BLASIUS AND THE DEMOCRATIC PARADIGM IN CORPORATE LAW

By Andrew C. Houston*

If the dominant issue in corporate law in the early and middle 1980s was the hostile tender offer and the response of target corporation boards of directors to it, the dominant issue in corporate law in the late 1980s and early 1990s has become corporate voting. This can be traced to two factors.

First, the efficacy of tender offers and corporate takeovers themselves has become dependent on voting. The widespread adoption of second-generation control share acquisition statutes[1] and business combination statutes,[2] which typically provide that a corporation's board of directors can vote to opt the corporation out of the operation of the statute, following the United States Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*,[3] together with the widespread adoption by United States corporations of so-called poison pill rights plans, which are typically redeemable by a corporation's board,[4] renders control of a corporation's board a necessary prelude

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* Partner, Wachtell, Lipton, Rosen & Katz, New York, New York. B.A. Yale University; M.A., Ph.D., Cornell University; J.D., Yale University. This article was completed in January 1992 and does not include or discuss developments in the law occurring after that date.

1. Control share acquisition statutes typically provide that, in order to vote "control of shares" after their acquisition, the acquiror must secure a vote of the target corporation's disinterested shareholders. *See, e.g.*, Ariz. Rev. Stat. Ann. § 10-1211 (1991); Haw. Rev. Stat. §§ 416-171 to -172 (1990); Ind. Code Ann. § 23-1-42 (Burns 1991); La. Rev. Stat. Ann. § 12:135 to 140.2 (West 1992); Mass. Gen. L. ch. 110D (1992); Minn. Stat. Ann. § 302A.671 (West 1992); Mo. Ann. Stat. § 351.407 (Vernon 1992); Nev. Rev. Stat. § 78.378 to .3793 (1991); N.C. Gen. Stat. § 55.9A-01 to -09 (1991); Ohio Rev. Code Ann. § 1701.831 (Anderson 1991); Okla. Stat. tit. 18, §§ 1145-1155 (1992); Utah Code Ann. § 61-6-1 to -6-12 (1989); Wis. Stat. Ann. § 180.1150 (West 1991).

2. Business combination statutes typically prohibit or limit the ability of an acquiror of shares in a corporation to effectuate a business combination with the target corporation for a period of years unless certain conditions are met. *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 10-1222 to -1222 (1991); Del. Code Ann. tit. 8, § 203 (1991); Ind. Code Ann. § 23-1-43 (Burns 1991); Ky. Rev. Stat. Ann. § 271B.12-200 to -230 (Baldwin 1991); Minn. Stat. Ann. § 302A.673 (West 1991); Mo. Ann. Stat. § 351.459 (Vernon 1992); N.J. Stat. Ann. § 14A:10A (1991); Wash. Rev. Code § 23B.11 (1991).

3. 481 U.S. 69 (1987).

4. "Poison pills" typically involve the issuance of warrants or preferred stock that provide for favorable exercise or conversion rights in the event of a change of

to a large scale purchase of its shares in many instances.[5] Hence, in the takeover world, the offense has turned to combined tender offers and proxy fights, with the defense frequently centering on measures, such as the formation of leveraged employee stock option plans (ESOPs), designed to influence corporate voting.[6]

Second, the recent increase in institutional shareholder activism has also focused attention on issues relating to corporate voting.[7] This is perhaps best exemplified in the SEC's recent "proxy reform" proposals and the responses of several large, institutional shareholders and shareholder groups to those proposals.[8]

In Delaware corporate jurisprudence, the leading recent case on corporate voting is the decision in *Blasius Industries, Inc. v. Atlas Corp.*[9] This article will closely scrutinize the relevant portions of *Blasius* to ferret out their assumptions on corporate voting and the meaning of those assumptions. This author argues that the central holding implicit in *Blasius* is that shareholder voting rights trump directorial powers when the two conflict. This holding is justified by resort to a paradigm under which democratic ideals are central to corporate law. In the final portion of this paper, this paradigm is criticized, several alternative paradigms for corporate voting are suggested, and some of the considerations involved in choosing between these paradigms are outlined.

