management's creation of an executive-ESOP financed by nonrecourse promissory notes, even though it had a "collateral effect of enhancing the power of the incumbent management." Id. at 794.

The *Shoen* court sought to distinguish *Blasius* and other Delaware voting cases on the ground that the dissident groups in those cases actually held majority power. The distinction is plainly
tolerance. In 1985, the Delaware Supreme Court enjoined an ESOP intended to dilute an acquirer's fifty-one percent majority bloc—a straightforward application of the 1950s rule against diluting an extant control bloc. In 1989, however, Vice-Chancellor Berger upheld a Polaroid defensive ESOP in Shamrock Holdings, Inc. v. Polaroid Corp., commenting that the ESOP would increase firm "productivity." In a second opinion on the same control contest, Berger had to address several new defenses, including a $300 million dilutive stock issue to a white knight and a $1.1 billion stock buyback whose effect was to increase the combined voting power of the ESOP and the white knight.

Berger used Unocal rather than Schnell as the appropriate legal standard because management had negotiated the defensive maneuvers in response to Shamrock's hostile tender offer, several weeks before Shamrock announced its proxy contest. Berger stated that "Polaroid directors were focusing more on ways to defeat Shamrock in the market place than upon a means to defeat it at the polls." Berger noted that the Polaroid board had not only managed to secure 33.4% of the vote through its defensive efforts, but it could also count on the votes of at least 22% of the stock in the hands of arbitrageurs and therefore would "be going into the proxy contest with about the same percentage of likely votes as will Polaroid." Remarkably, according to the court, the effect of the defenses did "not provide strong evidence of a primary purpose to interfere with the election."

Two recent cases decided by Chancellor Allen demonstrate the erratic line between proper and improper board action in an election contest. In both cases, a board issued a dilutive block of stock during an election contest. Allen sided with one board and against the other. In Glazer v. Zapata Corp., management sold a seventeen percent voting stake to an outside investor following the announcement by a thirty-eight percent shareholder that he intended to conduct a proxy contest. The equity wrong. In Shoen, the dissidents had actually accumulated consents constituting a majority bloc, while the Delaware cases generally involved only the likelihood (but not certainty) the dissidents would garner a majority. Nonetheless, one could distinguish Shoen as a close corporation case in which shareholder voting may have been subject to special intendments, such as that the business would not lightly be sold outside the family.

327. Polaroid I, 559 A.2d 257 (Del. Ch. 1989) (upholding ESOP funded by employees, not corporation or shareholders, as fair despite possible minimal reduction in earnings per share).
329. Applying Unocal, Berger held the defensive measures reasonable because Polaroid was anticipating a $5 billion judgment in a pending patent infringement suit, and "Polaroid's stockholders really have very little way of assessing the present worth of this extremely valuable asset." Id. at 290.
330. Id. at 286. After Polaroid announced its defensive restructuring in response to Shamrock's tender offer, Shamrock announced a proxy contest to replace the entire Polaroid board.
331. Id. at 286. The conclusion is hard to accept. It is similar to Berger's claim in Polaroid I, which she admitted was wrong in Polaroid II, that Shamrock had a realistic chance of obtaining support for its hostile tender offer from the employee-ESOP stockholders. Id. at 281.
infusion was part of a pre-established business plan to refinance the company's debt. Allen chose a business judgment review of the dilutive issue, rejecting even a *Unocal* proportionality standard, because the evidence did not show that the "transaction is motivated solely, primarily or even substantially as a defensive transaction." Allen pointed out that the new investor was not an accommodation white knight and would "be as free as . . . any public [investor] to vote in whatever way the holder believes will be most likely to increase the net value of his or her investment." Recasting earlier dilutive issue cases as cases involving obstructionist motives, Allen concluded that "the purpose that motivates the board . . . is critical," not the effect of perpetuating control.

In *Commonwealth Assocs. v. Providence Health Care*, the board issued twenty percent of the company's stock during a pending election contest under an agreement that prohibited the purchaser from voting or exercising written consents against the incumbent board. The board had been negotiating a cash investment in the purchaser before the insurgency, but dramatically accelerated the negotiations and converted the transaction from a cash purchase into a stock exchange when the insurgent announced its consent solicitation. After the transaction, the company's CEO (and his family) and the voting-restricted purchaser together held over fifty percent of the company's stock. In granting the insurgent's motion for summary judgment, Chancellor Allen acknowledged that not every busi-

333. Id. at *25. Chancellor Allen, in refusing to apply the Schnell test, noted that "issues of this sort are highly particularized." Allen concluded that the Norex transaction was "the outgrowth of a long-term plan pursued by management for more than a year, of obtaining new capital for Zapata." The history of the insurgency, however, raises serious questions about the board's motives. In July 1992, Malcolm Glazer bought 38.8% of Zapata's stock and filed a Schedule 13D. Zapata representatives met with Glazer from July through November, seeking a standstill agreement. When the Glazer negotiations failed, the Zapata board began negotiations in January 1993 with Norex to issue new stock. In early February, a disgruntled Glazer amended his Schedule 13D and announced his intent to nominate a slate to fill the three seats up for election on Zapata's staggered board at the upcoming June annual meeting. Immediately afterward, the board committed to sell Norex 17.5 million convertible preferred shares and 15 million common shares. When Glazer learned of the sale, he offered to buy 15 million common shares at a higher price; the Zapata board refused.

334. Id. at *26.
335. Id. at *28.
337. Providence began negotiations in March 1993 with NuMed to purchase NuMed stock for cash. Providence (an operator of nursing homes) viewed an investment in NuMed (a provider of health care) as less risky than acquiring nursing homes; Providence could sell the stock, listed on NASDAQ, if the investment did not work out.

On August 27, 1993, Commonwealth (a significant Providence shareholder) filed a Schedule 13D and announced its intention to remove the Providence board and CEO through a consent solicitation. Providence immediately accelerated its negotiations with NuMed and on September 2 agreed to terms: Providence would buy 40% of NuMed's common shares (with an option for another 10.1%); NuMed would receive cash and 20% of the outstanding shares of Providence, along with the promise of a seat on Providence's five-member board. The agreement compelled NuMed to vote its Providence stock in any control contest in support of the incumbent board. Two days after the NuMed transaction closed, the Providence board announced that it had affectively won the control contest since Providence's CEO (and his family) and NuMed together held over 50% of the Providence stock.
ness action that “may have collateral effects upon a forthcoming vote” is suspect. Nonetheless, citing to Schnell and Blasius, Allen concluded the record was “radically inconsistent” with a benign story that the board “happened to negotiate the sale of 20% of Providence stock into friendly hands . . . just three days after learning of the commencement of the solicitation of consent.” Noting that a transaction with the purchaser “had only days earlier been thought a contingent future proposition,” Allen found that the dilutive effect of the stock sale was “not collateral or secondary but was the main, principal, indeed probably the sole reason” for the transaction.

Perhaps Glazer and Commonwealth can be reconciled. In Glazer, though the dilutive stock issue incidentally may have affected a pending election contest, it carried forward a preexisting financing plan. In Commonwealth, the dilutive stock issue did not execute a pre-existing acquisition program, but rather converted an investment possibility into a defensive device. If so, why should a pre-established business plan remove a dilutive issue entirely from Schnell review and its requirement of a “compelling justification” for voting interference during an election contest? Although plausible on its facts, Glazer nibbles away at the core of Schnell by relaxing judicial suspicion when a board interferes with voting opportunities in the face of an announced control contest.

Poison Pill Plans. A poison pill plan can also frustrate shareholder voting opportunities. Although drafters originally designed the plans as an in terrorem device to compel unwanted tender offer bidders to negotiate with the incumbent board, many plans sweep broadly to discourage voting contests. Typical pills are triggered when any person or group acquires more than a specified percentage (ten or twenty percent) of the firm's voting shares, but many plans are also triggered upon any agreement, arrangement, or understanding on voting among shareholders whose aggregate holdings exceed the specified threshold. The effect is to
seriously discourage an insurgent from undertaking an election contest if it contemplates either acquiring a controlling block of stock or mounting a joint solicitation with other shareholders.343

Poison pills have garnered immense academic attention, but most has focused on their effect on hostile tender offers, not their side effects on proxy contests.344 Nonetheless, this latter aspect—with its Schnell doctrine overtones—was a principal basis for the challenge in Moran v. Household Int'l, Inc.345 In the Chancery Court, Moran (a significant shareholder) challenged the Household plan as a restriction on a shareholder’s fundamental right to conduct a proxy contest. Moran argued that shareholders are more prone to support a large (and demonstrably committed) shareholder than an insurgent with a small holding. Joined by the SEC, Moran also argued that the Household plan’s effective twenty percent cap would discourage joint proxy contests “and more than doubles the chance that Household’s management will prevail in any such contest.”346

Both the Chancery Court and the Delaware Supreme Court, on review, agreed the Household plan would be invalid under Schnell if the plan’s effect were as argued, but concluded its actual effect on proxy contests would be minimal.347 Both courts ignored the argument that group financing of a proxy fight is generally more effective than individual financing.

Since Moran, voting-based challenges of poison pills have turned on whether accumulations of proxies or accumulations of stock trigger the pill. The former are subject to Schnell review, the latter to Unocal review. In a handful of recent decisions, judges have shown open hostility to poison pills that chill voting, and incumbent boards faced with straight voting contests now carve proxy contest exceptions to their poison pill plans after insurgents challenged the pills under Schnell.348 In an analogous case, Chancellor

proxy contests).

343. See Thomas, supra note 18, at 512-15 (describing effect of poison pill plans). In one case, the plan effectively forbade large shareholders from even discussing the possibility of launching a proxy fight. See Henley Group, 1988 Del. Ch. LEXIS 32. In another instance, a rights plan prevented a dissident group from adding new members because of the plan’s effective 20% ceiling. See Thomas, supra note 18, at 514-15 (describing aborted proxy contest in 1991 for Avon by a dissident group).

344. Professor Thomas argued against the use of poison pill plans to chill proxy contests, asserting that courts should apply heightened review to plans that adversely affect a dissident’s chances of winning. Thomas, supra note 18, at 548.

345. 490 A.2d 1059 (Del. Ch.), aff’d, 500 A.2d 1346 (Del. 1985).

