INTERFERENCE WITH VOTING RIGHTS: THE METAPHYSICS OF *BLASIUS INDUSTRIES v. ATLAS CORP.*

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ABSTRACT

This article reviews the cases applying the Blasius *doctrine in an effort to find some definable patterns, and to assess whether the doctrine serves a useful purpose. Part II focuses on the proscribed effect of thwarting the shareholder vote or impeding the shareholder franchise, concluding that: conduct, which has a proscribed effect, often involves weighing the imminence of shareholder action and the degree to which the director's action precludes, delays or renders the shareholder action more difficult; the court is much more likely to find that action having the proscribed effect was undertaken for that purpose if the board action does not involve a business decision; and the evidence of the proscribed motive must be particularly strong. Part III discusses whether the board could ever take action for the primary purpose of thwarting the shareholder franchise under the "compelling justification" standard, and concludes that no director has ever established a compelling justification. Part IV examines the usefulness of the* Blasius *doctrine because of the substantial overlap with* Unocal. *The article concludes that* Blasius *serves a purpose not served by*

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Unocal, *it applies when the board action at issue does not involve a contest for control or a defensive action, but does involve the requisite purpose and effect, which is particularly true where the board action does not involve a business transaction, but relates solely to the governance or electoral process.*

I. INTRODUCTION

A classic problem of lawmaking, whether by judicial decision or statute, is the problem of "drawing lines." In the area of corporate law, the need to draw lines arises in both transactional and litigation contexts, and the needs in one area often conflict with the needs of another. Transactional lawyers desire "bright" and predictable lines because they want to know, with certainty, the consequences of the structures they choose for their transactions. Fine and ephemeral distinctions are less important than clarity. In litigation, where issues of personal liability and reputation are at stake, courts want the freedom to consider all the nuances of the particular factual circumstances confronting them. Certainty of future application is less important than reaching the correct result in the immediate case.

In a perfect world of perfect lawyers and judges, these desires for a fully-nuanced resolution of an individual case and for clarity in future applications would not collide. The drawing of lines would take into account all existing and potential factors that could impact the issues at hand and would set forth a fully integrated rule that deals with all factors in conceptual harmony. Of course, we do not live in a perfect world, and it is that fact that creates work for lawyers (or is it vice versa?).

In the corporate law, there may be no more difficult area in which to draw lines than that addressed in the decision in *Blasius Industries, Inc. v. Atlas Corp.*[1] *Blasius* stands for the beguiling proposition that a board of directors may take an action "for the sole or primary purpose of thwarting a shareholder vote" if the board has a "compelling justification" for the action.[2] In slightly more expansive language, the supreme court restated the proposition, noting that the *Blasius* "compelling justification" standard applies whenever "the 'primary purpose' of a board's action [is] to interfere with or impede exercise of the shareholder franchise."[3] These propositions, which are perhaps as uncontroversial as a politician's support for mothers and apple pie, prove the adage that "the devil is in the details." A court's first challenge when deciding to "draw lines" is to determine the ever-elusive

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[1]564 A.2d 651 (Del. Ch. 1988).

[2]*Id.* at 661-63.

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

"purpose" of the board's action. This can be a difficult task if the board is determined to deny the seemingly evident purpose (with the aid of counsel skilled at making the simple, complicated). Moreover, there is the equally daunting task of determining what acts constitute "thwarting a stockholder vote" or "interfering with or impeding the shareholder franchise" — definitions that possess a task as daunting as attempting to define pornography ("I know it when I see it, even though you may not[4]).

If these challenges appear daunting, try listing the "compelling justifications" that will bless this homicidal treatment of corporate democracy. No Delaware decision has ever found a "compelling justification" for an action deemed to have been taken for the primary purpose of thwarting, impeding or interfering with a shareholder vote. Thus, to borrow again from the definition of pornography, the definition of a "compelling justification" might simply be: "I have never seen it."

The purpose of this article is to review the cases applying the *Blasius* doctrine in an effort to find some definable patterns, and to assess whether the doctrine serves a useful purpose. From our review, we reach the following conclusions: (1) conduct, which has the proscribed effect, often involves a weighing of two factors: the imminence of shareholder action and the degree to which the director's action precludes, delays, or renders the shareholder action more difficult; (2) the court is much more likely to find that action having the proscribed effect was undertaken for that purpose if the board action does not involve a business decision, but only relates to the governance or electoral process of the corporation; (3) the evidence of the proscribed motive must be particularly strong; and (4) no director has ever established a "compelling justification," although Chancellor Allen (who created the concept) twice mused as to what it might be.

On the question of usefulness, we conclude that, despite the considerable overlap between the *Blasius* standard and the *Unocal* standard, the *Blasius* standard serves a purpose not served by *Unocal*. *Blasius* applies when the board action at issue does not involve a contest for control or a defensive action, but does involve the requisite purpose and effect. This conclusion is particularly true where the board action does *not* involve a business transaction, but relates solely to the governance or electoral process.

