COMMENTS

HAS THE EVOLUTION OF THE POISON PILL COME TO AN END?
— CARMODY v. TOLL BROTHERS, INC.;
MENTOR GRAPHICS, INC. v. QUICKTURN DESIGN SYSTEMS, INC.

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I. INTRODUCTION

During the 1980s, corporations throughout the United States faced a frenzied hostile takeover environment. The furious acquisition climate was primarily financed through junk bonds—high yield sub-investment grade securities. Corporate raiders lacking independent resources used junk bonds to finance hostile takeovers. Therefore, many companies found themselves the subjects of hostile acquisition attempts in an extremely short time frame. In addition, raiders developed a number of takeover tactics that had deleterious effects on a target corporation, including the "bust up" takeover bid and the "street sweep." Corporations were likened to castles under siege, and directors, defenders of the "corporate bastion."

Corporate directors searched fervently for a defensive measure to reduce their susceptibility to these harmful tactics and provide adequate time to act in the event of a hostile acquisition. The most potent defensive measure implemented by corporations at the time was a shareholders' rights plan, commonly referred to as a poison pill. Poison pills provided corporations with an adequate defense against the coercive hostile techniques developed by raiders during the 1980s by allowing corporations to "just say no" to a hostile acquiror's tender offer. In response, however, raiders developed techniques to circumvent poison pills, namely coupling a tender offer with a voting contest to remove the target board and redeem the

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1See Charles M. Yablons Poison Pills and Litigation Uncertainty, 1989 DUKE L.J. 54, 54 (1989) (noting that in the early 1980s, hostile takeovers were a fundamental and recognized part of the American corporate environment).


3See id.

4See id. The SEC and the courts allowed raiders to make hostile tender offers contingent on obtaining financing through junk bonds. Id.

5See id. A "bust up" takeover was implemented by a raider who would find third parties to commit in advance to purchase portions of the target corporation following the completion of the raider's tender offer, thereby breaking up the company. See id.

6See FLEISCHER & SUSSMAN, supra note 2, § 5.04[A], at 5-36. A "street sweep" was implemented by a buyer buying up large blocks of shares of the target corporation in a very short time, and then applying pressure to break up the corporation or engaging in some other restructuring business deal. Id.


8See FLEISCHER & SUSSMAN, supra note 2, § 5.04[A], at 5-36.


poison pill, thus circumventing the obstacle to the hostile acquisition.\textsuperscript{11} In response to this tactic, more potent forms of the poison pill were developed, such as the continuing directors provision, referred to as the dead hand poison pill,\textsuperscript{12} and more recently, the no hand poison pill.

This comment examines the recent Delaware Court of Chancery's ruling that the dead hand provision of a poison pill is subject to challenge under Delaware law. In addition, the invalidation of the no hand delayed redemption provision of a shareholders' rights plan will be explored. Part II provides an overview of the development of the poison pill as a defensive measure to hostile takeovers and its treatment by the Delaware courts. In addition, the development of variations of the poison pill will be explored, including their treatment thus far in Delaware and elsewhere. Part III explores the rationale of the court of chancery's decision that the dead hand poison pill is subject to legal challenge under Delaware law. Part III also discusses the rationale of the Delaware courts' invalidation of the no hand poison pill. Finally, Part IV discusses why the implementation of dead hand and no hand poison pill provisions violate a board of directors' fiduciary duties. In addition, Part IV contains a discussion of the similarities between the no hand and dead hand poison pills and explains why both violate basic norms of Delaware statutory law.

II. BACKGROUND

Since the Delaware courts' validation of a poison pill for use as a defensive measure against hostile takeovers,\textsuperscript{13} the poison pill\textsuperscript{14} has been adopted by numerous corporations to fortify their defensive arsenal.\textsuperscript{15} A poison pill was initially regarded as a "show-stopper" that would prevent all

\textsuperscript{11}See Lese, supra note 9, at 2175.
\textsuperscript{12}See id. at 2175-76.
\textsuperscript{13}See Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985) (upholding adoption of poison pill as a pre-planned defensive measure where board determined corporation was vulnerable to hostile acquisition). See also Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986) (upholding adoption of a poison pill in response to a hostile takeover bid that the board concluded was inadequate).
\textsuperscript{14}The invention of the poison pill has been attributed to Wall Street lawyer Martin Lipton. See Guhan Subramanian, A New Takeover Defense Mechanism: Using an Equal Treatment Agreement As An Alternative to the Poison Pill, 23 DEL. J. CORP. L. 375, 397 (1998).
\textsuperscript{15}See Randall S. Thomas, Judicial Review of Defensive Tactics in Proxy Contests: When Is Using a Rights Plan Right?, 46 VAND. L. REV. 503, 510 (1993) (noting that approximately half of the major United States corporations have shareholders' rights plans). See also Subramanian, supra note 14, at 376 (noting that "[f]ifteen years after their first appearance in corporate boardrooms, poison pills currently provide the centerpiece for more than half of the Fortune 500 companies' takeover defenses"). By 1997, more than 1700 corporations had adopted shareholders' rights plans. See id. at 398.
hostile acquisitions.\textsuperscript{16} Defensive measures adopted by boards prior to the inception of the poison pill did not act as sufficient deterrents to hostile acquirors.\textsuperscript{17} Indeed, the poison pill was the first defensive measure to provide a board with adequate power to deal effectively with a raider's bid for control.\textsuperscript{18} As noted above, however, raiders soon developed techniques to avoid the effects of a poison pill.\textsuperscript{19} Before addressing variations of the poison pill developed in response to these techniques, the mechanics of a poison pill and its effects will be discussed below.