346. Id. at 1074.

347. Id. at 1079-80, aff’d 500 A.2d at 1355. The Chancery Court relied on the testimony of a proxy solicitor who opined that the key factor in a proxy contest is not the size of the insurgent’s holdings, but the persuasiveness of his position. Professor Thomas assumed that the lack of an evidentiary record on the plan’s actual effects explains the courts’ reluctance. See Thomas, supra note 18, at 519.

Allen suggested that Blasius would invalidate a "change of control" provision in a firm's overfunded pension plan that prevented an insurgent board (but not the incumbent board) from removing excess accumulations from the plans.349

When a plan aims at both proxy and stock accumulations—as in a two-step proxy contest/tender offer—the Delaware courts have retreated. In Stahl v. Apple Bancorp, Inc. (Stahl II),350 Chancellor Allen upheld a typical pill whose definition of "beneficial ownership" concededly prevented the insurgent-bidder in a two-step proxy contest/tender offer from forming an insurgent group bound by a revocable understanding to vote against incumbent nominees. The decision has garnered widespread criticism.351

Allen concluded—without further explanation—that the pill did not materially impair the insurgent-bidder's ability to mount a proxy fight. The bidder could always gather other shareholder proxies subject, of course, to the federal proxy regulations. Chancellor Allen argued, "I am unable to say that stockholders have an absolute right to reach agreements with each other concerning the voting of stock . . . ."352

Allen refused to apply a Schnell standard of review, even though he concurred with the "normative argument" that in the context of elections "honest men seeking their (disputable) vision of what is best . . . are capable of gross impositions . . . . Where the franchise is involved a special obligation falls upon courts to review with care action that impinges upon legitimate election activities."353 Allen concluded that stringent Schnell review applies only when "the board action is directed specifically and primarily towards the voting process,"354 despite the statements by both courts in Moran that a poison pill plan should be judged according to its effects on voting, not its motives. Since the Apple Bancorp plan in Stahl II

These settlements comport with the holdings in early cases dealing with poison pill plans that affected shareholder voting directly. The courts rejected the plans because of their discriminatory treatment of voting rights. Unilever Acquis. Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407, 410 (S.D.N.Y. 1985) ("[D]iscrimination strips the [triggering] shareholder of the ability to transfer voting rights without prior warning, compensation or shareholder authorization . . . ."); Asarco Inc. v. Court, 611 F. Supp. 468, 477 (D.N.J. 1985) ("situation in which [stockholders] who acquire 20 percent of the shares . . . will have their voting power diluted five-fold").

349. Sutton Holding Corp. v. Desoto, Inc., No. 12051, 1991 Del. Ch. LEXIS 85, at *3 (May 14, 1991). The case involved an unusual situation. Following the insurgent's suit challenging the "change in control" provision, the incumbent board agreed to interpret the provision as not triggered by a successful insurgency. Chancellor Allen, however, refused to declare the validity of this interpretation under Delaware corporate law because the plan beneficiaries (whose rights were protected under federal ERISA) were not parties to the suit. Nonetheless, citing Blasius, he suggested the original adoption of the "change in control" provision violated the board's duty of loyalty. Id. at *3-4.


351. See Warren & Abrams, supra note 46, at 664-65; Thomas, supra note 18, at 522 ("Apple Bancorp raises serious doubts about the Delaware courts' commitment to protecting the shareholder franchise from management's defensive tactics.").


353. Id. at 97,035.

354. Id. at 97,036.
focused primarily on unapproved stock acquisitions, the *Unocal* test applied. Under that standard, the board could protect shareholders from the threat they would sell without receiving an adequate premium for their shares.

Some pills take more direct aim at two-step takeovers by prohibiting directors not nominated by the incumbent board from rescinding poison pill plans in place. Under these plans, a potential bidder who mounts a successful proxy contest for the board cannot make the follow-up tender offer for the target's stock because the new board is powerless to void the plan.355

In *Davis Acquisition Inc. v. NWA Inc.*, Chancellor Allen considered a challenge to a then-novel 180-day waiting provision that the board of NWA, the parent company of Northwest Airlines, had added to a typical flip-in/flip-over rights plan in the midst of a two-step proxy contest/hostile bid by Marvin Davis.356 The provision would have paralyzed a Davis-nominated board for six months following a successful proxy contest, preventing it from undoing the pill to pave the way for a sale to Davis. Davis argued the provision would chill shareholders from voting for his slate of directors, thus warranting *Schnell* review. The incumbents had made themselves more electable because they, and only they, could sell the company soon after the election. Allen skirted the issue, agreeing that the 180-day provision "is likely to have some effect upon the voting by the shareholders,"357 but concluding Davis had not made a sufficient showing of irreparable harm to justify a preliminary injunction.358 With the market price at $102 at the time of suit, even though the Davis tender offer stood at $90, Allen left open the possibility of a permanent injunction under the effects standard of *Moran* and urged the board to find a better proposal.359

Other courts outside of Delaware have been less accommodating and have disabled disabling poison pill plans that sterilize the power of a newly elected insurgent board. A New York trial court, applying New York law, invalidated a rights plan that, when any business combination was pro-

355. See Linda Sandler, Heard on the Street, Wall St. J., Dec. 12, 1990, at C1 (stating that a successful proxy contest would cause Time Warner to issue a new lot of common shares to nonvoting preferred shareholders, who also can convert their preferred shares into voting common, deterring any common shareholder from mounting a proxy fight).


357. Id. at *15.

358. Allen attempted to mitigate the effect of his dodge by suggesting shareholders should be informed that he would determine the validity of the 180-day provision within 45 days after the election, creating the possibility of a prompt sale even if the shareholders elected a Davis-nominated board.

359. Id. at *14. The drawbacks of a quick sale to Davis seemed to weigh on Allen: Had the NWA board not recently announced itself willing to consider a value "enhancing" transaction, I would feel more confident that the real issue facing the shareholders is whether they want the Company sold now or not. In that context, the issue would have been clearly joined and the Delayed Redemption Provision would have seemed a relatively insignificant cloud.

Id.

The market reaction indicated a drawn-out sale of the company, facilitated by the 180-day waiting provision, would have been more beneficial to shareholders.
posed, permitted only a board consisting of a majority of "continuing
directors" or a board elected by two-thirds of the outstanding shareholders
to redeem outstanding rights. The judge invalidated the provision as a
restriction on the power of the board that needed to be in the certificate of
incorporation.

The Delaware poison pill cases present a curious eclecticism. Once a
judge is convinced that a poison pill plan directly affects proxy contests, the
standard of review can be very strict, stricter than the basic Schnell test. It
apparently is not a defense that a board adopted the pill before a control
contest became manifest or that a board adopted a plan in the exercise of
the board's ministerial power over shareholder voting. Poison pill plans
that are triggered by proxy solicitations may be per se invalid. Yet, if the
plan takes aim at hostile tender offers, and in the process two-stage proxy
contests/tender offers, the Delaware courts have shown almost supine
dererence.

The plan defined continuing directors as members of the existing board or new directors
ominated by a majority of any continuing directors then on the board.
361. Id.
362. Neither Moran nor Stahl II made such distinctions.
363. Courts invalided earlier poison pill plans that did not rely on flip-ins or flip-over but
contained supervoting contingencies. In Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618
F. Supp. 407 (S.D.N.Y. 1985), the board issued participating cumulative preferred stock to all
existing shareholders. The new preferred stock entitled the holder to 25 votes per share unless
the holder transferred the stock, in which case the new holder had only 5 votes per share for
36 months. The drafters designed the stock to stop unwanted stock acquisitions, which would,
if consummated, take 36 months to transfer control (unless the bidder bought over 90% of the
preferred stock). The court, applying Delaware law, held the plan invalid as an unlawful
restriction on transferability and as an unlawful discrimination among stockholders. See also
Asarco Inc. v. Court, 611 F. Supp. 468 (D.N.J. 1985) (holding invalid as an unlawful
redistribution of voting power a plan which gave all holders of a new class of preferred stock,
other than the bidder, five votes per share if an unwanted bidder bought over 20% of the
common stock). These early cases led all later drafters of poison pill plans to eschew voting
right contingencies in favor of put or call plans.
364. In the latest Delaware Supreme Court case dealing with tender offer defenses by target
boards, Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994), the
court sought to correct its ill-considered opinion in Paramount Communications, Inc. v. Time,
Inc., 571 A.2d 1140 (1990). On its face, the QVC Network correction is minor, distinguishing
Time on its facts, rather than overruling it. Moreover, the attempted distinction may have
worsened the court's logical predicament.

In QVC Network, the court placed great significance on the effect of a shift of control from
a fluid body of public shareholders to a single entity. As a result of the change, public
shareholders lose the power of their vote, which at best becomes a "formality," and no longer
can claim part of a control premium in any further control changes. QVC Network, 637 A.2d
at 42-43. The court held:

[The Paramount stockholders are entitled to receive and should receive, a control
premium and/or protective devices of significant value [such as supermajority voting
provisions]. There being no such protective provisions in the ... transaction, the
Paramount directors had an obligation to take the maximum advantage of the current
opportunity to realize for stockholders the best value reasonably available.

Id. at 43. Using this analysis, QVC Network distinguished Time-Warner on the ground that
"there was no change of control in the original stock-for-stock merger between Time and
Warner because Time would be owned by a fluid aggregation of unaffiliated stockholders both
3. Shareholder Consent to Board Action

The board has in its statutory arsenal a variety of techniques by which it can enlist shareholders in their own disenfranchisement. The Schnell doctrine does not address the problem of midstream changes accomplished with shareholder approval. Schnell's underlying principle that the basic voting agreement empowers shareholders to vote as they see fit would seem to support any firm action that shareholders had ratified. A robust theory of corporate democracy suggests that shareholders should be free through the voting mechanism to modify the firm's governance structure, including their voting rights.