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[4]Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

II. "FOR THE SOLE OR PRIMARY PURPOSE OF THWARTING A SHAREHOLDER VOTE" OR "FOR THE PRIMARY PURPOSE OF INTERFERING WITH OR IMPEDING THE SHAREHOLDER FRANCHISE."

A. *Thwart, Interfere, or Impede*

When assessing whether the *Blasius* standard applies to an individual case, lawyers are often consumed by the question of the defendant's motive or purpose. They sometimes fail to appreciate that courts make an equally important inquiry into whether the defendant's action, whatever its purpose, had the proscribed effect. As originally promulgated in *Blasius*, the proscribed effect was "thwarting a shareholder vote," and the conduct at issue in that case had precisely that effect. It precluded the company's shareholders from electing a majority of the board of directors via a consent solicitation. As noted above, subsequent cases have employed arguably broader language — "to interfere with or impede exercise of the shareholder franchise" — but the results in those cases appear to be the same.[5] In each case decided under the *Blasius* doctrine, the conduct at issue precluded or delayed the effectuation of an imminent shareholder vote or practically precluded or severely prejudiced pending or proposed shareholder action, albeit not imminent action.

The proscribed effect of thwarting a shareholder vote or impeding the shareholder franchise has been found in two types of cases (or in cases presenting elements of both types). The first type of case involves a board's attempt to interfere with an imminent shareholder action. In the second type of case, the threatened or proposed shareholder action is not imminent, but the board action effectively precludes the shareholders from obtaining their objectives, at least until the next election. Where the shareholder action is not imminent and the board's conduct is not preclusive, the board generally will not be found to have thwarted, impeded or interfered with the shareholder franchise. Similarly, when a shareholder vote is not required as a matter of corporate law, a board's action preventing such a vote will not be deemed to have thwarted, impeded or interfered with the shareholder franchise.

The decisions in *State of Wisconsin Investment Board v. Peerless Systems Corp.* (*Peerless*)[6] and *Aprahamian v. HBO & Co.*[7] are examples of the first type of case. In *Peerless*, the shareholders decided at the time of the

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[5]*See* Apple Computer, Inc. v. Exponential Tech., Inc., No. 16,315, 1999 Del. Ch. LEXIS 9, at *17-*18 (Del. Ch. Jan. 21, 1999), *reprinted in* 24 DEL. J. CORP. L. 949, 960 (1999) (citing Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996)).

[6]No. 17,637, 2000 Del. Ch. LEXIS 170 (Del. Ch. Dec. 4, 2000).

[7]531 A.2d 1204 (Del. Ch. 1987).

meeting to vote down the board's proposed expansion of a stock option plan.[8] The board, however, prevented the shareholders from defeating the proposal by adjourning the meeting and keeping the polls open.[9] The board argued that the adjournment was beneficial to the shareholder franchise because it provided more time for shareholders to vote.[10] This clever assertion, however, was demonstrably false on the facts of the case. The board did not make any effort to publicize the adjournment or to inform all of the shareholders that they had more time to vote.[11] Instead, the adjournment was announced only at the meeting — which few, if any, shareholders attended — and the board selectively solicited shareholders to vote in favor of the proposal.[12] Moreover, the evidence revealed that the board previously considered adjourning the meeting if it appeared that the proposal was going to be defeated (not if it merely appeared that not enough shareholders were voting).[13] Such selective and one-sided use of the adjournment power, if permitted, would fundamentally undermine the process of shareholder voting. In addition, a one-sided voting process would surely deter any proxy contestant and undermine the institutional integrity of corporate democracy.

Aprahamian involved similar facts. In that case, the board of directors postponed an annual meeting on the evening before, after learning that a dissident board would be elected.[14] Rather than adjourning the meeting, however, the directors thwarted an imminent shareholder action via postponement.[15] The difference between postponing a meeting and convening a meeting only to adjourn it immediately appears to be immaterial to the determination of the effect of the action.

Cases involving the second type of conduct are more numerous. In *Blasius*, for example, a dissident stockholder owning only 9.1% of the corporation's stock delivered to the staggered board a written consent seeking to expand the board by a sufficient number of directors to elect a majority.[16] The board immediately reacted and voted to add two seats to the board, and to fill those seats.[17] Thus, even if the stockholder's consent solicitation were successful, he could not elect a majority of the board for

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[8]*Peerless*, No. 17,637, 2000 Del. Ch. LEXIS at *6-*8.
[9]*Id.* at *9.
[10]*Id.* at *11.
[11]*Id.* at *14.
[12]*Peerless*, No. 17,637, 2000 Del. Ch. LEXIS at *14-*15.
[13]*Id.* at *15.
[14]*Aprahamian*, 531 A.2d at 1205.
[15]*Id.*
[16]*Blasius Indus.*, 564 A.2d at 653-54.
[17]*Id.* at 655.

one year (until the next stockholders' meeting).[18] The success of the shareholder's consent solicitation was not imminent (or even predictable), but the directors' action was entirely preclusive, at least temporarily.