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control. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (upholding share purchase rights plan with "flip over" provision); Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 30-31 (1987).

5. *See* Randall Smith, *Storming the Barricades with a Proxy*, Wall St. J., May 10, 1990, at C1. *See generally* Robert J. Klein, *The Case for Heightened Scrutiny in Defense of the Shareholders' Franchise Right*, 44 STAN. L. REV. 129, 135-38 (1991) (providing suggestions for proxy reform and discussing the use of poison pills to gain control of a corporation).

6. *See, e.g.*, NCR Corp. v. American Tel. & Tel. Co., 761 F. Supp. 475 (S.D. Ohio 1991) (holding that ESOP formed primarily to thwart tender offer was invalid); Shamrock Holdings Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989) (upholding ESOP where intent was, at least partly, intended to increase long-term corporate earnings).

7. *See generally* Klein, *supra* note 5, at 132-35; Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991).

8. *See* Letter from United Shareholders Association to Jonathan G. Katz, Secretary, SEC (May 20, 1990); Letter from California Public Employees Retirement System to Linda C. Quinn, Director, Division of Corporate Finance, SEC (Nov. 3, 1989).

9. 564 A.2d 651 (Del. Ch. 1988).

I. *BLASIUS*

A. The Facts

The controversy in *Blasius* began when two businessmen, Michael Lubin and Warren Delano, took control of Blasius Industries "with the assistance of Drexel Burnham's well noted junk bond mechanism."[10] Blasius, in turn, acquired a position of some nine percent in Atlas Corporation and filed a Schedule 13D with the SEC, indicating its intent to encourage Atlas management to consider a restructuring or other transaction.[11] At a meeting with Atlas management shortly after the filing of the Schedule 13D, Lubin and Delano proposed a leveraged recapitalization of Atlas.[12] Atlas' management reacted negatively to the proposal, but referred the matter to its investment banker, Goldman Sachs & Co., for study.[13]

While the Goldman Sachs study was underway, Blasius delivered to Atlas an executed consent, seeking (1) adoption of a precatory resolution recommending that the board adopt a restructuring proposal, (2) an amendment to the Atlas bylaws increasing the board from seven to fifteen members, and (3) election of eight named persons to fill the new directorships.[14] Following receipt of this consent, Atlas called an emergency board meeting. At the meeting, the Atlas Board voted to amend the company's bylaws to increase the company's board from seven to nine members and appointed two new directors to fill the newly created posts.[15] Under Atlas' certificate of incorporation, which provided for staggered voting, the terms of these two new directors extended until 1988 and 1990.[16] More importantly, because Atlas' certificate of incorporation provided for a maximum of fifteen directors, the board's action insured that the Blasius consent solicitation could not result in majority representation on the board for Blasius.[17]

Approximately one week after this action, Goldman Sachs presented its report on the proposed leveraged recapitalization to the

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10. *Id.* at 653.
11. *Id.*
12. *Id.* at 653-54.
13. *Id.*
14. *Id.* at 654.
15. *Id.* at 654-55.
16. *Id.* at 655.
17. *Id.* at 654.

Atlas Board. The presentation concluded, in effect, that the recapitalization was neither feasible nor financially prudent.[18]

B. Contentions of the Parties

Not surprisingly, the parties argued to different legal conclusions from these facts. Plaintiffs argued that the Atlas Board's action constituted "a selfishly motivated effort to protect the incumbent board from a perceived threat to its control of Atlas."[19] In doing so, they placed principal reliance on *Schnell v. Chris-Craft Industries*.[20] Defendants, on the other hand, argued that the board was not self-interested because nothing in Blasius' consent solicitation or proposals threatened the positions of existing board members.[21] They argued that the protections of the business judgment rule applied to their actions and that, even if the less lenient, intermediate standard of review first propounded in *Unocal Corp. v. Mesa Petroleum Co.*[22] applied, defendants' behavior met that standard as well.[23]

C. The Court's Findings

Faced with these facts and contentions, the *Blasius* court made a series of findings that appear to have been designed to set up the legal discussion to come. The court's principal finding, which it called "critical" to its analysis of the issues, was that Atlas' Board acted for the principal purpose of preventing the shareholders from placing a majority of new directors on the Atlas Board.[24] The court made it quite clear, however, that in so finding it was not also finding that the board was selfishly motivated.[25] Indeed, it concluded that the board acted "not selfishly, but in order to thwart implementation of the recapitalization . . . ."[26] Thus, the court explicitly found good faith on the part of the Atlas directors.