On the other hand, shareholders have seemed too ready to ratify management-initiated charter amendments or bylaw changes that create substantial controls or limitations on their voting rights, and too ready to tender their shares in dual class voting stock recapitalization plans. In some cases, shareholders vote in favor of charter amendments and tender into firm tender offers even though they lose value. Do the principles of Schnell suggest judges should engage in some form of substantive review for fairness or wisdom?

a. Charter Amendments

Shark Repellents. During the 1970s and 1980s, shareholders regularly approved "shark repellent" charter amendments designed to make control contests, both proxy contests and tender offers, more difficult. Managers introduced, and shareholders ratified, charter amendments on staggered boards, supermajority voting requirements, aggregation caps on voting power, board-size provisions, and limits on the written consent procedure. Meanwhile, event studies provided evidence that these changes often decreased shareholder value.

The decisions on shark repellents are sparse, but uniformly unsympathetic toward arguments of shareholder vulnerability. The Delaware Su-
preme Court, reading the voting provisions of the Delaware statute broadly, has upheld aggregation caps in the original articles that limit the one-share/one-vote rule for larger shareholdings. Midstream charter amendments that limit (or eliminate) the consent procedure that grant the board exclusive power to fix the board's size, and that stagger the board are also valid.

Judges reviewing shark repellents have been unpersuaded by arguments based on management's exploitation of shareholder passivity, on the inherent conflict of interest when the board solidifies its incumbency, and on the merits of lasting, nonwaivable shareholder democracy in public corporations. Focusing instead on the board's statutory powers, courts will listen to these arguments only if the charter amendment is impermissible under the applicable statute, if the amendment's language suggests a narrow construction, or if management misled shareholders when shareholders approved the amendment. None of these arguments has fared well over time.

To date, the courts have not construed shark repellent amendments narrowly. Insurgents seeking to avoid staggered board provisions by increasing the size of the board and filling the vacancies with their own nominees have met a wall of judicial hostility and disingenuity. In such cases, courts have interpreted charter provisions to grant the board exclusive power to fill vacancies, even though the vacancy-filling provision did not explicitly so provide, even though established case law gave shareholders coterminous power to amend bylaws and fill board vacancies, even though the statute suggested a limited board role in fixing its size, and even though a coterminous power in the shareholders to fix board size would not have been “inconsistent” with a staggered board.

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369. Allen v. Prime Computer, Inc., 540 A.2d 417, 419-20 (Del. 1988) (suggesting board's consent procedures would have been valid if shareholders had adopted a charter amendment endorsing them).

370. Henley Group, Inc. v. Santa Fe S. Pac. Corp., No. 9569, 1988 Del. Ch. LEXIS 32 (Mar. 1, 1988) (upholding charter provision that permitted board to fix its size, despite section 141(b) which permits the charter to fix the number of directors, but does not permit changes then to be made by the board; noting that the shareholders had voted to create the provision).


375. Centaur Partners, 582 A.2d at 929. In the analogous situation where the board classifies itself to undermine the effectiveness of cumulative voting, courts have held a staggered board is not inconsistent with cumulative voting rights. See Humphrys v. Winous Co., 133 N.E.2d 780
Although the courts insist on shark repellents being clearly stated and approved after full disclosure, few cases find disclosure deficiencies, especially when compared to the large number of successful disclosure challenges in fundamental transaction cases.\textsuperscript{376} And even when state courts do find disclosure deficiencies, the usual remedy is only corrective disclosure before the meeting at which shareholders will consider the amendment.\textsuperscript{377}

\textit{Stock & Stock Right Authorizations.} Charter amendments can also authorize the board to issue large amounts of stock and stock rights at its discretion. There are three forms of such authorizations. First, through charter amendments, the board obtains residual “overhang authority” to issue stock in amounts that dwarf outstanding shares. Second, through “blank check” charter authorizations for preferred stock, the board may not only issue new stock, but also specify the rights and privileges of the stock. Third, unless the firm opts out of statutory provisions on stock rights and options, the board can issue and specify the price and terms of a wide range of derivative equity instruments.

Compared to the shark repellent cases, the cases on stock authorizations reveal greater judicial resolve. As noted before, the well-established dilutive issue cases prevent the board from issuing new stock that dilutes the voting power of an otherwise or imminently successful opponent in a proxy contest.\textsuperscript{378} Still, the courts’ intervention is quixotic; beyond the dilutive issue cases, the courts have closed the door to shareholder complaints. A board can use its overhang authority to avoid shareholder ratification votes whenever management decides to buy or sell control of the firm. Without a shareholder vote, the board can acquire another firm using a triangular merger,\textsuperscript{379} or sell the firm using an exchange offer.\textsuperscript{380} As we have seen,

\textsuperscript{376} Centaur Partners, 582 A.2d at 927 (upholding as “not unclear or ambiguous” a requirement that any change to staggered board provisions be approved by an 80\% supermajority vote); \textit{see also} id. (“There must be no doubt that the shareholders intended that a supermajority would be required.”).


\textsuperscript{377} Cavalcade Oil Corp. v. Texas Am. Energy Corp., No. 7605, 1984 WL 8215, at *1 (Del. Ch. May 22, 1984) (enjoining meeting because of “probably inadvertent” misleading disclosure concerning proposed charter amendments to stagger the board, allow for removal of directors only for cause, and eliminate removal by written consent).

\textsuperscript{378} \textit{See} supra text accompanying notes 312-31.

\textsuperscript{379} Equity Group Holdings v. DMG, Inc., 576 F. Supp. 1197 (S.D. Fla. 1983) (holding that merger of subsidiary and acquiring company, which resulted in acquiring group holding 64\% of resulting firm's outstanding shares, did not trigger voting rights for parent shareholders under merger provisions).

\textsuperscript{380} Bank of N.Y. Co. v. Irving Bank Corp., 528 N.Y.S.2d 482, 485 (N.Y. Sup. Ct. 1988) (holding that bank's exchange offer for shares of another bank, resulting in the acquisition of the second bank's business, did not trigger voting rights for shareholders of the acquiring
courts have permitted boards, relying on provisions that permit "blank check" preferred stock and issuance of options, to create (among other devices) poison pill plans, which augment substantially the board's power over shareholders' ability to sell their own shares.

In Lennane v. ASK Computer Sys., Inc., Chancellor Allen turned a deaf ear to claims of shareholder surprise in the face of a board's use of a stock authorization. In the case, Allen refused to postpone the issuance of already authorized common stock to finance a cash tender offer. Although the issuance did not require further shareholder approval under state law, the board's failure to do so potentially violated the NASDAQ/NMS listing requirements and threatened to cause the delisting of the company's stock. A nine-percent shareholder sought a preliminary injunction to delay the issuance so shareholders could express their nonbinding views or even oust the incumbent board at the approaching annual shareholders' meeting.

Chancellor Allen refused to grant the injunction because no statutory or charter provision required a shareholder vote. Conceding that the fiduciary claims presented "some prospect for ultimate success," Allen concluded that they did not warrant interlocutory intervention. The board could weigh the value of the transaction against the costs of public delisting, and any "shareholder veto" risked upsetting a transaction entrusted to the board's business judgment.

Starkly missing from the Lennane opinion is even the suggestion that authorization of a control block may be suspect, warranting heightened judicial review. Instead, Allen treated the shareholders' earlier stock authorization as definitive. He denied the shareholders even a chance to express their nonbinding understanding of the extent to which the authorization had delegated delisting authority to the board.

382. Allen commented that judicial protection of voting is limited to those matters entrusted "to the shareholder vote as provided in the corporation[s]' constitutional documents"—namely the corporate statute, the corporation's charter, and its bylaws. Id. at *26.
383. Allen wrote:

The relationship between the directors' duty of loyalty to the corporation (and to all of its shareholders as a class) and the shareholders' right to participate through the franchise in the governance of the enterprise is complex. When the corporation law statute, the certificate of [in]corporation or the company's by-laws creates a right to vote on a matter, loyalty to shareholders will ordinarily require director[s] to establish a compelling justification for action that significantly impairs that right. In those circumstances, the right to vote is constitutional, in the sense that the documents constituting the corporation and empowering directors to act provide for that vote. Directors are bound to accord great deference and respect to the shareholder vote as provided in the corporation[s]' constitutional documents. A right to vote that arises only from director action is not constitutional in this sense, and with respect to such right, directors are bound simply to exercise their business judgment in an effort to promote the welfare of the corporation and the shareholders derivatively. Therefore, a vote of that type where it reasonably may be seen as endangering the accomplishment of a transaction that directors in good faith believe is in the corporation[s]' best interest, may present a threat against which directors may act without breaching faith with shareholders. Directors are not required in all instances to follow shareholder views of advantageous corporate action.
The most important case of shareholder surprise has been Moran v. Household Int'l, Inc., which established the board's inherent authority to promulgate poison pill plans.\(^3\) In the case, the board issued contingent stock rights as dividends on common stock. Once triggered by a stock acquisition of which the board did not approve, the rights would vest and entitle the holder the option to purchase \(\frac{1}{100}\) of a share of preferred stock for \$100, or wait for a back-end transaction between the firm and the bidder to purchase \$200 worth of the bidder's common stock for \$100 (a classic "flip-over" provision). The plan, like others modeled on it, is a series of illusions. Normally, stock rights are derivative equity investments in the firm. If exercised, the firm collects cash (a capital investment) and issues stock. The stock rights in Moran, on the other hand, were designed never to be exercised. Rather, the drafters of the plan sought to deter unwanted stock acquisitions; the board could redeem the rights before they vested once it struck an acceptable deal. In the unlikely event the rights were to vest, no shareholder would choose to buy the preferred stock because the exercise price was higher than value.\(^3\) Instead, all rights holders would wait for a back-end transaction and hope to buy stock in the bidder at half price, a possibility that would discourage any sane bidder from engaging in a back-end transaction.

Moran, a large shareholder and potential bidder, argued that section 157 of the Delaware General Corporation Law, the provision that gives the board power to issue stock rights, did not authorize a poison pill plan. The plaintiff's point was simple and powerful: The Delaware legislature designed section 157 to give boards financing flexibility in acquiring capital, never meaning or conceiving it to authorize takeover defenses. The rights plan was a pretext and a sham. It had nothing to do with a corporation's statutory power to finance itself.

As a matter of legislative history and purpose, the argument is undeniably correct. When the Delaware legislature passed section 157, it could hardly have thought that it was authorizing poison pill plans. Yet the court imposed on the plaintiff the virtually impossible burden of showing that the legislature "meant to limit" the section to corporate financing.\(^3\) The burden was virtually impossible to overcome. The court, to protect shareholders from surprise and particularly in light of the negative effect poison pill plans have on stock price,\(^3\) could have insisted the legislature authorize such plans directly.\(^3\) It is a device to which textualists often

\(^{384}\) 490 A.2d 1059 (Del. Ch.), aff'd, 500 A.2d 1346 (Del. 1985).