In *Condec Corp. v. Lunkenheimer Co.*,[19] a hostile stockholder had acquired 51% of the corporation's stock. Thereafter, the board entered into a third party transaction that this stockholder opposed.[20] As part of that transaction, the corporation issued shares to a third party, which diluted the dissident shareholder to below 51% and prevented him from blocking the transaction.[21] Thus, the case did not involve imminent stockholder action, but the effect of the board action was to deprive the dissident shareholder of its controlling block of shares.

Another example of this second type of action occurred in *Chesapeake Corp. v. Shore*,[22] which involved a target corporation whose bylaws established a staggered board. When a hostile bidder emerged, the target's board feared that the hostile bidder would amend the bylaws, eliminate the staggered board and elect a new majority of the directors.[23] The incumbent directors thus amended the bylaws to require a supermajority vote for further amendments to the bylaws (initially amended to 66 2/3% and later reduced to 60%).[24] Because the incumbent management controlled 24% of the target's stock, the bylaw made it mathematically impossible for the shareholders to eliminate the staggered board without management's support, assuming there was a 90% stockholder turnout.[25] This amendment had the proscribed effect of interfering with and impeding the shareholders' ability to amend the bylaws and eliminate the staggered board.[26]

In *Carmody v. Toll Brothers, Inc.*,[27] the court concluded, in denying a motion to dismiss, that an allegation that the "dead hand" provisions of a poison pill would either preclude a hostile bidder from waging a proxy contest or coerce shareholders to vote for the incumbent directors (because their potential successors would not have the power to redeem the pill) stated

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[18] *Id.*

[19] 230 A.2d 769 (Del. Ch. 1967).

[20] *Id.* at 772.

[21] *Id.* at 772-73.

[22] 771 A.2d 293 (Del. Ch. 2000).

[23] *Id.* at 296.

[24] *Id.* at 296-97.

[25] *Id.* at 297.

[26] *See Chesapeake Corp.*, 771 A.2d at 297; *see also* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (advancing the meeting date to effectively preclude any proxy contest); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980) (setting a meeting date that prevented a dissident shareholder from complying with an advance notice bylaw).

[27] 723 A.2d 1180 (Del. Ch. 1998).

an actionable *Blasius* claim.[28] The court said that "[a] claim that the directors have unilaterally 'create[d] a structure in which shareholder voting is either impotent or selfdefeating' [sic] is necessarily a claim of purposeful disenfranchisement."[29]

By contrast, where shareholder action is not imminent and board action does not preclude effective shareholder action (either indefinitely or until the next shareholders' meeting), Delaware courts have concluded that the board action does not impede or interfere with the shareholder vote. For example, in *Kidsco v. Dinsmore*,[30] the board amended the bylaws to allow an unscheduled stockholders meeting to be held twenty-five days later than previously permitted under the bylaws.[31] A hostile bidder had previously announced an intention to solicit proxies at the meeting, but the meeting had not been scheduled, and a proxy solicitation had not been commenced.[32] Thus, the board action had not precluded imminent shareholder action (or delayed it) nor interfered at all with the ability to elect a new board. The court rejected the application of *Blasius* to the board's decision to change the bylaw.[33]

Similarly, in *In re Gaylord Container Corp. Shareholders Litigation*,[34] the court held that a series of defensive measures adopted in advance of, and not in response to, any bid or proposed shareholder action did not trigger *Blasius* review. The court stated:

> the prototypical case implicating so-called *Blasius* review involves a situation where: i) a stockholder vote or action by stockholder consent is imminent or threatened; and ii) the board purposely thwarts the opportunity for that vote or action to take place or takes steps to reverse the likely result (*e.g.*, by reducing the voting power of a particular stockholder).[35]

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[28]*Carmody*, 723 A.2d at 1195.

[29]*Id.* at 1193 (citation omitted).

[30]674 A.2d 483 (Del. Ch. 1995).

[31]*Id.* at 485.

[32]*Id.*

[33]*Id.* at 495-96.

[34]753 A.2d 462 (Del. Ch. 2000).