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18. *Id.* at 657.
19. *Id.* at 657.
20. 285 A.2d 437 (Del. 1971). In *Schnell*, the Supreme Court of Delaware held that management's utilization of the corporate machinery and the applicable laws for the purpose of perpetuating itself in office was inequitable and would not be deemed legally permissible. *Id.* at 439-40.
21. *Blasius*, 564 A.2d at 657-58.
22. 493 A.2d 946 (Del. 1985).
23. *Blasius*, 564 A.2d at 657-58.
24. *Id.* at 655.
25. *Id.* at 656, 658.
26. *Id.* at 658.

The court's finding of good faith was critical to its analysis. It is that finding that allowed the court to go on to assert that "the real question" is whether "the board, even if it *is* acting with subjective good faith . . . may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors."[27] However, the court subsequently shifted from asking whether, in the given circumstances, a good faith standard or something stricter applied to asking whether the *Unocal* standard or something stricter applied.[28]

This is not at all the same question. *Unocal* imposes an objective standard to evaluate a board's actions. The first part of the two-part test asks whether the board's perception of a threat was reasonable, and the second part asks if the board's response was reasonable in relation to the threat perceived.[29] This test is not satisfied by a mere finding of good faith.[30] This point is worth making because, while the court made a finding of directorial good faith in *Blasius*, it did not make, at least explicitly, sufficient findings to conclude that the *Unocal* standard was met. The court simply held, without explanation, that the board reasonably perceived the proposed recapitalization as a threat to Atlas.[31] But it did not hold, as it must under the *Unocal* standard, that the Atlas directors' response was reasonable given the threat they perceived.[32] Nor, for that matter, did the court find that the Atlas directors acted advisedly in approving the expansion of the board.

The court went on to question the applicability of the *Unocal* standard.[33] The arguments relating to this question are the centerpiece of the *Blasius* decision, and they are, therefore, worth exploring in some detail.

Blasius presented two arguments. The first, in subsection IV(1)(A) of the opinion, shall be called the legitimacy argument.[34] The second,

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27. *Id.* (emphasis omitted).
28. *Id.* at 658-59.
29. *Unocal*, 493 A.2d at 955.
30. *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 115 (Del. Ch. 1986).
31. *Blasius*, 564 A.2d at 658.
32. *Unocal*, 493 A.2d at 955. *See also* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989).
33. *Blasius*, 564 A.2d at 659.
34. *Id.*

in subsection IV(1)(B), shall be called the allocation of powers argument.[35]

D. *The Legitimacy Argument*

Blasius' legitimacy argument is brief, eloquent, and puzzling. It has two aspects: (1) the rejection of any functional explanation or justification of shareholder voting, and (2) the theory that shareholder voting is necessary to legitimate directorial power.

It is quite clear that *Blasius* rejects the view that the justification for shareholder voting for directors lies in its function in disciplining or controlling wayward or ineffective directors and managers.[36] Indeed, *Blasius* appears to argue that the true justification for corporate voting is independent of any function that corporate voting plays in making the corporation operate more efficiently as an economic entity.[37]

Blasius' rejection of any functional view of corporate voting is striking. After all, one version of the functional view, the view that shareholder voting is justified as one means by which shareholders can exercise control over directors, is perhaps the dominant academic paradigm for analyzing voting rights.[38] More generally, it is surprising that *Blasius* looks to the realms of politics and ethics, rather than economics, to resolve a problem of corporate law.

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35. *Id.* at 659-60.

36. Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 735 (1992). [71-72 in 10/21/91]

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

38. *See, e.g.*, Bernard S. Black, *Shareholder Passivity*, 89 MICH. L. REV. 520 (1990) (asserting a law and economics theory to resurrect shareholder voting as a constraint on management); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991) (proposing a strategy for improving corporate governance that is largely within the shareholders' control). *See generally* William J. Carney, *Controlling Management Opportunism in the Market for Corporate Control: An Agency Cost Model*, 1988 WIS. L. REV. 385; Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Mark J. Loewenstein, *Toward an Auction Market for Corporate Control and the Demise of the Business Judgment Rule*, 63 S. CAL. L. REV. 65 (1989); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). *But see* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 190-202 (1991) (rejecting the proposition that conformity to stockholder wishes is the primary role of corporate governance). *See also* John W. Ellwood, *The Effects of Mergers and Acquisitions on the Governance of the Modern Corporation*, *in* HANDBOOK OF MODERN FINANCE 31-1 to -53 (Dennis E. Logue ed. 1990) (providing a comprehensive survey of the recent academic literature addressing corporate governance).

Nevertheless, it is clear that *Blasius* rejects any functional justification of corporate voting. It is less clear what view it proposes to replace it with. There are really only two sentences in the relevant portion of *Blasius* that actually bear on this. The first states that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[39] Several sentences later, after raising and rejecting the functional "control" view, *Blasius* amplifies on this remark, stating that the shareholder franchise "is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own."[40]

Despite the references to the "theory that legitimates" and the "ideological underpinning" of directorial powers, as if these were commonplace, it is unclear what theory or ideology is being invoked. It might be thought that to determine what theory underlies the corporate voting provisions of the Delaware General Corporation Law (DGCL) we should make reference to legislative history, or at the least to cases construing and explaining those provisions. However, *Blasius* cites neither legislative history nor case law to explain what the theory in question is or to confirm the assertion that it is the theory referred to that underlies the voting provisions of Delaware corporate law.

In the absence of such materials, we must speculate to some extent as to what *Blasius* is saying. At first blush, there would seem to be two readings. The first, somewhat prosaic, reading is: As a general matter, Delaware law provides that corporate directors are selected by shareholder voting; that being so, any action that destroys the legitimacy of a corporate election robs the directors chosen in that election of legitimacy under Delaware corporate law.

There are, however, several problems with this interpretation. First, the language in which *Blasius* presents the argument certainly seems to promise more than this. Indeed, it specifically contrasts the "broad, institutional perspective" that it takes in the legitimacy argument with the "less generalized, doctrinal point of view" represented in the allocation of powers argument.[41] It is the latter argument that appeals to principles of Delaware corporate law and

39. *Blasius*, 564 A.2d at 659.
40. *Id.*
41. *Id.*

which is cited to in cases and statutes, all of which are absent from the legitimacy argument.[42]

Second, if this is all that *Blasius* is saying, then it is not clearly rejecting or proposing an alternative to the functional view. After all, proponents of the functional view could agree with everything in the legitimacy argument. For example, one could agree that shareholder voting is the proper method for selecting directors under Delaware corporate law and that if the shareholders' right to elect the directors is interfered with, then the directors lack legitimacy. Thus, this narrow construction of *Blasius*' view does not clearly distinguish it from the functional view that it rejects.

It seems, then, that *Blasius* must be arguing something stronger. Indeed, it seems it must be arguing that it is not a matter of the narrower concerns of Delaware corporate law, but of a more general political or ethical theory, that only directors who are elected by shareholders can legitimately exercise power over corporate property.

The problem with this view, of course, is that *Blasius* does not, in fact, give any argument for it, and it is doubtful whether it is true. It is not easy to point to any general political or ethical theory that requires directors of corporations to be elected by shareholders. In our society, most people believe that only a *government* that enjoys the consent of the governed is legitimate, and most would agree that, as a practical matter, elections are the most effective means through which this consent can be demonstrated. This is necessary because governments are by nature public, all-inclusive bodies that exercise coercive force on citizens in a variety of ways. These charateristics do not necessarily apply to corporations because corportions, as opposed to governments, are inherently private and shareholder participation is voluntary.