\(^{385}\) There was earlier authority in Delaware invalidating "illusory" preferred stock. See Televest v. Olson, No. 5798 (Del. Ch. March 8, 1979). The court distinguished the preferred stock in Moran because it had superior dividend and liquidation rights to that in the Televest case, even though the Moran preferred stock would never be bought. The court distinguished one fairy tale from another based on the make-believe clothing of the central characters.


\(^{387}\) See Jarrell & Poulsen, supra note 97.

resort. But the Delaware courts had a different, notably noninterpretive agenda.

*The judicial abdication.* The stock authorization cases are disappointing. Courts have permitted management (with the help of clever lawyers) to seize new and unanticipated authority. The literalist approach of the courts in these cases is in stark contrast to the *Schnell* line of cases, and the courts offer us no reasons for the differences in analysis or result. The legislature, judges note, can amend the statute, or a firm's shareholders can amend the firm charter to stop the new practices. Still, future changes do not help surprised shareholders and, more important, those changes will likely heavily burden dissenting shareholders, given managerial influence over state legislatures and managerial domination of the charter amendment process.

**b. Dual-Class Recapitalizations**

Managers have discovered that they can convince shareholders to give up their voting rights in an exchange that leaves the shareholders with non-voting or low-voting stock and the managers with high-voting stock. In a dual-class restructuring, accomplished by charter amendment, managers use the corporate treasury to pay shareholders a one-time "dividend sweetener" for parting with voting control. In an exchange offer, shareholders receive a premium for their voting shares from the corporation.

Both forms of disenfranchisement involve a degree of coercion. One event study of dual-class recapitalizations indicates that the decline in value generally exceeds the dividend sweetener, suggesting that apathetic shareholders receive less than full value for their control rights. Corporate law shows remarkable indifference to these shenanigans. Modern statutes permit the creation and issuance of non-voting and low-voting shares, and thus dual-class voting structures. Most statutes, including Delaware's, do not provide for an appraisal remedy when the board changes the voting structure and the few that do are avoidable with an exchange offer. The only serious inroad on under-priced share-
holder vote-selling came in the short-lived SEC one-share/one-vote rule.394

Judges, with remarkable ease, respect the vote-selling implicit in a
dual-class recapitalization. Disclosure review of such plans is cursory and
derferential,395 and fiduciary review noncommittal.396 Although Vice Chan-
celler Berger has intimated that dual-class recapitalizations might constitute
a fiduciary breach397 and Chancellor Allen has suggested that the standard
of review should be higher than the business judgment rule,398 no Delaware
case has reached the merits of a dual-class plan. Even when courts outside
Delaware have reviewed recapitalizations under a fairness standard, share-
holder approval has tempered the scrutiny.399

When the board openly coerces shareholder approval in a dual-class
recapitalization, Schnell provides the only meaningful fiduciary limits. In
Lacos Land Co. v. Arden Group, Inc.,400 Chancellor Allen preliminarily
enjoined a dual-class recapitalization when management's proxy statement
boldly announced that if shareholders failed to approve the plan, the
dominant shareholder-CEO would refuse to support any transaction that
"might make the Company vulnerable to an unsolicited or hostile takeover
attempt . . . for which his approval might be required."401 Not questioning
the statement's honesty or sincerity, Allen found the CEO's implicit threat
to violate his fiduciary duties "fatally flawed." Even if the recapitalization
was in the shareholders' interests and the threat benevolent, Allen held that
the method of solicitation was an invalid manipulation of the voting process
under Schnell.402

394. See Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (invalidating Rule
19c-4).
court suggested that mergers require more disclosure than recapitalizations and upheld
management's disclosure concerning Phillips's defensive recapitalization plan. Under the plan,
which was subject to shareholder approval, Phillips shareholders would receive a mix of equity
and debt for their common stock, Phillips would undertake a $1 billion stock repurchase
program, and the articles would be amended to classify the board and eliminate action by
written consent. See also Margolies v. Pope & Talbot, Inc., No. 8244, 1986 WL 15145 (Del. Ch.
Dec. 23, 1986) (dismissing claims of inadequate disclosure in connection with shareholder-
approved restructuring in which company spun off its timberlands assets to existing share-
holders).
396. Although his criticism may be a bit harsh, Professor Andre has concluded that judges
glibly disregard the risk that shareholders will part with control for less than they would have
had the transaction involved conditions of competitive bidding. Andr, supra note 73.
recapitalization was impermissible management entrenchment in denying defendant's motion
for summary judgment); Field v. S&C Elec. Co., No. 11175, 1990 WL 60644 (Del. Ch. Feb. 6,
1990) (approving attorney fees of $100,000 for 175 hours of work that led to settlement of
claim that recapitalization breached fiduciary duties).
1987) (enjoining merger-recapitalization and dilutive stock issuance to CEO).
399. Honigman v. Green Giant Co., 309 F.2d 667, 672 (8th Cir. 1962) (upholding trial
court conclusion that recapitalization was "fair, equitable and beneficial both to the non-voting
Class B stockholders and to the corporation").
400. 517 A.2d 271 (Del. Ch. 1986) (written by Allen, Ch.).
401. Id. at 276 (emphasis in original omitted).
402. Id. at 278.
C. Complete Candor: A Corollary to Schnell in Nonelection Voting

Although by its terms Schnell review applies generally to shareholder voting, almost all the voting manipulation cases involve election contests. A different, though analytically related, regime has developed for cases of nonelection voting. In such cases, state judges (principally in Delaware) place themselves in the omnipotent position of the "reasonable shareholder" to review management disclosure under a common-law fiduciary standard of "complete candor." Curiously, even though management misinformation is process manipulation of the first order, neither the disclosure nor the Schnell cases acknowledge their close kinship. This is unfortunate; the judicial sympathy toward shareholder passivity implicit in the disclosure cases ought to infuse the Schnell line as well. Judicial development of the disclosure obligations that inhere in the basic voting agreement provide a model for construing related obligations outside the process setting.

As under Schnell, courts use "complete candor" review to infer duties well beyond the rudimentary statutory requirements of notice of shareholders' meetings and facilitating shareholder-initiated inspection rights. The seminal Delaware case, Lynch v. Vickers Energy Corp., adopts the framework and materiality standard of TSC Indus. v. Northway, Inc. Lynch prohibits false and misleading statements and requires "information such as a reasonable shareholder would consider important in deciding whether to [vote]." The "complete candor" duty applies to any management communication with public shareholders, whether in a proxy solicitation, a tender offer, a notice of a shareholders' meeting even if proxies are not

403. From 1899 to 1967, Delaware's corporate code imposed personal liability on directors and officers who "knowingly" caused to be published any written statement or report concerning the corporation's business "that is false in any material respect." 21 Del. Laws 451 (1898); see Pease, supra note 114, at 448. The Delaware legislature removed this provision in 1967. 56 Del. Laws 151 (1967).

404. 383 A.2d 278, 281 (Del. 1977); see Kahn v. Household Acquis. Corp., 591 A.2d 166, 171 (Del. 1991) (stating that there is no duty to supplement proxy statement in squeezeout merger if new events are tentative or ill defined or if their revelation would add little to "total mix" of information previously made available).


406. 383 A.2d at 281.

407. The full-bodied disclosure rule does not apply in close corporations. See Stroud v. Grace, 606 A.2d 75, 87 (Del. 1992) (concluding that notice in close corporation is adequate if it complies with explicit notice provisions of Delaware statute).

408. "Under Delaware law, it is undisputed that when a board of directors 'is required or elects to seek shareholder action,' it is under a duty 'to disclose fully and fairly pertinent information within the board's control'" Stroud v. Milliken Enters., Inc., 552 A.2d 478, 480 (Del. 1989) (quoting Lacos Land Co. v. Arden Group, Inc., 517 A.2d 271, 279 (Del. Ch. 1986)); see also Rosenblatt v. Getty Oil, 493 A.2d 929, 944-45 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858, 889-93 (Del. 1985); Lynch, 383 A.2d at 281.

409. Delaware's "full candor" standard applies when the corporation (or controlling shareholder) makes a tender offer. Joseph v. Shell Oil Co., 482 A.2d 335 (Del. Ch. 1984) (enjoining parent tender offer for failure to disclose that management had withheld information from appraiser and had estimated value at $91, while minority shareholders were offered $58). Unlike the federal rules governing tender offer disclosure, the "full candor" duty extends only to corporate fiduciaries, not third-party offerors. See Citron v. Fairchild Camera.
solicited, or a notice of a short-form merger for which no meeting is required.

State disclosure review, like its federal counterpart, opens a channel for judicial supervision of a significant area of corporate governance, namely those matters on which shareholders vote. As the "complete candor" cases demonstrate, Delaware courts exercise significant freedom in interpreting and adjusting the shareholder-manager relationship. In public corporations, managerial disclosure duties to a "reasonable shareholder" substitute ex post judicial intervention at the behest of a few shareholders for ineffectual ex ante policing by rationally apathetic shareholders. As with federal proxy fraud litigation, plaintiff-shareholders need not show the alleged misinformation would have changed the outcome of the shareholder vote.

Even though the heart of a disclosure case is management manipulation of the voting process, challengers rarely seek corrective disclosure. More often they ask for a judicial reformulation of the bargain—money damages. And in Delaware the courts have obliged with significant damage awards. Shareholders use the "complete candor" tool principally to challenge (and effectively rewrite) the terms of mergers, reorganizations, and charter amendments—a substitute for fiduciary review on the merits.


Even when neither proxies nor tenders are solicited, full disclosure allows shareholders to decide whether to seek appraisal or to challenge the transaction on fiduciary or other grounds.

See Pease, supra note 114, at 473-76.

Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913 (1982) (criticizing Lynch's activism and increased power of minority shareholders and predicting heightened disclosure review will decrease in value-increasing transactions).