[35]*Id.* at 487; *see also* Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25 (Del. Ch. 1998) (amending bylaw to allow a special meeting to be held 90-100 days later does not trigger *Blasius* review); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990) (postponement of meeting not yet scheduled but for which record date had been established does not trigger *Blasius* review); Golden Cycle, LLC v. Allan, No. 16,301, 1998 Del. Ch. LEXIS 80 (Del. Ch. May 20, 1998) (setting an early record date for annual meeting in the face of a hostile offer does not trigger *Blasius* review); H.F. Ahmanson & Co. v. Great W. Fin. Corp., No. 15,650, 1997 Del. Ch. LEXIS 84 (Del. Ch. June 3, 1997) (postponement of annual meeting to the same date as a vote on a merger

One circumstance that clearly does not impede the shareholder franchise occurs when a board recommends a course of action to the shareholders but leaves the ultimate decision to their uncoerced vote. In that situation, so long as the electoral process is not impeded or manipulated, the fact that the proposed action, such as a bylaw amendment or charter provision, will in some manner constrain future shareholder action or impact the future operation of the shareholder franchise does not raise a *Blasius* issue. For example, in *Stroud v. Grace*,[36] the supreme court held that the board's recommendation of a charter provision and the shareholders' subsequent adoption of the provision did not implicate *Blasius* because "the factual predicate of *unilateral* board action intended to inequitably manipulate the corporate machinery is completely absent."[37] Additionally, shareholder voting rights are not thwarted when a board's actions prevent a shareholder vote that is not required by the corporate law.[38]

In summary, it appears that the determination of whether board action operates to "thwart a shareholder vote" involves the balancing of two factors: the imminence of the shareholder action in question and the degree to which the board action renders the effectuation of that action either difficult or practically impossible. The more imminent the shareholder action, the less preclusive the board action must be to constitute "interference" under *Blasius*. If shareholder action is less imminent, the board action in response must be substantially more preclusive to constitute the requisite interference.

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agreement with a termination fee does not trigger *Blasius* review); Stahl v. Apple Bancorp, Inc., No. 11,510, 1990 Del. Ch. LEXIS 121 (Del. Ch. Aug. 9, 1990) (definition of beneficial ownership in poison pill does not trigger *Blasius* review).

[36]606 A.2d 75 (Del. 1992).

[37]*Id.* at 92 (emphasis added); *see also* Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) (directors' recommendation of charter amendment to recapitalize corporation does not trigger *Blasius* review).

[38]*See* Lennane v. Ask Computer Sys., Inc., No. 11,744, 1990 Del. Ch. LEXIS 164 (Del. Ch. Oct. 11 1990), *reprinted in* 19 DEL. J. CORP. L. 1521 (1991) (structuring a transaction to avoid a vote required by NASDAQ does not trigger *Blasius* analysis because vote not required by DGCL); Paramount Communications Inc. v. Time Inc., No. 10,866, 1989 Del. Ch. LEXIS 77 (Del. Ch. July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990) (recasting a transaction from a merger — which required a vote under NYSE rules but not under the DGCL — into a tender offer — which required no vote — does not trigger *Blasius* review); *see also* Hubbard v. Hollywood Park Realty Enters., Inc., No. 11,779, 1991 Del. Ch. LEXIS 9, at *30 n.11 (Del. Ch. Jan. 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 238, 256 n.11 (1992) (rejecting the applicability of *Blasius* review with respect to the board's refusal to waive an advance notice bylaw provision to allow nominations after the deadline).

B. *Non-Business Decisions Concerning the Electoral Process*

The *Blasius* standard seems most often to be applied to board action involving the electoral process, as opposed to board action approving business decisions that effect the electoral process or outcome. This distinction is consistent with the underlying rationale of the *Blasius* standard. A discussion of acts that trigger the application of the *Blasius* standard might properly begin with an understanding of the rationale for applying that heightened standard to board action, as opposed to the more deferential business judgment standard. The rationale was most succinctly stated in *Blasius* itself. Simply put, the court explained that the business judgment standard did not apply because the conduct at issue did not involve a business decision.[39] Rather, it involved the question of who should constitute the directors of Atlas Corporation and what conduct by the incumbent directors should be prohibited or permitted in determining the directors or affecting that determination. The court stated as follows:

> [A] decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance. That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation, but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority. 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. This need not be the case with respect to other forms of corporate action that may have an entrenchment effect — such as the stock buybacks present in *Unocal, Cheff* or *Kors v. Carey*. 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

[39] *Blasius*, 564 A.2d at 659.

> 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.[40]

This analysis suggests that actions governed by the *Blasius* standard are most typically actions that involve the electoral process or the election of directors as distinct from business transactions that have either the incidental effect or primary purpose of affecting the voting process. For example, in *Blasius*, the conduct at issue was the expansion of the number of directors on the board and the filling of those newly created positions by two individuals selected by the incumbent directors.[41] The action was taken in response to a consent solicitation by a hostile party to expand the board by a greater number and fill those vacancies with individuals who supported a recapitalization that the incumbent board opposed.[42] The effect of the action by the incumbent directors was to limit the number of directors who could be elected in the consent solicitation to less than a majority of the entire board of directors.[43] The conduct at issue in *Blasius* did not involve a business transaction, but simply was an act relating to the process by which directors would be selected. For that reason, the defendants nearly conceded that the action was taken to thwart the consent solicitation, and the court indicated that any other explanation would have been "incredible."[44]

Aprahamian presented the same rationale for the inapplicability of the business judgment rule. In that case, the incumbent board postponed the date of the annual meeting when it learned that a dissident stockholder group had or appeared to have proxies representing a majority of the outstanding votes.[45] The act of delaying the meeting was not a business decision, it was purely a decision involving election procedures. Consequently, the court stated:

> 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

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[40] *Id.* at 659-60; *see also* E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 394 (1997) (more searching judicial scrutiny is appropriate when directors make decisions about "ownership" rather than "enterprise" issues).