Blasius implicitly suggests that for it to be legitimate for corporate directors to exercise power over "vast aggregations of property that they do not own," voting is required.[43] However, it is hard to see why. Corporations that own large aggregations of property do so because people voluntarily capitalized them at the outset and voluntarily did business for and with them, causing that capital to grow. If the directors of such corporations were not elected, but were self-perpetuating, would this really pose an ethical or political problem? Of course, there might be a problem with the value of the corpor-

42. *Id.* at 659-60 & n.2.
43. *Id.* at 659.

ation's shares if the corporation was not run in the shareholders' interests and the shareholders were unable to do anything about it. But to say that is to revert to the functional theory that *Blasius* rejects.

Indeed, it is striking that *Blasius* seems to imply that there is a serious ethical or political problem with a business form similar to the Delaware corporate form that lacks any of the control characteristics of shareholder voting.[44] While one might seriously question the efficiency of such a form, no one believes that the directors and trustees who run them lack legitimacy in some fundamental way.

While *Blasius* is not explicit about this, the legitimacy argument seems to appeal to an analogy between political and corporate bodies. Specifically, it appeals to an analogy between a central problem of political theory—how can it be justified for one person to rule over another—and a supposedly analogous corporate law problem—how can it be justified for one person to exercise control over another person's property. However, the value of this analogy is doubtful. The corporate law question is not quite as problematic as the political question. It is answered almost definitionally: If you want to conduct a business in the form of a large, publicly owned corporation, then these characteristics of control are inherent. This is pointed out by the difference between quasi-corporate forms of business where the board is self-perpetuating, which do not pose any ethical problems, and political bodies with self-perpetuating leaders, which many would view as ethically and politically problematic.

E. The Allocation of Powers Argument

Blasius' second argument in support of the proposition that *Unocal* does not apply to actions of a board designed to affect a corporate vote is the allocation of powers argument. The central point of this argument is the assertion that the type of decision under review "does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights and obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation."[45] While the business judgment rule applies to the former type of decision, it

44. One such form is the so-called Massachusetts Business Trust, which may be set up with self-perpetuating trustees. *See* HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 61 (3d ed. 1983).

45. *Blasius*, 564 A.2d at 660.

cannot apply, *Blasius* argues, to the latter, which is up to the court, not the directors, to decide.[46]

This argument is stated so briefly that it obscures the fact that the argument does not support the conclusion the opinion draws from it. For *Blasius* concludes from the argument not only that allocation of powers questions are for the court rather than the directors to decide, but also that an especially strict standard of review applies to directorial action that involves allocation of powers issues. Indeed, immediately following the allocation of powers argument, *Blasius* proceeds to the question of which especially strict standard applies, a per se rule of invalidity on the one hand or one that requires compelling justification on the other.[47] The conclusion that an especially strict standard of review applies, however, does not follow from the allocation of powers argument.

Of course, *Blasius'* assertion that that allocation of powers between the directors and the shareholders is not a matter for the business judgment of the directors is correct. Corporate directors are not empowered to do anything they believe is reasonable and in the best interests of the corporation. They must also have a basis for their decisions in the Delaware corporation statute and in the corporation's certificate and bylaws.[48] Whether they have such a basis or not is a question for the court, and the court clearly owes no deference to the directors' judgment when questions of this type are presented.[49]

The aforementioned, however, does not get *Blasius* to the conclusion it apparently wants to draw, to wit, that it should apply an especially strict standard in reviewing breaches of fiduciary duty by directors that affect the corporate franchise. Stated another way, *Blasius* proceeds as if the issue is: What sort of standard of review should be applied to the directors' actions for purposes of determining whether their fiduciary duties have been met. But allocation of powers questions are not questions of fiduciary duties of loyalty and care at all. Rather, they are questions about how the powers of the directors and the shareholders are to be measured and balanced

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46. *Id.*

47. *Id.*

48. *See, e.g.*, *Moran*, 500 A.2d at 1350 (citing *Unocal*, 493 A.2d at 954, and asserting that "[w]hen a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders").