A. The Mechanics of a Poison Pill

While there is no precise definition of the term poison pill,\textsuperscript{20} it generally denotes a right distributed to shareholders which is triggered by certain specified events involving a hostile acquisition of the target company.\textsuperscript{21} Typically, the plan provides each shareholder of record with the right to buy, at a significant discount, an additional share for each share held when the poison pill is triggered.\textsuperscript{22} Prior to the triggering of the poison pill, the rights have no value and are not transferable.\textsuperscript{23} Once triggered, however, the rights attain significant economic value.\textsuperscript{24} Generally, a poison pill is triggered when a hostile acquiror either announces a tender offer or obtains stock in the target corporation over a prescribed threshold.\textsuperscript{25}

The most common rights plan contains both "flip in" and "flip over" features.\textsuperscript{26} The "flip in" provision is triggered when an acquiror purchases stock in excess of the threshold limit, or when an acquiror announces a tender offer.\textsuperscript{27} When such a triggering event occurs, the rights vest in all the

\textsuperscript{16}See Yablon, supra note 1, at 55.

\textsuperscript{17}See FLEISCHER & SUSSMAN, supra note 2, § 5.04[A], at 5-37. For example, some structural changes, known as shark repellants, made it more difficult, but not impossible, for a raider to succeed. But even these less-than-perfect defenses were difficult to implement because they required shareholder approval, which was increasingly difficult to obtain as institutional investors became prevalent. See id.

\textsuperscript{18}See Yablon, supra note 1, at 55.

\textsuperscript{19}See supra notes 11-12 and accompanying text.

\textsuperscript{20}See Yablon, supra note 1, at 58.

\textsuperscript{21}See FLEISCHER & SUSSMAN, supra note 2, § 5.01[B], at 5-6.

\textsuperscript{22}See Yablon, supra note 1, at 58.

\textsuperscript{23}See Thomas, supra note 15, at 510.

\textsuperscript{24}See FLEISCHER & SUSSMAN, supra note 2, § 5.01[B], at 5-7 (explaining that when the poison pill is triggered, shareholders exercising their rights may buy additional stock at a 50% discount).


\textsuperscript{26}See FLEISCHER & SUSSMAN, supra note 2, § 5.01[B], at 5-7.

\textsuperscript{27}See id.
shareholders of the corporation except the potential acquiror.\textsuperscript{28} The right generally entitles shareholders, other than the acquiror, to purchase additional voting stock at a substantially discounted price, typically 50% of market value.\textsuperscript{29} The "flip over" feature of the rights plan is triggered "if, after a flip-in event, the company is involved in a business combination or substantial asset sale with any person."\textsuperscript{30} When this occurs, shareholders of the target company, other than the hostile acquiror, obtain the right to buy stock in the acquiror's company at half the price of its market value.\textsuperscript{31}

Shareholders' rights plans can be adopted by a board of directors without shareholder approval.\textsuperscript{32} They can be enacted quickly in the face of a specific threat to the corporation\textsuperscript{33} or as a pre-planned defensive measure.\textsuperscript{34} In addition, the power to redeem the rights (i.e., to buy back the rights at a nominal price) is vested in the board of directors.\textsuperscript{35} This power to redeem the rights provides the board with significant leverage in negotiations with a potential acquiror.\textsuperscript{36} The directors can redeem the rights and prevent the economic dilution that would occur if the acquiror accumulated stock in excess of the threshold level, provided they are satisfied with the price and other terms offered by the acquiror.\textsuperscript{37}

\textsuperscript{28}See id.
\textsuperscript{29}See id.
\textsuperscript{30}See Fleischer & Sussman, supra note 2, § 5.01[B], at 5-7.
\textsuperscript{31}See Lese, supra note 9, at 2180; Rifkind, supra note 10, at 109.
\textsuperscript{32}See Lese, supra note 9, at 2181. See also Rifkind, supra note 10, at 111 (noting that "[t]he great power of poison pills derives from the board's ability to adopt them without shareholder approval").
\textsuperscript{34}See Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985).
\textsuperscript{35}See Thomas, supra note 15, at 512. See also Lese, supra note 9, at 2181 n.30 (citing Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions 744 (2d ed. 1995) (noting that a board may redeem the rights at any time prior to a bidder's acquisition over the threshold percentage of shares at a price of $.01 per right).
\textsuperscript{36}See Fleischer & Sussman, supra note 2, § 5.01[B], at 5-8 (noting that "one of the fundamental attributes of the pill is that it can be adopted by a board of directors without a stockholder vote and the board alone has the power to redeem it").
\textsuperscript{37}See Yablon, supra note 1, at 61. Poison pills give: incumbent management substantial power and discretion to delay or eliminate a poison pill's deleterious effects on offerors. Many pills authorize incumbent directors to suspend the exercise of Rights for a substantial period of time following a triggering event, and almost every pill now provides that a majority of incumbent directors can cause the target corporation to redeem the Rights for a nominal price, thereby removing their deterrent effect on offerors.