[41] *Id.* at 655.

[42] *Blasius*, 564 A.2d at 653.

[43] *Id.* at 654.

[44] *Id.* at 656.

[45] *Aprahamian*, 531 A.2d at 1205.

manipulated, those in charge of the election have the burden of persuasion to justify their actions.[46]

Similarly, in *Peerless*, the conduct at issue was the adjournment of the annual stockholders' meeting and keeping the polls open on a matter, proposed by the incumbent directors, that was about to be defeated by the shareholders.[47] This action did not involve a business decision, but rather involved the operation and conduct of the electoral process. As the court said in both *Blasius* and *Aprahamian*, those who conduct corporate elections "must be held to the highest standards"[48] and when conflict arises between the directors and the shareholders over the conduct of that process "[it] is not . . . a question that a court may leave to the agent finally to decide so long as he does so honestly and competently."[49]

Additionally, in *Chesapeake*, the conduct at issue did not involve a board decision on a business transaction. Rather, the board acted to require a supermajority vote to amend bylaws.[50] When the effect of that bylaw amendment was to mathematically preclude a shareholder vote amending the bylaws without the vote of shares controlled by management, the defendants had the impossible task of convincing the court that this effect of the bylaw was not intended.[51] Predictably, they failed, and the court found that the *Blasius* standard applied. In fact, the court suggested that the clarity of the effect of the action taken was persuasive evidence of its purpose.[52]

The conduct at issue in *Carmody* may be on the borderline of a "non-business" decision. That case concerned a "dead-hand" provision in a poison pill.[53] To the extent that a pill is a security, the terms of the security might be considered a business decision. A pill, however, is a special type of security having as its obvious purpose, the creation of certain governance power in directors.[54] Indeed, the effectiveness of the pill is premised on the expectation that no one would ever trigger the pill and cause it to trade as a separate security. In addition, the provision at issue in *Carmody* related

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[46] *Id.* at 1207.

[47] *Peerless*, 2000 Del. Ch. LEXIS at *2-*3.

[48] *Blasius*, 564 A.2d at 661; *Aprahamian*, 531 A.2d at 1207.

[49] *Blasius*, 564 A.2d at 660; *see also* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (rescheduling and accelerating a meeting date); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980) (changing the bylaws and scheduling the annual meeting so that plaintiff could not comply with advance notice provisions of the bylaws).

[50] *Chesapeake*, 771 A.2d at 296-97.

[51] *Id.*

[52] *Id.* at 320, 345.

[53] Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998).

[54] *See id.* at 1184.

expressly to the power of directors and sought to deprive a certain class of directors, elected by the stockholders, of powers otherwise available to them.[55] Thus, the reality of the "dead hand" pill provision was that it had little to do with the business of the corporation and much more to do with the election process and the power of the directors.[56]

The fact that the conduct at issue does not involve a business decision, but only involves a determination of the directors or the conduct of the electoral process, is not solely determinative of the question of whether the *Blasius* standard applies. The conduct at issue must nevertheless have the effect of interfering with or impeding the shareholder franchise, and that effect must be its primary purpose. It is easier to establish such a purpose, however, in the case of conduct not involving a business transaction and more difficult to establish such a purpose for conduct relating to a business transaction. Thus, for example, not every postponement or adjournment of a stockholders' meeting is tested under the *Blasius* standard. Conversely, a business transaction, such as the issuance of shares, may be found to have the sole or primary purpose of interfering with the shareholder franchise even though it arguably has an independent business justification and effect.

C. *Business Transactions*

The application of the *Blasius* standard is not limited to board decisions involving the electoral process or the election of directors. Several cases have invalidated business transactions when the court has found that the sole or primary purpose of the transaction was to impair or interfere with the shareholder franchise. The typical situation involves the issuance or repurchase of shares.[57]

While these cases indicate that the *Blasius* standard will be applied to business transactions approved by the board, there are practical problems of proving an improper purpose in these cases that are not present in a case

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[55] *Id.* at 1189.

[56] *See* Sutton Holding Corp. v. DeSoto, Inc., No. 12,051, 1991 Del. Ch. LEXIS 85 (Del. Ch. May 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 363 (1992) (change of control provision in a pension plan may have been created to deter a change of control in a proxy contest).