Smith v. Shell Petroleum, No. 8395, 1990 Del. Ch. LEXIS 190 (Nov. 26, 1990) (awarding $2 per share in a class action, totaling approximately $700 million, because of $1 billion understatement of oil reserves in short-form merger); Kahn v. United States Sugar Corp., No. 7313, 1985 WL 4449, at *1 (Del. Ch. Dec. 10, 1985) (awarding $4 per share in a class action, or $14.5 million in total, because "it would be impossible" following trial to rescind the self-tender).

The courts have made these awards without ever making a finding on causation. In one case a chancellor on remand awarded damages of $1 per share, stating his impression based on years of experience that the vast majority of public shareholders would take any substantial premium rather than hold out for more. Weinberger v. UOP, Inc., No. 5642, 1985 WL 11546 (Del. Ch. Jan. 30, 1985).

As the corporate bar discovered three decades ago in federal proxy cases, disclosure challenges can be brought as direct class actions, hence avoiding such derivative suit procedures as board demand and dismissal.

Noticeably absent from the modern "complete candor" cases, though explained by their term-rewriting impetus, are any challenges to management disclosure in election contests. Cf.
Disclosure review under Delaware’s “complete candor” standard has generally mirrored traditional fiduciary review. Courts have readily excused disclosure deficiencies as to matters over which the board traditionally has discretion: executive compensation, business dealings between affiliated companies, negotiated mergers, stock repurchases, and recapitalizations.

On the other hand, Delaware courts have scrutinized with zest management disclosure in conflict-of-interest transactions otherwise subject to stringent fiduciary review: parent-subsidiary mergers, self-tenders

Empire S. Gas Co. v. Gray, 46 A.2d 741 (Del. Ch. 1946) (enjoining dissident from soliciting proxies using statement that suggested board had authorized solicitation).

Michelson v. Duncan, 407 A.2d 211, 222 (Del. 1979) (refusing to require management to state opinions or make legal conclusions in proxy statement in support of management resolution to ratify executive compensation packages).

Schreiber v. Pennzoil Co., 419 A.2d 952 (Del. Ch. 1980) (upholding management fees charged to subsidiary in connection with its investment in affiliated company and contract amendment which permitted affiliates to participate with subsidiary in future lease arrangements).


The Delaware courts have sometimes upheld parent-subsidiary mergers. Bershad v. Curtiss-Wright Corp., 535 A.2d 840 (Del. 1987); Rosenblatt v. Getty Oil Co., 493 A.2d 929...
and tender offers by controlling shareholders,\textsuperscript{421} going-private transactions,\textsuperscript{422} and defensive recapitalizations.\textsuperscript{423} Many courts are explicit that heightened review applies to disclosure in a transaction colored by conflicting interests.\textsuperscript{424} In a squeezeout merger, even if a majority of the minority approves the merger—thus shifting to the plaintiff the burden of showing unfairness in the transaction—the parent retains the burden of proving the adequacy of disclosure.\textsuperscript{425}

The growing body of cases in Delaware that employ disclosure deficiencies to reject and redraft negotiated mergers—normally insulated by the usual business judgment presumptions—illustrates the power of the "complete candor" tool.\textsuperscript{426} Under the "complete candor" standard, the

\begin{enumerate}
\item In re Roberts v. General Instrument Corp., No. 11639, 1990 Del. Ch. LEXIS 138, at *37 (Aug. 13, 1990) (applying TSC Industries "total mix" standard to deny preliminary injunction of MBO since "[a]ny reader of the Offer to Purchase would recognize that management had no legal rights but probably had some unenforceable expectations"); Fort Howard Corp. Shareholders Litig., No. 9991, 1988 Del. Ch. LEXIS 110 (Aug. 8, 1988) (requiring management buyout group and LBO partner, Morgan Stanley, to provide full disclosure to both shareholders' and board's independent committee).
\item Lacos Land Co. v. Arden Group, Inc., 517 A.2d 271, 276 (Del. Ch. 1986) (written by Allen, Ch.) (preliminarily enjoining issuance of supervoting stock because of misleading proxy statement suggesting that if the shareholders did not vote the company's largest shareholder into office, he could make changes without shareholder approval if any shareholders' takeover actions were asserted); In re Anderson, Clayton Shareholders' Litig., 519 A.2d 669, 679 (Del. Ch. 1986) (written by Allen, Ch.) (preliminarily enjoining defensive recapitalization because shareholders had only "extraordinarily short time" to consider and act on proxy supplement).
\item Glassman v. Wometco Cable TV, Inc., No. 7307, 1989 WL 1160 (Del. Ch. Jan. 6, 1989) (disclosure standards higher in a short-form merger than transaction in which shareholders vote); Sealy Mattress Co. of N.J. v. Sealy, Inc., 532 A.2d 1324, 1338 (Del. Ch. 1987) (noting that a squeezeout merger provides a "more compelling case for application of the recognized disclosure standards" because the parent controls the outcome of merger vote) (quoting Wacht v. Continental Hosts, Ltd., No. 7954, 1986 WL 4492, (Del. Ch. Apr. 11, 1986)); Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051, 1057 (Del. Ch. 1987) (duty of disclosure is "more onerous in self-tender than contested offer because disclosures are unilateral and because of conflicts of interest, But see Barkan v. Amsted Indus., 567 A.2d 1279, 1288 (Del. 1989) (courts should be "particularly mindful of the danger of omissions and misrepresentations in situations where directors are confronted with conflicts of interest... [but] these dangers do not affect the definition of materiality").
\item Bershad v. Curtiss-Wright Corp., 555 A.2d 840, 846 (Del. 1987) (citing Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983); Rosenblatt v. Getty Oil, 493 A.2d 929, 937 (Del. 1985)) ("[T]he defendants retain the burden of proving complete disclosure of all material facts relevant to the merger vote.").
\item The most famous such case is Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (finding violations of "complete candor" requirements in management's failure to disclose manner in which merger was negotiated, board's hurried deliberations, and sketchy valuation information). It is often forgotten that the case was brought as a class action, not a derivative suit. See
\end{enumerate}
courts abandon the usual causation requirement connecting the fiduciary lapse to a shareholder harm. The "materiality" finding substitutes for proof that proper disclosure would have affected shareholder voting deliberations. Further, it is no defense that the board relied on information from other sources; the business judgment rule's reliance corollary is inapplicable. Recently, the Chancery Court faulted management in a short-form merger for failing to investigate information prepared by a third party under management control understating oil reserves by $1 billion.\textsuperscript{427}

In fact, Delaware's disclosure duty and materiality standard, as applied, seem more encompassing and demanding than their federal counterparts.\textsuperscript{428} The remarkable movement over the last several years to Delaware-based disclosure litigation powerfully suggests that the plaintiff's bar concurs. Many factors explain the shifting preference away from federal to Delaware courts: lately the Delaware judiciary seems more willing to intervene;\textsuperscript{429} Delaware's materiality standard may require valuation and other forward-looking information traditionally disfavored by SEC rules and federal courts;\textsuperscript{430} Delaware's rescissory standard for calculating damages (unlike the prevailing federal out-of-pocket standard) allows for the recovery of lost benefits, such as the sharing of any synergy values in a parent-subsidiary merger;\textsuperscript{431} Delaware imposes strict liability for proxy deception, while many federal circuits have intimated a due diligence defense;\textsuperscript{432} Delaware bases attorneys' fees in class actions on the result


427. Smith v. Shell Petroleum, No. 8395, 1990 Del. Ch. LEXIS 82, at *48 (June 19, 1990) (noting that even though parent did not prepare statement of oil reserves, parent had control over its preparation and "must bear responsibility for the error").

428. Balotti & Finkelstein, Developments in the Evolving Delaware Law of Disclosure, 1 Insights 34 (July 1987). Some commentators have read at face value the statement in Rosenblatt that Delaware's materiality standard is the same as its federal counterpart. 493 A.2d 929, 944 (Del. 1985); see Pease, supra note 114, at 452 ("Rosenblatt unquestionably establishes that the Delaware and the federal standard of disclosure are coterminous."). The results in the cases suggest otherwise.


431. Booth, supra note 430, at 98 ("The most striking contrast between federal and state law is in the monetary remedies available.").

432. See Pease, supra note 114, at 484-88.

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accomplished or the benefits achieved, compared to the less generous federal "lodestar" method which focuses on time spent; and Delaware has a well-deserved reputation for expeditious and skillful corporate litigation.

While not all states have embraced the "complete candor" tool, many have. Curiously, in those states that have followed Delaware's lead, the courts (as well as federal courts applying Delaware law) seem disinclined to apply the "complete candor" standard as vigorously as their Delaware counterparts. For example, disclosure deficiencies in parent-subsidiary squeezeouts, regularly a basis in Delaware for invalidating such transactions, are rarely faulted outside of Delaware.

"Complete candor" review, which by its terms applies only to public corporations, substitutes disclosure-based judicial activism for rational shareholder apathy. The cases thus represent the apogee of judicial intervention into the voting process and in one sense are antithetical to a vigorous theory of shareholder control. As troublesome as substituted judicial judgment might be in political voting, however, such judicial activism is already an essential element of the corporate contract. Fiduciary duties substitute judicial intervention for shareholder voting and market discipline because of the imperfections in the latter. Without this judicial role, we would have to significantly rework or abandon the corporate contract. The "complete candor" tool bridges the gap between the ideal of shareholder control and the realities of public corporate voting. Schnell could well learn from its kissing cousin.

IV. THE CAUSES AND CURES OF JUDICIAL SCHIZOPHRENIA

Judicial review of shareholder voting presents a fascinating case of jurisprudential schizophrenia. When a state court invokes Schnell, we read of the bedrock significance of shareholder suffrage and see the exacting application of a "strict scrutiny" test that demands a nearly impossible showing of "compelling justifications" for board action. The pitch of judicial review is unmatched elsewhere in corporate law. Judges trumpet

433. See id. at 488-97.
434. See, e.g., Lewis v. LFC Holding Corp., No. 7974, 1985 WL 11554 (Del. Ch. Apr. 4, 1985) (interpreting Pennsylvania law not to impose a "full candor" duty in a squeezeout tender offer).
the theme of corporate democracy and, when they apply the Schnell standard, almost always chaste the board for inappropriate interference.