49. *Id.*

under the corporation statute, the certificate of incorporation, and the bylaws.

This then brings us to one of the most remarkable aspects of *Blasius*. Having posed the question of corporate control as one of allocation of power between the directors and the shareholders, and having identified that issue as one for the court to resolve, *Blasius* does not explicitly discuss the question of control.[50] Rather, it effectively assumes that, wherever shareholder voting is involved, directorial power has to give way. It is only this strong assumption, that shareholder voting provisions trump directorial power provisions of the DGCL, not the much weaker proposition that allocation of powers questions are for the courts to decide, that gets *Blasius* to its conclusion that the directors must show compelling justification before taking any actions designed to affect the corporate franchise.[51] In other words, when the powers of the directors conflict with the voting rights of the shareholders, the shareholders' rights take precedence unless compelling justification can be shown.

F. The Ramifications of Blasius

So stated, *Blasius* has a number of important ramifications. It is worthwhile to describe these ramifications by outlining the allo-

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50. *Blasius* does not place a great deal of reliance on precedent, even in the allocation of powers argument that it labels as "doctrinal." It does, however, devote one extended footnote to the proposition that "Delaware courts have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights." *Blasius*, 564 A.2d at 659 n.2. *Blasius* cites a number of cases in support of this proposition, including Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971), and several cases following *Schnell*. Perhaps most interesting about this footnote, though, is that it is only a footnote. In other words, it raises an interesting question: Why did *Blasius* not place more reliance on *Schnell*? After all, *Schnell* was the principal authority relied on by the plaintiffs in *Blasius*, and perhaps the principal pre-*Blasius* case that comes to mind when one thinks of cases dealing with interference in corporate elections. Part of the answer is, no doubt, that the *Schnell* court, in effect, found bad faith in the case before it. Moreover, *Schnell* involved a more direct interference in the shareholder vote itself (changing the place of election with the result that fewer shareholders would attend) than *Blasius*, which indirectly affected the vote by changing the meaning that the vote would have rather than directly interfering with the vote itself. So it is possible that, on close analysis, the *Blasius* court regarded *Schnell* as not being a conclusive precedent, as plaintiffs urged. More generally, however, *Blasius* may have limited its discussion of *Schnell* because the court was interested in making a series of theoretical points about shareholder voting and its place in corporate law. Simple reliance on *Schnell*, which placed a greater emphasis on discussion of facts than on theories to reach its results, would limit the theoretical possibilities.

51. *Blasius*, 564 A.2d at 660-62.

cation of powers issues raised in *Blasius*. Section 141(b) of the DGCL provides generally that the number of directors on a corporate board can be set in the company's bylaws, unless the certificate of incorporation sets the number.[52] Atlas' certificate apparently set a ceiling of fifteen directors, but did not otherwise specify the size of the board leaving that determination to the bylaws.[53] Section 109 of the DGCL enables the directors to amend the bylaws if the corporation's certificate of incorporation so provides.[54] We must assume that the Atlas certificate granted the directors the power to amend the bylaws.

The action of the Atlas Board was thus taken pursuant to explicit authority in the DGCL and Atlas' certificate of incorporation. This being so, the issue posed by *Blasius* was whether or not the provisions of the corporation statute and the certificate that effectively gave the directors power to change the size of the board conflicted with the shareholders' right to elect the board and, if so, how the conflict is to be resolved. Once the problem is posed, it becomes apparent that *Blasius* effectively resolved this issue by limiting the section 109 power of the directors over the bylaws by reference to the sections of the DGCL that provide for voting for directors by shareholders.