[57] *See* Condec Corp. v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967) (enjoining a stock issuance found to be for the primary purpose of diluting the voting rights of a shareholder); Canada S. Oils, Ltd. v. Manabi Exploration Co., 96 A.2d 810 (Del. Ch. 1953) (same); Commonwealth Assoc. v. Providence Health Care, Inc., No. 13,135, 1993 Del. Ch. LEXIS 231 (Del. Ch. Oct. 22, 1993), *reprinted in* 19 DEL. J. CORP. L. 704 (1994) (same); Phillips v. Insituform of N. Am., Inc., No. 9173, 1987 Del. Ch. LEXIS 474 (Del. Ch. Aug. 27, 1987), *reprinted in* 13 DEL. J. CORP. L. 774 (1988) (same). In each of these cases, the court found that the primary purpose for the business transaction at issue was not to advance the interests of the shareholders, but to dilute the voting rights of dissident shareholders.

involving a decision simply concerning the electoral process. A business transaction usually has some professed purpose other than impeding the shareholder franchise, while decisions involving the electoral process or the appointment of directors do not. For example, in the case of a stock issuance to a friendly shareholder, the transaction may have a dual purpose: (1) to raise needed capital and (2) to increase the number of shares held by those who support management. In that situation, it may become difficult to determine the "primary purpose" of a transaction that could truthfully have two, equally significant purposes. From a doctrinal perspective, it could be argued that there is less justification for applying the *Blasius* standard because these transactions, unlike decisions involving only the electoral process or appointment of directors, are business decisions more appropriately evaluated under the business judgment standard. If the evaluation of business transactions were limited to *Unocal* scrutiny, the decision would be sustained so long as the directors were not conflicted, exercised appropriate care, acted reasonably in relation to a legitimate corporate objective and acted in good faith (that is, for what they sincerely believed to be in the shareholders' best interests and not for some other purpose).[58] Where the challenged board action involves a business transaction, *Blasius* usually has been found *not* to apply, even where the transaction had the effect of diluting or interfering with voting rights.[59]

D. *Determining Motive*

Whether the conduct at issue involves a business decision or not, the application of the *Blasius* standard requires a determination of motive. While the cases do not articulate any standard of proof other than the standard applicable in any civil action, an examination of the cases suggests that the court usually finds the necessary improper motive when the defendant admits to the improper motive or when the defendant offered a plainly illogical or incredible purportedly proper motive. For example, in *Blasius*, the defendants argued that their decision to expand the board and add two directors was simply motivated by a desire to add good businessmen

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[58]*See* Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1373 (Del. 1994).

[59]*See id.* at 1361 (holding that share repurchase does not trigger *Blasius* review); Glazer v. Zapata Corp., 658 A.2d 176 (Del. Ch. 1993) (upholding a stock issuance during a proxy contest stating that *Blasius* "does not... require that management refrain from issuing voting securities, and thereby diluting the voting strength of insurgent stockholders, during the pendency of a proxy contest, when the issuance legitimately has a primary purpose directed to the management of the corporation and its businesses"); Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989) (holding that share repurchase and issuance of preferred stock does not trigger *Blasius* review); Hills Stores Co. v. Bozic, 769 A.2d 88 (Del. Ch. 2000) (holding that operation of change of control provisions in an employment contract does not trigger *Blasius* review).

to the board of directors.[60] Two incumbent directors, however, virtually admitted that the board added the two directors to prevent a majority of directors from being elected in the consent solicitation.[61] Since this effect of adding directors was apparent, and since the board was expanded only after a hostile consent solicitation had been commenced, the court indicated that denying such a motivation would have been incredible.[62]

The court confronted a similar motive in *Peerless*. In essence, the evidence was uncontradicted that the meeting was adjourned only because a proposal recommended by the directors would have been defeated in the absence of the adjournment.[63] The director who made the decision and other officers expressly testified to that motivation.[64] While the defendants argued that their purpose was to facilitate the franchise by creating greater opportunities for participation, it was undisputed that these greater opportunities would not have been made available if the stockholder vote, however close, had been in favor of the proposal.[65] This fact belied the defendants' argument. In addition, the incumbent directors did nothing to publicize the postponement and made no effort to inform all of the shareholders that the polls remained open.[66] They did, however, attempt to solicit those shareholders whom they thought would support the proposal, and to solicit those who voted against the proposal to change their vote.[67] This conduct was logically inconsistent with the avowed purpose of facilitating the shareholder franchise, as opposed to thwarting a negative shareholder vote. Similarly compelling facts existed in other cases.[68]

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[60]*Blasius*, 564 A.2d at 656.

[61]*Id.*

[62]*Id.*

[63]*Peerless*, 2000 Del. Ch. LEXIS 170, at *34-*35.