But, oh, how quickly the judicial personality can change! If a board, for example, uses the voting process to facilitate its sale of the firm or to drive away a two-step insurgent-bidder, courts see no malignant disregard for voting rights, but only benign board paternalism. The courts—led by the Chancery Court in Delaware—note that managers run firms, not intermeddling shareholders, and in some cases imply darkly that shareholders may not know what is in their own best interests. And when the board reshapes the voting structure with shareholder-approved shark repellents or stock authorizations, or structures control transactions to avoid shareholder voting, judges exhibit callous, even proactive, indifference.

Describing this judicial inconstancy as schizophrenia may be a bit harsh. But schizophrenia—characterized by faulty thought processes, bizarre actions, and unrealistic behavior dominated by private fantasies and occurring most commonly in late adolescence or early adulthood—may come closest to capturing the lack of coherence in the developing lines of voting cases. Indeed, like individuals inflicted with the disorder, the Delaware courts may have a hereditary predisposition that makes them more likely to develop the symptoms when exposed to particular environmental stresses.

A. The Cause

The judicial schizophrenia in voting cases is understandable. In the 1980s, shareholders asked state judges (particularly in Delaware) to intercede in the flood of major control changes through tender offers. The placid days were gone when the corporate docket contained only a sporadic case or two on proxy contests. Moreover, tender offers excited the passions of interested groups in ways that proxy contests never did. Employees worried about losing jobs, shareholders about overnight premiums, politicians about executive campaign contributors and their tax base, economists about debt load, target managers about raiders and bust-up artists, and bidders about entrenched, incompetent target managers. As the number and size of tender offers grew, so did the intensity of the participant's cries. State judges found themselves in the middle—cognizant of the social importance of the controversy, concerned about making the right decisions, and not terribly aided by the cacophony of academic scholarship that the takeover era spawned.

Clever lawyers, the primary professional beneficiaries of this intense conflict, pushed the edges of time-worn corporate statutes and common-law doctrines in novel and surprising ways to protect their clients, incumbent managers. State legislatures, aided by the same lawyers, pushed the edges of constitutional law and corporate federalism in the same effort. With each new defense came clever counter-offensive and counter-defensive maneuvers. Litigation over these novel tactics became inevitable and commonplace. The struggle stretched state courts' competence and patience to the breaking point.

In this thicket, the state judiciary's primary instinct, honed by years of reliance on the business judgment rule, was to avoid declaring control
The business community, which can point to tangible accomplishment, has intimidated state judges for years with backroom whispers on the incompetence of lawyers who dare to sit in judgment of business people: "Judges don't understand finance, or even a balance sheet, much less the pressures of operating a complex billion-dollar business." Falling back on the old adage that "judges are not business experts," state courts second-guessed management only in clear and egregious circumstances. Target boards, regally supplied with drafters, lobbyists, analysts, strategists, and public relations specialists, ultimately designed the "show stoppers" that have now largely halted hostile takeovers. The courts took solace in the coalescence of popular opinion, formed by the sound bites of political campaigns, against hostile takeovers.439

By the late 1980s, the Delaware courts had choked the Schnell doctrine into a narrow class of cases on the mechanics of shareholder meetings. The Delaware courts, after planting the seeds for a daring break from judicial conservatism, returned to their original course. Voting contests, while receiving vaunted accolades, secured only bounded protection.

The arguments for judicial conservatism are often made, and a few of the common ones need only be alluded to here. The courts are not the proper forum for establishing social policy, especially on basically economic issues. The peoples' voices—including those of corporate constituents—are better heard through the election of legislators than the appointment of judges. The hearing process of a legislative committee is more competent to assemble data from a wide variety of affected parties than the evidentiary process of a trial. Experts heard or appointed by elected officials can best deal with economic problems, not judges with marginal economic training.

Yet state courts, in their well-intentioned and heartfelt concern to be socially responsible, became too sensitive to the bullying of the business community.

**B. The Cure: Back to the Purposive Nature of Law**

As difficult as some of the issues of the 1980s were, state judges in control cases were still doing what judges had done for centuries, interpreting statutes through a common-law process of accumulated wisdom and experience. The rules of thumb for these basic functions are time-worn and tested, but we should not lose sight of them in the tumult. The problems of interpretation in corporate law are little different from interpretive problems in other legal fields.

Two famous American scholarly debates on statutory interpretation, the Radin-Landis debate in 1930440 and the Hart-Fuller debate in the late

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438. The state courts' earlier "equity dignity" rule, which allowed the court to stay out of negotiated transactions opposed by minority shareholders, comes from a similar spring. The opposite rule, the de facto merger rule, would have involved the state courts in assessing the essence of all major negotiated transactions that were not structured as statutory mergers.


1950s, reinforced long-held notions that words in statutes are defined by "a purpose, or more commonly, in a congeries of purposes." A literal approach, devoid of a sense of purpose, is an empty and pointless inquiry. Some recent theoreticians go so far to conclude that a statute is nothing but its purpose.

So how and where do we find legislative purpose? Some have argued that an inquiry into purpose is inherently indeterminate, but the position is not well accepted. Indeterminacy at the margin does not doom the useful operation of a rule; indeed, the phenomenon of marginal indeterminacy is common and unavoidable.

The lesson of Fuller's famous illustration seems too often lost in modern judging. If a statute says, "no vehicles shall be taken into the park," the statute's interpreter and enforcer ought not to prosecute a defendant for bringing in a World War II jeep, even if in good working order, and placing it upon a pedestal as a war memorial, or for wheeling a baby buggy through the park. Once we are confident that the purpose of the statute is to preserve the park for pedestrian traffic, this purpose defines the scope and meaning of the words.

To Fuller, a literal approach to statutes would not only often produce nonsense, but would place too heavy a burden on the legislature. A system of literal interpretation would compel the legislature either to foresee all

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441. Lon L. Fuller, Positivism and Fidelity to Law—A Reply to Professor Hart, 71 Harv. L. Rev. 630 (1958).
442. Lon L. Fuller, American Legal Philosophy at Mid-Century, 6 J. Leg. Ed. 457, 470 (1954). Elsewhere, Fuller used the language of a 1584 case in Court of Exchequer: [T]hat for the sure and true interpretation of all statutes in general... four things are to be considered: 1st. What was the common law before the making of the Act. 2nd. What was the mischief and defect for which the common law did not provide. 3rd. What remedy the Parliament hath resolved and appointed to cure the disease of the commonwealth. And 4th. The true reason of the remedy; and then the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy.

444. Steven Knapp & Walter B. Michaels, Against Theory, Critical Inquiry, Summer 1982, at 725 (what a text means and what its author intends it to mean are ontologically identical inquiries).
445. See, e.g., Gerald C. MacCallum, Jr., Legislative Intent, 75 Yale L.J. 754 (1966) (discussing the problem of ascribing intent to a collegial law-making body).
448. Fuller, supra note 441, at 661-69.
future contingencies (if this were even possible) or to amend constantly as
the legislature discovered that the literal language produced unintended
consequences.

Court interpretations of statutes should not surprise those acting in
reliance on them. Applying the principle to management oversight of
shareholder voting, board action violates the voting agreement when it
diminishes shareholder value and surprises shareholders. Economists say
that shareholders have not "priced" an unanticipated change. Sharehold-
ers, who bought shares before the change, cannot discount (or add to) the
price they received for their stock based on their assessment of the value
and probability of the change. When shareholders have not assumed the
risk of board resolutions or charter amendments that fundamentally and
detrimentally alter their voting rights, courts ought to step in.

The Schnell case is a classic application of Fuller's views on the
importance of purpose. By statute, the board has the authority to schedule
meeting times; the statute's purpose was to delegate ministerial authority to
the board. When the board used its ministerial powers to affect the outcome
of the meeting, the board acted outside the scope of its authority under the
statute. By the 1980s, however, a more literal approach to corporate
codes had come to dominate court thinking. Judges found that statutory
provisions on preferred stock and stock rights, enacted to provide flexible
financing to corporations, authorized a wild assortment of poison pill stock
and rights plans. The board used these devices to modify the basic
agreement between managers and equity investors, executed unilaterally
without the consent of the shareholders. The contingent rights stopped
bidders from seeking to buy equity shares in tender offers, unless the
incumbent board approved.

Laypeople, if they can understand these bizarre devices at all, inevi-
tably view them with total incredulity. Yet the courts took a literal approach
in finding poison pill plans within the scope of the board's statutory
authority to provide firms with financial flexibility. The trickery, so obvious
to laypeople, slid by our judges. If the state courts had held (as some federal
district courts did) that the statute did not authorize poison pill stock or
rights plans, the courts would have eliminated a convoluted defense
strategy in favor of more transparency. Target firms would have to rely on
charter amendments, ratified by shareholders, and state antitakeover legis-
lation, molded in a political forum that by the end of the 1980s

449. See Fuller, The Morality of Law, supra note 415, at 83 (adding a fifth plank to the
judge's opinion in Heydon's Case: judges interpreting statutes should take into consideration
how "those who must guide themselves by its words would reasonably understand the intent
of the Act").


451. See Coffee, supra note 188, at 1665 (arguing that a charter amendment have sufficient
specificity to permit the shareholders to "appreciate its likely impact at the time they approved
it"—in other words, to "price the difference between the provision and the normally
applicable legal rule").

452. The odd nature of state antitakeover statutes (control share statutes, business
combination statutes, and the like) is explained by states attempting to navigate the shoals of
federal constitutional law. See Alan R. Palmiter, The CTS Gambit: Stanching the Federaliza-

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offered organized investors nearly equal political footing with business executives.453

Applying Fuller's insights to the general issue of shareholder suffrage, we ought to inquire into the defining purposes of state corporate code provisions on shareholder voting. State codes ascribe to the board two basic, overlapping functions. First and foremost, the board administers the voting machinery, establishing the rules on who votes, when, and on what. Second, the board initiates changes to a firm's voting structure, through charter amendments or statutory mergers, that the board considers to be in the firm's best interests. In both cases, the statutes consciously do not empower the board to affect the outcomes of the election, other than as an advocate.454

With regard to the board's administrative function, the board (as some agency must) supervises the organization and the holding of shareholder meetings. The board's ministerial role, however, goes beyond the details of planning, scheduling, and administering a shareholder meeting. The board is also responsible for minimizing the impact of crackpot shareholder minorities, who can abuse their access to a shareholder meeting to grandstand for personal causes at the firm's expense. The board does this primarily by using its control over the corporate funding of the proxy mechanism.