Id.
B. The Effect of a Poison Pill in Hostile Acquisitions

The poison pill acts by diluting the economic and voting rights of a hostile acquiror that has obtained stock in excess of a predetermined threshold amount.\(^\text{38}\) Since a hostile acquisition cannot be completed without triggering the rights plan, "the raider cannot swallow up the company without also ingesting the economic poison represented by the value that has to be delivered upon exercise of the rights."\(^\text{39}\) Therefore, the poison pill provision acts as a doomsday device, dissuading hostile acquirors from obtaining an amount of stock in excess of the threshold for fear of the costly dilution that would result when the rights are triggered.\(^\text{40}\) Thus, the pill is effective by reason of its deterrence.\(^\text{41}\)

Commentators have asserted that poison pills benefit shareholders by protecting them from coercive hostile bids such as two-tiered tender offers.\(^\text{42}\) A corporation with a poison pill in place will be able to effectively deal with coercive action on the part of bidders — a major justification for poison pills, since coercive action may have a negative impact on shareholders.\(^\text{43}\) A poison pill will also provide a board with adequate time to consider more lucrative alternatives.\(^\text{44}\) In addition, since the pill provides the board of a target corporation with more leverage, the mere presence of a poison pill allows a board to negotiate with an acquiror, thereby helping to provide full value to shareholders.\(^\text{45}\) Conversely, a major criticism of poison pills is that


\(^{39}\)FLEISCHER & SUSSMAN, supra note 2, § 5.01[B], at 5-7.

\(^{40}\)See Riskind, supra note 10, at 109. See also Thomas, supra note 15, at 512 (noting that a poison pill with "flip in" and "flip over" features prevents potential acquirors from accumulating large amounts of the target's stock because of the inevitable dilution that will result if the bidder obtains more shares than the threshold level).

\(^{41}\)See FLEISCHER & SUSSMAN, supra note 2, § 5.01[C], at 5-15 to 5-16. See also Subramanian, supra note 14, at 397 (noting that the dilution that would result from triggering a poison pill "makes a tender offer a prohibitively expensive method of acquisition. Instead, potential acquirors are forced to negotiate a merger with the target's board").

\(^{42}\)Lese, supra note 9, at 2184-86.

\(^{43}\)Id. at 2186-87.

\(^{44}\)See FLEISCHER & SUSSMAN, supra note 2, § 5.01[A], at 5-5. See also Subramanian, supra note 14, at 398 (noting that the poison pill has been praised because of the protection it provides shareholders from coercive tender offers).

\(^{45}\)See Thomas, supra note 15, at 512. See also FLEISCHER & SUSSMAN, supra note 2, § 5.02[A], at 5-15 (noting that both commentators and courts have found that poison pills do not prevent takeovers but do result in higher premiums for shareholders).
they entrench incumbent management, wresting control of the corporation away from shareholders.46

C. Judicial Treatment of Poison Pills in Delaware

The Delaware Supreme Court has firmly established the authority of a board of directors to adopt poison pills.47 In Moran, the court determined that, under Delaware law, the board of directors has the authority to establish a shareholders' rights plan with a poison pill provision as a pre-planned defensive measure.48 Similarly, the Delaware Supreme Court upheld the board's power to adopt a poison pill in response to a hostile tender offer.49 Having established this authority to adopt poison pills, the issue becomes whether the adoption or retention of a poison pill is a breach of the board's fiduciary duties.50

The standard of review applicable to the adoption or retention of defensive measures by a board of directors was articulated by the Delaware Supreme Court in Unocal,51 and was later refined by that court in Unitrin.52 Generally, a court will apply the deferential business judgment rule to board action.53 In the context of a hostile takeover involving issues of corporate control, however, directors are often confronted with an inherent conflict of interest "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."54 Therefore, when a board adopts a defensive measure, it

46See Thomas, supra note 15, at 506 (explaining that shareholders ability to express their dissatisfaction with the incumbent board may be eliminated by permitting the use of the poison pill against proxy contests).


48See Moran, 500 A.2d at 1350-51.

49See Revlon, 506 A.2d at 180.

50See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (noting that "[i]n the board's exercise of corporate power to forestall a takeover bid our analysis begins with the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders").

51Id. at 954-55.


53See Stroud v. Grace, 606 A.2d 75, 82 (Del. 1992). The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Where the business judgment rule applies to board action, the court will not substitute its judgment for that of the board of directors. Id.

54Unocal, 493 A.2d at 954.
must satisfy the enhanced scrutiny standard set forth in Unocal before the business judgment rule applies.\textsuperscript{55}

Directors do not have the authority to defeat any perceived threat by whatever "draconian" means available.\textsuperscript{56} Under the Unocal enhanced scrutiny analysis, the board must satisfy a two-part balancing test before it is afforded the presumptions of the business judgment rule.\textsuperscript{57} First, the board must demonstrate that, in good faith, it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."\textsuperscript{58} Under the second prong of the balancing analysis, the proportionality test, the board must demonstrate that the "defensive response was reasonable in relation to the threat posed."\textsuperscript{59}

The application of the Unocal standard to defensive measures is a crucial issue for determining whether adopting variations of the poison pill is a valid exercise of the board's authority.\textsuperscript{60} Applying Unocal to the adoption of poison pill provisions, a board must satisfy the first requirement that the measure be adopted because the board reasonably perceived a threat to the corporation.\textsuperscript{61} In order to determine whether a defensive response is reasonable in relation to the perceived threat, the threat must be established under the first part of the analysis.\textsuperscript{62}

In Unocal, the court delineated a number of issues for a board to consider in determining whether a threat to the corporation exists.\textsuperscript{63} This list was not intended to be exclusive,\textsuperscript{64} and courts applying this prong of the

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\textsuperscript{55}Id. See also Rifkind, supra note 10, at 121-22 (explaining that the enhanced scrutiny test was developed "because of directors' strong entrenchment motive when adopting defenses against an unsolicited offer").