[64]*Id.* at *35-*37.

[65]*Id.* at *37-*38.

[66]*Id.* at *38.

[67]*Peerless*, 2000 Del. Ch. LEXIS 170, at *64-*65.

[68]*See Aprahamian*, 531 A.2d at 1208 ("[a]n examination of the uncontroverted facts does not show that any significant interests of the stockholders will be served by the postponement"); *Condec*, 230 A.2d at 777 (stating that "exchange of stock which brought no money into [the corporation,] was not connected with a stock option plan or other proper corporate purpose, and which was obviously designed for the primary purpose of reducing Condec's stock holdings"); *Chesapeake Corp.*, 771 A.2d at 345 (finding clear and strong evidence of director intent); *Phillips*, 1987 Del. Ch. LEXIS 474, at *21 (stating that defendants' actions were "clearly directed against one class of shareholders and, in the circumstances, require the board to justify those actions by reference to a significant threat to an important corporate interest or to the achievement of a significant corporate benefit"). *Cf. Canada S. Oils*, 96 A.2d at 813 ("When the undisputed facts are viewed cumulatively I find it *reasonable to infer* that the primary purpose behind the sale of these shares was to deprive plaintiff of the majority voting control.") (emphasis added).

There is another important point relating to motive. The directors need not act in bad faith or in their self-interest in order for the *Blasius* standard to apply. In fact, as *Blasius* makes clear, a finding of bad faith would invalidate the action regardless of whether it interfered with the shareholder franchise.[69] In *Blasius*, the court concluded that the directors were acting in good faith and for what they believed to be in the best interests of the corporation. This finding did not negate the application of the *Blasius* standard, nor did it serve to validate the action taken.[70] This does not, however, render the good faith of the directors entirely irrelevant to the motive inquiry. For example, where the directors mistakenly, but in good faith, failed to submit an asset sale to the shareholder vote required under Section 271 of the General Corporation Law of the State of Delaware, the directors' failure was not motivated by a desire to impede or interfere with the shareholders' voting rights and thus *Blasius* was inapplicable.[71]

III. A "COMPELLING JUSTIFICATION"

Prior to the decisions in *Blasius* and *Phillips v. Insituform of North America, Inc.*,[72] it was unclear whether board action undertaken for the primary purpose of thwarting the shareholder franchise could ever be sustained. The decisions in *Condec* and *Canada Southern Oils, Ltd. v. Manabi Exploration Co.*[73] could be read to stand for the proposition that share issuances undertaken for the primary purpose of diluting the voting rights of stockholders were per se invalid. In *Phillips*, however, and subsequently, in *Blasius*, the court of chancery rejected the argument for per se invalidity and held that there may be cases where such "extreme action" might be justified. The justification for such "extreme action" would need to be compelling. Explaining this decision, the court stated as follows:

> A *per se* rule that would strike down, in equity, any board action taken for the primary purpose of interfering with the effectiveness of a corporate vote would have the advantage of relative clarity and predictability. It also has the advantage of most vigorously enforcing the concept of corporate democracy.

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[69] *Blasius*, 564 A.2d at 658.

[70] *Id.* at 658-59.

[71] Apple Computer, Inc. v. Exponential Tech., Inc., No. 16,315, 1999 Del. Ch. LEXIS 9, at *14-*19 (Del. Ch. Jan. 21, 1999), *reprinted in* 24 DEL. J. CORP. L. 949, 959 (1999).

[72] No. 9173, 1987 Del. Ch. LEXIS 474 (Del. Ch. Aug. 27, 1987), *reprinted in* 13 DEL. J. CORP. L. 774 (1988).

[73] 96 A.2d 810 (Del. Ch. 1953).

> The disadvantage it brings along is, of course, the disadvantage a *per se* rule always has: it may sweep too broadly.
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> In my view, our inability to foresee now all of the future settings in which a board might, in good faith, paternalistically seek to thwart a shareholder vote, counsels against the adoption of a *per se* rule invalidating, in equity, every board action taken for the sole or primary purpose of thwarting a shareholder vote, even though I recognize the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance. It may be that some set of facts would justify such extreme action. This, however, is not such a case.[74]

The practical significance of this rule, however, may be questioned. The court never has found a justification sufficiently compelling to permit a board to thwart the shareholder franchise. In *Blasius*, however, the court outlined in a footnote one, possible "compelling justification." The court stated as follows:

> Imagine the facts of *Condec* changed very slightly and coming up in today's world of corporate control transactions. Assume an acquiring company buys 25% of the target's stock in a small number of privately negotiated transactions. It then commences a public tender offer for 26% of the company stock at a cash price that the board, in good faith, believes is inadequate. Moreover, the acquiring corporation announces that it may or may not do a second-step merger, but if it does one, the consideration will be junk bonds that will have a value, when issued, in the opinion of its own investment banker, of no more than the cash being offered in the tender offer. In the face of such an offer, the board may have a duty to seek to protect the company's shareholders from the coercive effects of this inadequate offer. Assume, for purposes of the hypothetical, that neither newly amended Section 203, nor any defensive device available to the target specifically, offers protection. Assume that the target's board turns to the market for corporate control to attempt to locate a more fairly priced

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[74] *Blasius*, 564 A.2d at 661-62.