The board is also an innovator. A firm's voting arrangement, like the rest of its governance structure, cannot remain forever static. Corporations are relational arrangements that must adapt to shifting business and capital environments. Board experiments in voting structures—new voting procedures, staggered boards, dual-voting classes—have a place. Over time, however, some of these innovations may become devices for entrenchment, and courts should be prepared to intercede when board innovations have run their course. The board's involvement in elections is necessarily problematic. Keeping crank minorities from exploiting the voting machinery at majority expense lies a close step away from keeping the majority from exercising control rights. Moreover, a board designing a voting structure to optimize firm value is a close step away from a board designing a voting structure to assure self-perpetuation. There is an inherent conflict of interest when the board both decides the details of election procedures and places its current members up for re-election.

453. See id. at 536-41 (describing impact of institutional shareholders and other organized shareholder groups on the drafting of the Delaware and Pennsylvania antitakeover statutes); Roberta Romano, Competition for Corporate Charters and the Lesson of Takeover Statutes, 61 Fordham L. Rev. 843 (1993) (same).

454. It is not enough, as Professor Thomas suggested, that the courts critically examine the managers' actions when they "impair the ability of shareholders to exercise their franchise effectively." Thomas, supra note 18, at 525. This test describes neither the limits on the board's administering the voting mechanism nor the limits on the board's implementing new voting structures.
American courts do not so casually tolerate this confluence of ministerial discretion and campaigning in political elections. The potential conflict of interest in the corporate system is obvious to even casual observers. We necessarily rely on state courts to oversee corporate management in ways comparable to those of courts in political elections.

As we have chronicled, state courts at present have a narrow view of their corporate policing role. If the conflict is evident on the facts (that is, there is an ongoing proxy contest), courts subject board actions affecting the voting process to strict scrutiny. There is excessive judicial tolerance, however, when a board introduces voting procedures outside the heat of a voting contest or when shareholders have ratified a change in procedures. This is unfortunate. After more than a decade of experience, many "ministerial" provisions cannot be explained as anything but thinly disguised entrenchment techniques. If adopted during the heat of an election battle, they would resoundingly fail a Schnell inquiry.

Consider, for example, advance-notice requirements. The usual board justification for these unilateral bylaw provisions, that an insurgent slate of candidates should not ambush the shareholders, is inherently suspicious on two counts. First, shareholders generally have at least as long to consider the insurgent's slate as to consider management's slate or views. Second, the "ambush" argument smacks of the paternalism explicitly rejected as a justification by Chancellor Allen in Blasius. At some point, this notion progresses from providing shareholders with desirable information into management self-promotion. If managers include these ministerial provisions only to protect passive shareholders, as they claim, the board should be prepared to waive the procedures once the insurgency shows itself not to be exploiting shareholder passivity any more than management does.

In sum, the courts ought not to construe the broad statutory delegations to boards of authority over a firm's voting processes to mean that anything within the boundaries of the statute's language is acceptable board behavior. Rather, the judiciary ought to understand these statutes as favoring board flexibility within the purposes of the grant. The statutory provisions, which outline the framework of the basic voting agreement, give boards ministerial discretion over voting mechanics and the power to initiate changes in the voting structure. The open-ended texture of the language invites, and perhaps even demands, greater judicial review, not less, of board action that is potentially self-serving.

If courts do not shoulder their responsibility, a system of detailed mandatory rules similar to those found in state election codes may be inevitable. Recent demands by institutional shareholders to the SEC for greater specificity in such matters as voting confidentiality, access to shareholder lists, and participation in the nomination process suggest that state judges have failed in their interpretive functions. Although Schnell

455. In states, for example, the amount of discretion vested in elected officials to set the details of the election is minimal. Moreover, most states make careful provision for election observers and have other protections. See generally Colo. Rev. Stat., § 1 (1980).

provides the doctrinal tools for judicial intervention, the cases reflect a prematurely stunted growth.\textsuperscript{457}

C. A Case Study in Schizophrenia: Combined Proxy Fights and Tender Offers

The most significant, recent judicial refusals to apply the Schnell doctrine come in cases involving combined proxy fights and tender offers. As we noted above, target boards that attack both tender offers and proxy fights seem to garner softer review than those defensive actions that target pure proxy contests.\textsuperscript{458} The judicial thinking in these cases seems to proceed as follows: a two-step strategy is really a tender offer in disguise; a tender offer is a distinctly more dangerous takeover tool than an election contest; a two-step defense (though it aims at voting) deserves more judicial deference than a defense to a pure proxy contest.\textsuperscript{459}

At first glance, the courts seem justified in their conclusion that tender offers and two-step strategies are functionally equivalent. A tender offer is powerful indirect voting. Tendering shareholders effectively cast their ballots for the bidder's plan, which is carried out only because the tendered shares carry a vote.\textsuperscript{460} A two-step strategy merely changes the sequence of events in a tender offer. In a two-step transaction, the insurgent-bidder replaces the board before (rather than after) acquiring a majority block, and shareholders receive their consideration after (rather than when) control changes hands.\textsuperscript{461} Seeing this functional equivalence, some have called for Schnell review of tender offer defenses.\textsuperscript{462}

\textsuperscript{457} Professor Thomas, for example, urged courts to place on incumbents the burden of persuading the court "that tangible benefits conferred upon shareholders justify the negative impacts of defensive tactics." Thomas, supra note 18, at 507. Yet Delaware already has such a test: the "compelling justifications" of Blasius. The problem is not the absence of law on the subject—the problem is one of judicial application and interpretation.

\textsuperscript{458} For an answer to the intriguing issue in two-step proxy contest/tender offers—what are the obligations of an insurgent board after it wins a proxy contest and before it approves a tender offer—see John M. Olson, The Fiduciary Duties of Insurgent Boards, 47 Bus. Law. 1011 (1992).

\textsuperscript{459} See Thomas, supra note 18, at 544-48 (reviewing the academic literature that tender offer defenses allow managers to negotiate higher competing bids and prevent shareholders from opportunistically reneging on implicit promises to management of job security). Professor Thomas concluded that courts should "balance legitimate threats to the corporation against the shareholders' right to control their investment." Id. at 548.

\textsuperscript{460} "There is, indeed, little difference between a voting process case and the shareholder disenfranchisement inherent in such devices as lockups and poison pills." Ribstein, supra note 44, at 128.

\textsuperscript{461} Moreover, the functional equivalence exists whether the insurgent offers a tender offer, a recapitalization, or another back-end transaction for value. For example, an election contest for an equity-for-debt recapitalization produces the same result as an equity-for-debt tender offer; an election contest for a debt-financed cash dividend looks like a leveraged cash tender offer.

\textsuperscript{462} Loewenstein, supra note 249, at 98 (decrying judicial failure to apply Schnell to the equivalent fact pattern of tender offer defenses).

Nonetheless, Schnell-Blasius would avail little in tender offer cases if limited, as in the case of voting, to protecting only the tendering process. Corporate law already eminently protects that process. State law's general antipathy to restraints on alienation, particularly in the public
Nonetheless, a closer investigation reveals that the two strategies are fundamentally different. Even if judicial deference to board paternalism is called for in tender offers, the same deference has no place in a two-step election contest/tender offer. In a two-step takeover, the shareholder vote to replace the board occurs before shareholders sell their shares; in a straight tender offer the board is replaced after the sale. This timing difference has important implications.

A two-step strategy in which shareholders vote before they tender raises fewer concerns of shareholder coercion. Like a bidder faced with a control-share statute, the two-step insurgent-bidder must make its arguments to shareholders acting collectively before appealing to them individually and perhaps coercively. Insurgent-bidders have not used—no doubt because they cannot as a practical matter—structurally coercive front-end-loaded two-tier offers, the widespread justification for takeover defenses and antitakeover statutes. Because there is no risk of stub value in an election fight, shareholders are not put into a prisoner's dilemma. Indeed, some legal economists have argued that all tender offers ought to have, by law, voting mechanisms attached to the offers.

Because a two-step strategy takes longer than a straight tender offer, shareholders and the market have more time to develop and absorb information. As has happened in recent two-step contests, the board also has greater opportunities to “jawbone” shareholders and to introduce the concerns of nonshareholder constituencies. If the insurgent-bidder plans to finance its bid by leveraging the firm or by breaking it up, the voting process can become the setting for a political debate, certainly more so than

corporation, disempower any board attempt to manipulate liquidity rights under a standard approximating that of Schnell-Blasius. Moreover, the federal Williams Act preempts management interference with the tendering process. 15 U.S.C. § 78n(d) (1988). The Supreme Court in CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987), invalidated the first generation of antitakeover statutes, aimed specifically at the tender offer process, and even after Edgar v. MITE Corp., 457 U.S. 624 (1982), they have not been revived. See Palmiter, supra note 452, at 535-41.

463. Professor Thomas argued that judges should review proxy contest defenses to see whether the board is justified in believing that shareholders are misinformed or lack the proper incentives to recognize opportunistic insurgents. Thomas, supra note 18, at 557-60. For example, Thomas might allow the board to create a poison pill directed at an insurgent if the board thought management “could do a better job of selling the company or restructuring it than could the dissidents.” Id. at 558. It is unclear, though possible, that the proportionality review that Thomas urged is less demanding than the “compelling justifications” standard laid out in Blasius. This would be an unfortunate step backward.

464. Control share statutes limit an unwanted bidder's right to aggregate the votes of any “control shares” the bidder holds, subject to the remaining shareholders restoring full voting rights. The statutes deny any shareholder that acquires shares above a specified threshold, such as 20%, 33-1/3%, or 50%, the right to vote these incremental “control shares.”