\textsuperscript{56}Unocal, 493 A.2d at 955.

\textsuperscript{57}See Unitrin, 651 A.2d at 1374; Unocal, 493 A.2d at 955.

\textsuperscript{58}Unitrin, 651 A.2d at 1373.

\textsuperscript{59}Id.

\textsuperscript{60}See Lese, supra note 9, at 2205 (explaining that the court will only use the business judgment rule to evaluate an antitakeover defense if both prongs of the Unocal standard are met).

\textsuperscript{61}Unocal, 493 A.2d at 955. The court further noted that the board may satisfy this burden by demonstrating good faith and reasonable investigation, which is enhanced where the board is comprised of a majority of outside independent directors. See also Fleischer & Susman, supra note 2, § 5.06(D)(2), at 5-113 to 5-114 (noting that under the first Unocal requirement of a reasonably perceived threat, "courts [are] willing to accept that virtually any company is vulnerable to hostile takeover tactics which could subject the company and its stockholders to significant disadvantage and that a board is justified in adopting a pill to protect against this risk").


\textsuperscript{63}Unocal, 493 A.2d at 955. The Unocal court noted that a number of threats may be legally cognizable: "[I]nadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of the securities being offered in the exchange." Id.

\textsuperscript{64}See Unitrin, 651 A.2d at 1384-85 (suggesting that this list contains examples only).
Unocal balancing test have failed to frame a list of acceptable threats justifying board action.65 Courts have recognized that a board may reasonably perceive a threat to the corporation where it is confronted with a coercive bid, such as a two-tiered tender offer, which may lead shareholders to tender their shares out of fear, and consequently receive an inadequate price.66 In addition, under Moran, a board may reasonably perceive a threat to the corporation based on the nature of the takeover climate.67 Courts have also recognized that uninformed shareholders may pose a threat to the corporation, justifying defensive action by the board.68

After demonstrating a threat to the corporation exists, the board then must show that the adoption of a defensive measure was reasonable in relation to the threat posed, or, that it was proportionate.69 Under this prong of the analysis, the adoption of a poison pill has generally been upheld as a proportionate response.70 This is true even when a board adopts the poison pill as a pre-planned defensive measure, so long as the board has demonstrated a reasonable belief that the corporation was vulnerable to "coercive acquisition techniques."71 Therefore, where a board, in good faith and after reasonable investigation, believes the corporation is subject to a hostile takeover through coercive means such as a two-tiered tender offer, the board's adoption of a poison pill is a proportionate response.72

A major reason for the Delaware Supreme Court's validation of the poison pill as a defensive measure was its view that the pill did not interfere with a dissident's chance to win a proxy contest, remove the board, and redeem the rights.73 In Moran,74 the adoption of a poison pill was determined to be a proportionate response to the threat of a hostile takeover

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65See Moore Corp. Ltd. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545, 1557 (D. Del. 1995). See also Rifkind, supra note 10, at 122 (noting that "Delaware courts have struggled to define what threats cited by management are sufficient to justify defensive action by directors under enhanced scrutiny standard").

66See Unocal, 493 A.2d at 956. See also Rifkind, supra note 10, at 122-23 (explaining that in the face of a front-loaded two-tiered tender offer, shareholders may tender in the front for fear that if they do not tender at this time, and enough other shareholders do, they will be subject to the back end consideration for their shares at far less value).


68See Moore, 907 F. Supp. at 1560. See also Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990) (recognizing that shareholders may be tempted to tender their shares out of "ignorance or a mistaken belief of the strategic benefit which a business combination with [Time] might produce").

69Unitrin, 651 A.2d at 1376.

70See Moran, 500 A.2d at 1357.

71Id.

72Id.

73See FLEISCHER & SUSSMAN, supra note 2, § 5.06[D][3], at 5-119.

74500 A.2d at 1346.
because it did not "strip[] stockholders of their rights to receive tender offers" and it did not "fundamentally restrict[] proxy contests." The court relied on the fact that the rights plan was not absolute, and could be redeemed by the directors. The decision of the board to redeem the pill, as the court noted, is subject to the same fiduciary duties as the initial decision to adopt the plan.

One of the major impacts of the Delaware Supreme Court's decision in Unitrin stems from the court's interpretation of the proportionality prong of the Unocal test. In determining whether a defensive measure is proportionate to the identified threat, a court must determine whether "a defensive response was draconian because it was either coercive or preclusive in character." If it is determined that the adoption of a defensive measure by the board is not draconian — not preclusive or coercive — then the second part of the Unocal analysis "requires the focus of enhanced judicial scrutiny to shift to 'the range of reasonableness'." Illustrating this point, the court cited Paramount Communications, Inc. v. Time Inc., where it was determined

that the Time board's defensive response was reasonable and proportionate since it was not aimed at "cramming down" on its shareholders a management-sponsored alternative, i.e., was not coercive, and because it did not preclude Paramount from making an offer for the combined Time-Warner company, i.e., was not preclusive.