> alternative that would be available to all shareholders. And assume that just as the tender offer is closing, the board locates an all cash deal for all shares at a price materially higher than that offered by the acquiring corporation. Would the board of the target corporation be justified in issuing sufficient shares to the second acquiring corporation to dilute the 51% stockholder down so that it no longer had a practical veto over the merger or sale of assets that the target board had arranged for the benefit of all shares? It is not necessary to now hazard an opinion on that abstraction. The case is clearly close enough, however, despite the existence of the *Condec* precedent, to demonstrate, to my mind at least, the utility of a rule that permits, in some extreme circumstances, an incumbent board to act in good faith for the purpose of interfering with the outcome of a contemplated vote.[75]

The court returned to the possibility of such a "compelling justification" in the subsequent case of *Mendell v. Carroll*.[76] In that case, the court again found no "compelling justification," but mused that a "compelling justification" may exist for issuing shares to dilute the voting power of a controlling stockholder if that stockholder "is abusing its power and is exploiting or threatening to exploit the vulnerability of minority shareholders."[77]

IV. *BLASIUS V. UNOCAL*

A number of supreme court and court of chancery decisions have discussed the interrelationship of the *Blasius* and *Unocal* standards. The supreme court twice suggested that the *Blasius* "compelling justification" standard is incorporated into the *Unocal* analysis when defensive action "purposefully disenfranchises . . . shareholders."[78] In *Chesapeake,* this interrelationship was perceptively and comprehensively examined, and the court of chancery noted that:

> one might reasonably question to what extent the *Blasius* "compelling justification" standard of review is necessary as a

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[75] *Id.* at 662 n.5.

[76] 651 A.2d 297 (Del. Ch. 1994).

[77] *Id.* at 304.

[78] *Stroud*, 606 A.2d at 92 n.3; *see also Unitrin*, 651 A.2d at 1378 (noting that defensive actions must pass a proportionality and reasonableness test if those actions result in shareholder disenfranchisement).

> lens independent of or to be used within the *Unocal* frame.... Stated differently, it may be optimal simply for the Delaware courts to infuse our *Unocal* analyses with the spirit animating *Blasius* and not hesitate to use our remedial powers where an inequitable distortion of corporate democracy has occurred.[79]

There is much to be said for preferring *Unocal*'s multifaceted weighing analysis to the more rigid analytical structure under *Blasius*. In our view, however, the *Blasius* analysis makes a meaningful contribution that is not entirely subsumed in the existing *Unocal* structure. First, the *Blasius* analysis can be applied to circumstances in which *Unocal* arguably may not apply. One example is the issue in *Peerless*, where the board's action did not implicate corporate control or the election of directors, but did have the effect of thwarting shareholder action (defeating a proposed stock option plan). Unless one believes that concern for the shareholder franchise should be limited to circumstances involving control contests or the election of directors, *Unocal* would not serve the analytical purposes that *Blasius* now serves. Additionally, there is no apparent reason that concern for the shareholder franchise should be limited to control contests or director elections. The stock option plan at issue in *Peerless* could easily be as important to shareholders as a defensive action in response to a hostile bid or the identity of persons who will serve as directors for the next year.

Second, the rationale of *Blasius* recognizes that not all board decisions are business decisions. As noted above, the standard often is applied to board action involving the electoral process. Where the board interferes with the electoral process, rather than undertaking a business transaction, for the primary purpose of interfering with the shareholder franchise, the more demanding standard of *Blasius*, rather than the balancing required by *Unocal*, seems appropriate.

Lastly, the *Blasius* standard is not devoid of its own balancing, although it is possibly less explicit than the balancing undertaken in a *Unocal* analysis. Whether certain conduct does "thwart shareholder action" often involves a balancing of the imminence of the shareholder action at issue, the severity of the impediment created by the board action and the credibility or persuasiveness of the other purposes proffered for the action taken. In addition, the definition of a "compelling justification" may be influenced by the nature of the board's interference with the shareholder franchise. So, while the analysis under *Blasius* is not as multifaceted as the analysis under *Unocal*, and the standard is not as explicitly flexible or discretionary, the *Blasius* standard does have its own degree of fluidity.

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[79]*Chesapeake Corp.*, 771 A.2d at 323.

Moreover, if the *Unocal* analysis now incorporates the "compelling justification" standard, it appears that a "standalone" application of *Blasius* need only occur where *Unocal* would not otherwise apply.