If *Blasius* solely connected sections 109 and 141(b), the case would be, perhaps, of lesser importance than it is. However, the action of the Atlas Board did not rest solely on sections 109 and 141(b). It was also authorized by section 141(a), which provides that the "business and affairs" of every Delaware corporation shall be under the direction of its board of directors.[55] Although DGCL section 141(a) is not mentioned in *Blasius*, and *Blasius* does not use that section's key terms,[56] it is clear nonetheless that *Blasius* implies an important limitation on the scope of section 141(a)'s grant of power to the directors. Traditionally, the scope of section 141(a)'s grant of directorial power and the scope of the business judgment rule have been conceived to be the same because the statutory basis of the

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52. *See* DEL. CODE ANN. tit. 8, § 141(b) (1990).

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

54. *See* DEL. CODE ANN. tit. 8, § 109 (1990).

55. *See* DEL. CODE ANN. tit. 8, § 141(a) (1990). The Supreme Court of Delaware has held that § 141(a) confers "inherent powers" on directors to, among other things, respond to takeover attempts. *See Moran*, 500 A.2d at 1353; *Unocal*, 493 A.2d at 953.

56. *Blasius* phrases its holding in terms of the "property" or "rights and obligations" of the corporation, rather than the "business and affairs" of the corporation. *Blasius*, 564 A.2d at 660.

business judgment rule is section 141(a).[57] But *Blasius* suggests that section 141(a)'s grant of authority over the business and affairs of the corporation, and the corresponding protections of the business judgment rule, are limited to matters involving the "property" or "rights and obligations" of the corporation, and do not involve allocation of power over corporate governance between the shareholders and the board of directors.

This may be the most important result in *Blasius* and what makes it, in some respects, a radical opinion. Traditionally, the focus in Delaware law has been on the directors and their powers and prerogatives. Section 141(a) of the corporation law has been viewed as the ideological center of the DGCL. Indeed, the Supreme Court of Delaware has called section 141(a) the "bedrock of the General Corporation Law of the State of Delaware."[58] As a result, the Delaware courts have been loath to adopt any limiting construction of directorial powers.[59]

Blasius, however, drastically alters this approach. Section 141(a) is deemed to have no relevance to any problem that relates to allocations of corporate powers between directors and shareholders. A wide zone of freedom from interference in shareholder affairs is carved out. And, most strikingly, the new center and bedrock of the DGCL, displacing section 141(a), is the shareholder voting provisions.

II. THE DEMOCRATIC AND OTHER PARADIGMS IN CORPORATE LAW

Blasius' attempt to displace section 141(a) from the center of Delaware corporate law is achieved by reference to the legitimacy argument. This argument rests on an analogy between corporations and political bodies. In short, the basis of the opinion is a very powerful paradigm of the corporation as an entity that embodies fundamental, democratic values. Of course, this paradigm is clearest in *Blasius*' rejection of any functional explanation of corporate voting and its insistence that voting establishes the legitimacy of directorships themselves.[60] One of *Blasius*' principal achievements is its demonstration that if this paradigm is pursued to its logical conclusion,

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57. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *AC Acquisitions*, 519 A.2d at 111.

58. Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984).

59. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Lowenschuss v. Option Clearing Corp., No. 7972, slip op. at 8-13 (Del. Ch. Mar. 27, 1985), *reprinted in* 10 DEL. J. CORP. L. 882, 886-88 (1985).

60. *See Blasius*, 564 A.2d at 659.

shareholder voting, and not directorial power, becomes the centerpiece of corporate law.

The issue then raised is whether or not the paradigm is correct. *Blasius* does not cite any materials indicating what paradigm the legislators who fashioned the current system had in mind. Nor does it proceed from any analysis of the structure of the DGCL. In this respect, *Blasius* accurately reflects the absence of a clear paradigm underlying the law of corporate voting as it stands today.

It has been asserted above that there is no particular reason to see fundamental political or ethical values as factors in corporate law. Corporations are economic entities, created and sustained for economic reasons. The justification of particular features of corporate law lies in the realm of economics, specifically, in a functional view. This being the case, political metaphors are only marginally helpful in understanding corporate voting, though they are frequently used. A corporation is not a political body, and the reasons and rationale for its operation are completely distinct from that of a political body.