Furthermore, the court noted that, in Moran, the adoption of a poison pill "was a proportionate response to the theoretical threat of a hostile takeover, in part, because it did not 'strip' the stockholders of their right to receive tender offers and did not fundamentally restrict proxy contests, i.e., was not preclusive." The court went on to find that the defensive measures adopted

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75 Id. at 1357.
76 Id. at 1354.
77 Id.
79 Id.
80 Id. at 1387-88 (quoting Paramount Communications, Inc., v. QVC Network, Inc., 637 A.2d 34, 45-46 (Del. 1994)).
81 571 A.2d 1140 (Del. 1989).
82 Unitrin, 651 A.2d at 1387.
83 Id.
would not be preclusive unless the opportunity to conduct a proxy contest was not a viable alternative.\textsuperscript{84}

D. The Shareholder Voting Franchise

Courts also scrutinize the adoption and retention of defensive measures by corporate boards where they impact on the shareholder voting franchise. The shareholder vote is the principle that legitimizes directorial powers.\textsuperscript{85} If shareholders do not agree with the policies of the board, they have the power to vote them out.\textsuperscript{86}

When the purpose of board action is to interfere with or frustrate the shareholder vote, a compelling justification must be shown to sustain that action.\textsuperscript{87} It has been suggested that this closer scrutiny, where a tender offer is coupled with a proxy contest, is not a separate test from the enhanced scrutiny test established by Unocal.\textsuperscript{88} As the Delaware Supreme Court noted, "A board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect under Unocal, and cannot be sustained without a 'compelling justification.'"\textsuperscript{89}

The question of who has the authority to run the corporation is raised when the board acts with the primary purpose of preventing the effectiveness

\textsuperscript{84}Id. at 1388. The court noted that a proxy contest remains a viable alternative unless "success would either be mathematically impossible or realistically unattainable." Id. at 1388-89. Similarly, in Moore, the federal district court of Delaware determined that the retention of a poison pill was not preclusive because it would "have no effect on the success of the proxy contest." Moore Corp. Ltd. v. Wallace computer Servs., Inc., 907 F. Supp. 1545, 1563 (D. Del. 1995).

\textsuperscript{85}Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988). See generally Morgan N. Neuwirth, Shareholder Franchise—No Compromise: Why the Delaware Courts Must Proscribe All Managerial Interference With Corporate Voting, 145 U. Pa. L. Rev. 423, 425 (1996) (noting that the "shareholder vote is at the heart of the economic principles that drive corporate efficiency, as well as the fiduciary principles that legitimate managerial exercise of power over the vast amount of assets that management does not own").

\textsuperscript{86}See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (noting that "i]f the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out"). See also Schnell v. Chris-Craft Indus., Inc., 283 A.2d 437, 439 (Del. 1971) (noting that the board of a Delaware corporation may not take action with the purpose of perpetuating itself in office).

\textsuperscript{87}Blasius, 564 A.2d at 658. See also Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 42 (Del. 1994) (recognizing that "b]ecause of the overriding importance of voting rights, this Court and the Court of Chancery have consistently acted to protect stockholders from unwarranted interference with such rights").

\textsuperscript{88}See Gilbert v. El Paso Co., 575 A.2d 1131, 1144 (Del. 1990). See also Kidsco Inc. v. Dinsmore, 674 A.2d 483, 495 (Del. Ch. 1995) (noting that where an acquiror initiates a proxy contest along with a tender offer, both Unocal and Blasius will be invoked).

\textsuperscript{89}Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992).
of a shareholder vote.\textsuperscript{90} Clearly, a conflict between the board and the shareholders arises where board action is "designed principally to interfere with the effectiveness of a [shareholder] vote."\textsuperscript{91} Under these circumstances, such a decision "may not be left to the [directors'] business judgment."\textsuperscript{92} In \textit{Blasius},\textsuperscript{93} the board was faced with a consent solicitation by a shareholder who held a nine percent interest in the corporation.\textsuperscript{94} The insurgent shareholder intended to nominate a majority of new directors to the Blasius board in order to consummate a takeover.\textsuperscript{95} In response, the board added two new directors, thereby preventing shareholders from electing a majority of new directors nominated by the insurgent shareholder.\textsuperscript{96}

Nevertheless, the \textit{Blasius} court rejected a per se rule of invalidity where a board's purpose is to interfere with the exercise of the shareholder vote.\textsuperscript{97} Instead, the court determined that a compelling justification must be shown for such board action.\textsuperscript{98} The court found that the board's belief the proposal was flawed, even if correct,\textsuperscript{99} did not justify the board's action because a "majority of the shareholders . . . could view the matter differently than did the board."\textsuperscript{100} The court noted that directors are not "platonic masters" over the affairs of the corporation, but rather agents of the shareholders.\textsuperscript{101}

Several cases following the court of chancery's decision in \textit{Blasius} addressed the issue of disenfranchisement. In both \textit{Stahl v. Apple Bancorp, Inc.},\textsuperscript{102} and \textit{Kidsco Inc. v. Dinsmore},\textsuperscript{103} the court of chancery examined whether a board had purposefully disenfranchised shareholders by changing the date of shareholder meetings. In \textit{Stahl}, the board deferred the annual shareholder meeting in the face of a majority shareholder's tender offer and