One effect of a control share statute is to discourage an insurgent-bidder from acquiring a substantial voting block and then mounting a two-step strategy. The 20% threshold, reduced in some states to 10%, becomes for the outsider an effective cap, since any shares acquired above the threshold become nonvoting. The statute adds risk to the tactic of assembling a substantial voting block before seeking proxies, a particularly useful tactic for a company whose shares are concentrated in large voting factions.

the tendering process. Rather than a naked appeal to shareholders' pocketbooks, the insurgent-bidder must also appeal to their sense of community. Lately insurgents are better financed and more savory, often proposing strategic (not purely financial) transactions, and they approach shareholders and incumbent management on this basis.\footnote{466}

In fact, there is empirical evidence that a two-step election contest/tender offer may actually provide shareholders with more information for their voting decision than a straight election contest.\footnote{467} During the 1980s, shareholders were more likely to reject an insurgent-bidder who combined an election contest with a tender offer, compared to an insurgent who brought a straight voting contest. According to a Georgeson & Co. study of voting contests from 1984 to 1990, shareholders rejected two-step insurgent-bidders in 45.9% of the thirty-six contests in which the insurgent made a tender offer within six months of the vote.\footnote{468} By contrast, shareholders rejected insurgents in 37.1% of the seventy-two straight election contests. More telling, shareholders were nearly twice as likely to hand over control to an insurgent in a straight voting contest. Two-step insurgent-bidders won only 18.9% of the time in contests involving a combined bid, compared to 32.9% when the insurgent did not combine a tender offer. These statistics raise powerful doubts about the assumption that a combined election contest/tender offer is somehow more coercive and thus more deserving of board intercession.

The timing differences in a two-step control bid also create greater fiduciary constraints on a successful insurgent-bidder than a straight tender offeror. When an insurgent-bidder succeeds in the election contest, the new "insurgent" board is subject to fiduciary duties arguably more meaningful than those that apply to a successful bidder's "dominated" board.\footnote{469} Unlike a straight tender offer, in which the successful bidder holds a majority block and can readily enter into a back-end transaction, a two-step strategy often will leave the new insurgent board technically unaffiliated with the insurgent-bidder.\footnote{470} In considering the insurgent-bidder's second-step bid and whether to remove any impediments, the board continues to be subject to a full range of fiduciary duties.

As agent of the buyer and fiduciary of the sellers, the insurgent board has an ineluctable conflict of interest at least as great as that of an incumbent board defending against an unwanted bid. If the insurgent-bidder proposes a transaction that would result in a transfer of control from a "fluid aggregation of unaffiliated stockholders" to a single controlling
The board may have a Revlon duty to conduct an even-handed auction or explore other alternatives that maximize immediate shareholder value. The insurgent board may find itself in a dicey situation, since the earlier board might well have concluded the bidder's offer was inadequate, and Smith v. Van Gorkom teaches that the board must become fully informed about any offer it accepts. The insurgent board's "complete candor" duties also demand that the shareholders receive—again—full information on the bid, duties that open a further opportunity for ex post reexamination of the deal. That shareholders elected a board openly intending to sell to the insurgent-bidder does not preclude fiduciary review.

The timing difference also means that equity shareholders will—for at least a while—bear the full risk of their vote, forcing them to carefully value the insurgent-bidder's proposal. In a straight tender offer, shareholders pass the risk of the transaction entirely onto the bidder and new (often debt) risk bearers.

Finally, as the Delaware Supreme Court itself noted in the mid-1980s (and now seems to have forgotten) when it established the softer standard of review for tender offer defenses, if shareholders do not like board actions in tender offers, voting the board out is their ultimate and final threat. Without this final threat, shareholders are left, individually and disparately, to selling their shares at discounted prices. The lower stock price, by itself, is not even a moderate deterrent to board misbehavior in control contests. To entrenched managers, it is better to have a job with a capital-poor company than no job at all. The proxy fight changes their calculus, forcing managers to factor in the prospect of unemployment, even if they can mount successful tender offer defenses. Courts crafted the standards for tender offer defenses assuming the backstop of a proxy contest. To now absorb the proxy contest defenses into the forgiving judicial regime for tender offer defenses is conceptually and practically mistaken. Unless the courts stiffen considerably their review of all takeover defenses, whether in the context of shareholder voice or exit, deferential review of voting defenses exposes a judicial duplicity.

If judges had applied Fuller's analysis to the two-step cases, the outcomes would have been different. The corporate statutes on share-

472. 488 A.2d 858 (Del. 1985); see also Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993) (holding that when directors breach their duty of care by not becoming sufficiently informed they assume the burden to show that the transaction was nonetheless entirely fair, both as to its terms and the process of approval).
473. Professor Thomas pointed to empirical studies which indicate that the performance of poorly performing companies declines markedly after a successful insurgency if the new management does not restructure or sell the company. Thomas, supra note 18, at 552, n. 222 (citing David Ikenberry & Josef Lakonishok, Corporate Governance Through the Proxy Contest: Evidence and Implications, Rice University Working Paper No. 86, at 4 (1991) (finding that earnings decline after a dissident victory); and Lisa F. Borstadt & Thomas J. Zvirlein, The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post Contest Control Changes and Firm Performance, Working Paper, at 9 (Sept. 1990) (finding significant negative abnormal returns following a dissident victory not accompanied by a sale to another firm). This suggests that straight insurgencies should concern courts even more than two-stage contests in which the insurgent-bidder offers to assume all post-contest risks.
holder voting do not distinguish among voting situations; they apply generically. Accordingly, the court ought to ask in the combined proxy/tender offer cases, just as it ought to ask in all voting cases, whether the board is merely administering the details of shareholder voting or attempting to affect the outcome of the election. The answer to this question of fact will be tractable, if not obvious. As interpreters of the corporate voting agreement, judges shirk their responsibility by not facing the question and sticking to the answer.

V. Conclusion

The shareholder franchise, more tested than ever, stands at a defining juncture. With the potent tools of Schnell to enforce the promises of the basic voting agreement, state judges have great potential to enable a vigorous corporate democracy. Shareholder voting, typically a formality in public corporations, offers a critical means for making business and governance adjustments. In an age of rapid financial, social, economic, and business changes, this flexibility has great value well beyond corporate politics. Age-old shareholder voting offers a discerning governance tool for firms to confront dynamic change.

What should be the personality of state judges toward shareholder voting? Within the Schnell domain, the judicial personality toward voting seems whole and healthy. When boards manipulate the voting process or dilute voting majorities, the pitch of judicial review is unmatched in corporate law—as should be the case. The Delaware courts, however, falter in some important respects outside the often narrow Schnell boundaries, and we urge greater judicial resolve in important areas:

1. Judges should recognize the pre-eminent status of voting in situations that combine voting and selling, particularly two-step proxy contests/tender offers. By permitting management defenses in this context, the courts renege on the fundamental assumption underlying Moran and Unocal that (despite tender offer defenses) shareholders nonetheless remain empowered to kick the board out.

2. Judges should look with suspicion on board-initiated innovations to voting structures. The “complete candor” cases seat judges as “reasonable shareholders” to reformulate the terms of corporate mergers and other fundamental transactions. The cases that interpret shark repellent amendments could learn from the thinking in the disclosure cases.

3. Judges should recognize, as have some federal courts, that the board’s role as voting administrator entails facilitative duties. In the face of a legitimate insurgency, courts should demand that boards undo voting impediments by providing, for example, management-available NOBO/COBO shareholder lists, waiving advance-notice requirements, and permitting broader shareholder communications. The board remains empowered to screen crackpot shareholder minorities, using the ministerial exception to Schnell, the board’s discretion to reimburse proxy expenses, and the “proper purpose” test for requests of shareholders’ lists.
If state judges do not accept a greater role—one that admittedly will test political resolve and courage—our corporate law will be the loser. Shareholders will increase their pressure for federal, principally SEC, intervention; such intervention would no doubt be wooden and reactive. As proof, witness the meandering ebb and flow of fifty years of the SEC shareholder proposal rule. The SEC has a history of extremism in regulatory drafting, either overgeneralizing or making its rules unduly technical. The SEC's failure to define "tender offer" or to specify what constitutes insider trading are two cases in point. Moreover, the conceptual incoherence of recent voting cases in federal court raises doubts about the federal judiciary's competence to interpret the corporate voting agreement.

Even were shareholders able to obtain greater details of their voting rights in state codes, it is unclear we would be better off than we are now. Managers and their lawyers will predictably find ways around the text of a statute, no matter how carefully crafted. The history of corporate law shows that for every offensive weapon insurgents devise, managers find an even more effective defensive response. Only judicial constancy offers a defining solution in this area of fluid tension between shareholder rights and management powers.

This is not say that the judicial task demands incessant and painful intercession. Judges, as is true throughout the law, have a number of alternatives at their disposal. For example, they could create safe harbor procedures for boards that delegate voting supervisory functions to outside, independent election inspectors, who would not only tally voting results but administer the mechanics of shareholder voting. Professional election inspectors could offer their services to corporate voting disputants, creating a private industry similar to those offered for mediation and arbitration disputes. An insurgent might, for instance, submit at the outset a list of acceptable election inspectors. Deferential review of the actions of neutral, well-meaning, diligent inspectors would guide and encourage the process.

Courts could also designate, and then forcefully stick with, categories of voting defenses that are beyond the pale. To a certain extent, this has already happened. Poison pills aimed at proxy gathering have garnered great judicial hostility. Empirical data—both from event studies and experience in past cases—would be useful in formulating the categories. Evidence, for example, that boards often put in sixty-day advance-notice bylaws in the heat of an election contest ought to reflect negatively on all sixty-day advance-notice bylaws, whether promulgated in response to a threatened voting contest or not. The Datapoint line of cases on bylaw changes that impede consent solicitations suggests the beginning of such an approach.

In the end, there will always be a residuum of cases in which the board has some discretion over the voting process that cannot be delegated to independent actors or that cannot be scripted by state statute or case law. In these cases, state judges should not shirk their oversight responsibilities to

\[474.\] Thomas, supra note 18, at 553-54 (suggesting studies on shareholder demographics at particular firm to decide on validity of poison pill threshold).

\[475.\] See supra text accompanying note 237.
protect shareholders against obvious conflicts of interest when incumbents establish election procedures. Judges should return to their time-honored role and evaluate the effect of voting impediments in light of the purposes, not the bare text, of the state corporate codes.

Ultimately, the question is one of political will. We place on our judges a difficult task when we ask them to countermand well-intentioned managers who believe obstructive voting procedures or a particular outcome are in a firm’s best interest. In Delaware, it is often politically correct—in the full sense of this term—for state judges to lend their support to management. Rebuking political correctness is at the heart of political courage.