In particular, there is no reason to view corporations as analogous to democratic political societies, with the shareholders assuming the role of citizens and the directors that of an elected representative body. In any event, if political terminology must be used, it is inaccurate to view corporations as "democratic." "Plutocratic" would be a more apt description. After all, most of the constituencies that have an interest in corporate affairs, often larger than any one shareholder, do not and cannot vote unless they can also buy shares. And, of course, voting is proportional to shares owned, at least where the corporation follows the typical one vote/one share scheme.

If this theory is correct, then the democratic paradigm for corporate voting is misleading and should be abandoned. Moreover, any useful paradigm for contemplating corporate voting questions is likely to be a functional view, in which voting functions to make the corporation operate more efficiently. This raises the question of which functional paradigm to adopt. Clearly, that problem cannot be solved here. Instead, we can only sketch two alternative paradigms for corporate voting and suggest some of the considerations involved in choosing between them, or in developing other views.

One available paradigm is provided by the current academic literature which views relations between shareholders and directors as essentially one species of principal/agent relationship. This view envisions corporate voting as one of several means provided in corporate law for shareholder-principals to discipline or control di-

rector-agents.[61] This principal/agent paradigm suggests that voting should exert constant and strict control over management and that it is evidence of a failure in the system if voting does not function in that way.

The second paradigm is quite different and is more consistent with the way in which our system of corporate elections, under which electoral challenges to directors are a comparative rarity, currently works. This paradigm analogizes shareholders and directors to two different branches of corporate government, the constitution of which establishes certain checks and balances. Under this paradigm, voting is a mechanism by which the powers of the directors, which otherwise are very sweeping, can in certain circumstances be restrained. However, this restraint may function only occasionally, in exceptional circumstances. Thus, this paradigm suggests rather different implications than the principal/agent paradigm. Under this paradigm, the fact that the shareholder vote rarely functions to replace existing directors and management does not evidence any failure of the system.

Choosing between these paradigms, one which represents the view of the shareholder rights movement and the other which adheres to the status quo, is likely to involve a number of competing considerations. Carrying into effect the principal/agent paradigm within the present institutional framework poses the threat of significant problems. Virtually all corporation statutes impose a requirement of annual shareholder meetings and director elections.[62] Unlike many other rules, the pattern of annual elections cannot be varied by provisions of the certificate of incorporation. But vigorously contested annual elections would entail serious drains on both management and shareholder energies. They could also promote an extremely short time frame on management planning that could be deleterious to the long-term competitiveness of corporations. Thus, there are real, functional problems with the principal/agent paradigm.

On the other hand, the checks and balances paradigm also poses problems. First, this paradigm relegates voting to a position of comparatively little importance in the functioning of the corporation. If this is so, then we might wonder why so much voting is necessary. Put another way, if the corporation's annual elections will often be meaningless, as this paradigm suggests, one might ask why annual

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61. *See supra* note 38 and accompanying text.
62. *See* Klein, *supra* note 5, at 131.

elections have to be held at all. Second, this paradigm suggests that shareholders' demands for greater influence on corporate policy through voting are simply misguided. But that answer is unlikely to satisfy shareholders who demand a larger role in corporate affairs.

The unsatisfactory nature of either paradigm suggests the need to develop a different vision of the role of corporate voting. As the considerations outlined above suggest, part of the problem in developing a more satisfactory paradigm lies in the uneasy fit between the requirement of annual elections and a model that assigns shareholder voting a meaningful role in determining the policies and direction of the corporation. This has led to a recent innovative proposal that suggests the coupling of a variety of measures for rendering shareholder voting more meaningful. It also suggests foregoing annual elections of directors in favor of five-year directorial terms in office.[63]

Adoption of this proposal would, of course, require legislative action. In the absence of such legislative actions, courts will have to decide the issues posed in the early 1990s regarding corporate voting without any clear indication of why corporate voting exists or what functions it is meant to serve. More thoughtful courts may, explicitly or implicitly, resort to one of the paradigms outlined above in resolving particular cases. But it cannot be said at present that any of these paradigms represents the law as it stands today or the theory underlying the law.

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63. *See* Lipton & Rosenblum, *supra* note 38.