\textsuperscript{90} \textit{Blasius}, 564 A.2d at 559-60.
\textsuperscript{91} \textit{Id}.
\textsuperscript{92} \textit{Id}. \textit{See also} Aprahamian v. HBO & Co., 531 A.2d 1204, 1206-07 (Del. Ch. 1987) (invalidating a board's decision to postpone shareholder meeting on eve of election where insurgent shareholder had proxies representing majority of shares).
\textsuperscript{93} 564 A.2d 651 (Del. Ch. 1988).
\textsuperscript{94} \textit{Id} at 652.
\textsuperscript{95} \textit{Id}.
\textsuperscript{96} \textit{Id}. The maximum number of board members was 15, so by adding two members of their own choosing, the current board ensured a continuing majority. \textit{Id}.
\textsuperscript{97} 564 A.2d at 662.
\textsuperscript{98} \textit{Id} at 661-62
\textsuperscript{99} In fact, the chancellor indicated that he believed the insurgent's proposal was flawed. \textit{Id}.
\textsuperscript{100} \textit{Id}.
\textsuperscript{101} \textit{Blasius}, 564 A.2d at 663.
\textsuperscript{102} 579 A.2d 1115 (Del. Ch. 1990).
\textsuperscript{103} 674 A.2d 483 (Del. Ch. 1995).
announcement that he would solicit proxies for the election of new directors to redeem the shareholders' rights plan.\textsuperscript{104} Since the meeting date was never formally set, the court found that the shareholder franchise was not impaired.\textsuperscript{105} The court reasoned that the delay did not prevent any shareholders from exercising their vote and the election process would still go forward.\textsuperscript{106}

In \textit{Kidsco}, the board amended the corporation's bylaws in order to delay a shareholder meeting for twenty-five days in response to an insurgent's combined tender offer and proxy contest.\textsuperscript{107} The court found that the bylaw change was not enacted for the primary purpose of interfering with the shareholder franchise, but was done to allow the board to present a competing bidder's offer to the shareholders without the distraction of a proxy contest.\textsuperscript{108} Furthermore, the court noted that the bylaw amendment did not preclude a shareholder vote, but only delayed it.\textsuperscript{109} These cases demonstrate that board actions that have an effect on the shareholder franchise will only be subject to the \textit{Blasius} standard if such actions were taken with the primary purpose of impeding the shareholder franchise.\textsuperscript{110}

**E. The Development of Poison Pill Variations**

A poison pill is a valuable line of defense for a corporation, but it is not a cure-all.\textsuperscript{111} Since its inception, hostile bidders have developed ways to circumvent the poison pill.\textsuperscript{112} Specifically, a potential acquiror may "combine a tender offer with a consent solicitation or proxy contest" to

\textsuperscript{104}Stahl, 579 A.2d at 1117.
\textsuperscript{105}Id. at 1123.
\textsuperscript{106}Id.
\textsuperscript{107}Kidsco, 674 A.2d at 490.
\textsuperscript{108}Id. at 496.
\textsuperscript{109}Id.
\textsuperscript{110}See Stahl v. Apple Bancorp, Inc., No. CIV.A. 11,510, 1990 Del. Ch. LEXIS 121, at *24 (Del. Ch. Aug. 9, 1990), reprinted in 16 DEL. J. CORP. L. 1573, 1587 (1991). The court noted that: the approach taken in \textit{Blasius} . . . is appropriate when board action appears directed primarily towards interfering with the fair exercise of the franchise (e.g., moving a meeting date; adopting a bylaw regulating shareholder voting, etc.). The stock rights plan may or may not have that effect, but it does not represent action taken for the primary purpose of interfering with the exercise of the shareholders' right to elect directors.

\textsuperscript{111}See FLEISCHER & SUSSMAN, supra note 2, § 5.02[A], at 5-15.
\textsuperscript{112}See id. (suggesting that poison pills have not completely eliminated corporate control contests).
transcend the board's reluctance to accept the bidder's offer. Therefore, a target corporation remains susceptible to a hostile takeover, even with a poison pill in place. To counteract this, the continuing directors provision, pejoratively labeled the dead hand poison pill, and the no hand poison pill, began to appear in shareholders' rights plans.

A dead hand provision provides that only the continuing directors, those directors who installed the pill, or their approved successors, can redeem the poison pill. The effects of a no hand provision are even more pronounced: A no hand poison pill prevents all the directors of the target board from redeeming the poison pill and effectuating a sale of the corporation. Therefore, these provisions severely limit a hostile acquiror's chances of succeeding in a takeover attempt that combines a tender offer with a proxy contest. Even if a hostile bidder were successful in a proxy contest, the newly elected board members would be powerless to redeem the rights and consummate the merger. In this respect, where a dead hand poison pill is triggered, if shareholders favor a sale of the corporation, or even approve of a specific bidder's proposal, they will be forced to vote for the incumbent board members because only they are empowered to redeem the rights and effectuate a sale of the corporation.

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113See Lese, supra note 9, at 2183. See also Yablonska, supra note 1, at 56 (noting that the bidder can sue the target corporation seeking redemption of the pill, and a bidder can initiate a proxy contest to replace the board with its own nominees, who will remove the pill). See also Kidsco, Inc. v. Dinsmore, 674 A.2d 483, 489-90 (Del. Ch. 1995) (recognizing that a hostile unsolicited tender offer may be coupled with a proxy contest to replace the incumbent board as an efficient way to circumvent anti-takeover defensive measures such as a poison pill).

114See Daniel A. Neff, The Impact of State Statutes and Continuing Director Rights Plans, 51 U. MIAMI L. REV. 663, 671 (1997) (noting that continuing directors provisions have a chilling effect on proxy contests which have become a regular part of a hostile takeover strategy since the validation of poison pills).


116Id. at 532.


118See Neff, supra note 114, at 676 (arguing that a continuing directors provision would "negate or significantly limit the effectiveness of the tactic which hostile bidders have invariably used in seeking to acquire companies which have rights plans — a tender offer or public acquisition proposal coupled with a proxy contest or consent solicitation to remove the target's directors and redeem the rights").

119See Lese, supra note 9, at 2191.

120See Gordon, supra note 115, at 540.
Judicial decisions passing on the validity of the dead hand feature are scarce.\footnote{Until recently, the validity of a no hand poison pill provision had not been assessed by the Delaware courts.} Plaintiffs in two Delaware cases have questioned the validity of continuing directors provisions, however, the rulings did not directly address the issue.\footnote{See Neff, supra note 114, at 673-74 (discussing judicial decisions in Delaware which had the opportunity to address the dead hand feature of a shareholders' rights plan).} In \textit{Davis Acquisition Inc. v. NWA, Inc.},\footnote{No. CIV.A. 10,761, 1989 Del. Ch. LEXIS 39 (Del. Ch. Apr. 25, 1989), \textit{reprinted in} 15 Del. J. Corp. L. 156 (1990).} the directors of NWA, Inc. adopted a standard rights plan with flip in/flip over features, but it contained a provision providing that the rights could not be redeemed by anyone other than the incumbent board for 180 days.\footnote{\textit{Id.} at *3, \textit{reprinted in} 15 Del. J. Corp. L. at 160. This type of dead hand provision, which makes the rights redeemable by the incumbent board only for a short duration (not the life of the rights) has been labeled a diluted continuing directors provision. \textit{See} Lese, supra note 9, at 2210.} The plaintiffs argued that this provision interfered with a proxy contest because shareholders would be discouraged from voting for a new board that would have less power than the incumbent board.\footnote{\textit{Davis Acquisition}, 1989 Del. Ch. LEXIS 39, at *4, \textit{reprinted in} 15 Del. J. Corp. L. at 160.} Therefore, the plaintiffs contended that the dead hand provision impermissibly interfered with shareholder voting rights and limited the power of future boards.\footnote{\textit{Id.} at 5-6, \textit{reprinted in} 15 Del. J. Corp. L. at 161.} The court, however, did not resolve the question of the dead hand provision's validity.\footnote{\textit{Id.} at *17, \textit{reprinted in} 15 Del. J. Corp. L. at 165.}

In \textit{Sutton Holding Corp. v. Desoto, Inc.},\footnote{No. CIV.A. 12,051, 1991 Del. Ch. LEXIS 85 (Del. Ch. May 14, 1991), \textit{reprinted in} 17 Del. J. Corp. L. 363 (1991).} while again not deciding the issue, the court of chancery suggested that a continuing directors provision was suspect.\footnote{\textit{Id.} at *3, \textit{reprinted in} 17 Del. J. Corp. L. at 366. At issue was a provision, prompted by the acquiror's proxy contest, that the target's pension plans could not be terminated or amended for five years following a change in control of the corporation. \textit{Id.} at *2, \textit{reprinted in} 17 Del. J. Corp. L. at 365.} In dicta, former Chancellor Allen suggested that the adoption of the continuing directors provision was a breach of the board's fiduciary duty of loyalty.\footnote{\textit{Id.} at *4, \textit{reprinted in} 17 Del. J. Corp. L. at 366.} The court felt that this provision, adopted in the face of a proxy contest, was intended to impinge upon the shareholder franchise, action which is "deeply suspect" under \textit{Blasius}.\footnote{\textit{Id.}} The most critical defect of the provision was that a raider, who had the support of the
shareholders, would trigger the continuing directors provision, rendering any new board members powerless to redeem the rights.132

Outside Delaware, the validity of a continuing directors provision has been addressed by two jurisdictions. In Bank of New York Co. v. Irving Bank Corp.,133 the Supreme Court of New York enjoined the use of a continuing directors provision as an invalid exercise of the Board's authority under New York corporate law.134 The court based its decision on statutory grounds, noting that a board is without authority to limit the power of a future board if such a restriction is not contained in the certificate of incorporation.135 The court recognized that the incumbent board, or those new directors approved by it, would have the power to redeem the rights plan if reelected by a plurality of shareholders, "but the insurgents would not if they were elected by the same plurality."136 The court held that this was "illegal discrimination" beyond the power of the board.137

Conversely, a Georgia federal district court upheld the use of a continuing directors provision under Georgia Corporate Law in Invacare Corp. v. Healthdyne Technologies, Inc.138 Invacare made an all cash, all shares tender offer for Healthdyne, and then announced that it would propose a new slate of directors at the annual meeting.139 Accordingly, Invacare sought a preliminary injunction declaring the continuing directors provision of the Healthdyne rights plan invalid.140 Rejecting Invacare's claim that the dead hand provision was invalid, the court relied on Georgia corporate law141 which provides the board of directors with the power to

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134Id. at 486.
135Id. at 485. New York Business Corporation law provides that a restriction placed on the board of directors must be stated in the certificate of incorporation. N.Y. Bus. Corp. Law § 620 (McKinley 1997).
136Irving Bank Corp., 528 N.Y.S.2d at 485.
137Id.
139Id. at 1579.
140Id.
141GA. CODE ANN. § 14-2-624(a) (1994). Section 14-2-624(a) provides in pertinent part that "a corporation may issue rights, options, or warrants with respect to the shares of the corporation ... . The board of directors shall determine the terms upon which the rights, options or warrants are issued ... ." Id. Section 14-2-624(c) provides that [n]othing contained in Code Section 14-2-601 shall be deemed to limit the board of directors' authority to determine, in its sole discretion, the terms and conditions of the rights, options, or warrants issuable pursuant to this Code section. Such terms and conditions need not be set forth in the articles of incorporation. Id. § 14-2-624(c).
issue rights, and determine the terms and conditions of those rights, in their sole discretion. The court determined "that the board of directors' discretion to set the conditions of a rights plan is limited only by their fiduciary obligations to the corporation." The court also rejected Invacare's argument that a compelling justification must be shown for the adoption of the continuing directors provision because it interferes with the exercise of shareholder voting rights. The court opined that the continuing directors provision does not interfere with shareholders' rights to elect a new board, but instead the plan merely ensures that the rights plan can only be redeemed by one or more continuing directors.

III. ANALYSIS

A. Carmody v. Toll Brothers, Inc.

1. Introduction

In a case of first impression under Delaware law, the court of chancery, in a decision by Vice-Chancellor Jacobs, held that a dead hand provision of a rights plan was subject to legal challenge under Delaware law on both fiduciary and statutory grounds. For the reasons that follow, the court found the complaint stated a claim upon which relief could be granted and denied the defendants' motion to dismiss.

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142Invacare, 968 F. Supp. at 1580. But see Gordon, supra note 115, at 535-36 (criticizing the Invacare decision as "quite a stretch" based on the statutes and legislative history).

143Invacare, 968 F. Supp. at 1580. The court found little merit in the possibility of a fiduciary duty claim because Invacare argued that the continuing directors provision was invalid as a matter of law and did not argue that the directors had breached their fiduciary duties. Id. at 1581.

144Id. at 1581.

145Id. The court refused to find that there must be a showing of compelling justification, distinguishing the case from Blasius because: the continuing director feature in the Healthdyne rights plan does not infringe on the shareholders' right to elect a new board. The continuing director provision only ensures that the rights plan can not be redeemed or amended without the consent of at least one of the continuing directors. In this respect, the continuing director provision does not interfere with shareholder voting rights; nor is it coercive.

Id.


147Id.
2. Facts

The plaintiff, James Carmody, a shareholder in the defendant corporation, brought an action against Toll Brothers, Incorporated, (Toll Brothers) and the Toll Brothers board of directors (the board), alleging that the dead hand provision of the rights plan adopted by the board "violate[d] the Delaware General Corporation Law and/or the fiduciary duties of the board of directors who adopted the plan."148 Toll Brothers is a Delaware corporation, with its principal place of business in Pennsylvania.149 It operates in thirteen states and five regions of the United States designing, building, and marketing single family luxury homes.150 In 1986, Toll Brothers went public, issuing shares traded on the New York Stock Exchange, and has continued to grow and enjoy considerable success since that time.151

Since the late 1980s, the home building industry has been evolving into an industry in which regional companies serve large markets throughout the country.152 This consolidation has been accomplished through acquisitions, subjecting many companies to hostile takeovers.153 Therefore, in order to protect against the risk of a hostile takeover, and because the board of directors believed the company was a potential acquisition target at the time, the Toll Brothers board adopted a rights plan that contained a dead hand provision.154

The Shareholders' Rights Plan (Rights Plan) adopted by the board contained the standard "flip in"155 and "flip over"156 features, but also

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148 Id.
149 Id.
150 Toll Bros., 723 A.2d at 1182.
151 Id. According to the court, Toll Brothers expects to continue the success it has thus far enjoyed based on its continued expansion, backlog of home building contracts, and a strong demand for luxury housing in the regions in which it operates. Id.
152 Id. Historically, the home building industry was made up of local companies who served local and regional markets, but this has been changing over the last 10 years as companies have expanded. Id.
153 Id. at 1182-83.
154 Toll Bros., 723 A.2d at 1183. The board of directors adopted the rights plan on June 12, 1997, when the company's stock was trading at $18 per share, close to the "low end of its established price range." Id.
155 Id. The "flip in" provision of the rights plan provides for a dividend distribution of one preferred stock purchase right (a "Right") for each outstanding share of common stock as of July 11, 1997 . . . initially entitl[ing] the holder to purchase one thousandth of a share of a newly registered series Junior A Preferred Stock for $100. The Rights would become exercisable, and would trade separately from the common shares, after the "Distribution Date," which is defined as the earlier of (a) ten business days following a public announcement that an acquiror has acquired, or obtained the right to acquire, beneficial
included a dead hand provision. This dead hand feature provided that the rights issued pursuant to the shareholders' rights plan were redeemable only by the continuing directors — those board members in office at the time of the plan's adoption, or successors whom the current board had recommended and approved. 

3. Parties' Contentions

The plaintiff alleged that since the dead hand provision of the rights plan created different classes of directors — those who have the power to redeem the pill and those who do not — the restriction was ultra vires the board's authority because the power to implement such restrictions was not contained in the Toll Brothers certificate of incorporation. In addition, the complaint alleged the dead hand provision severely discouraged a hostile acquiror from engaging in a proxy contest to gain control over the corporation because the newly elected members could not redeem the Rights. The complaint further alleged that the dead hand provision disenfranchised shareholders because they would be forced to vote for the incumbent directors in a proxy contest because only they have the power to redeem the pill, thus stripping the shareholders of any real choice. The plaintiff contended that the only "purpose that the 'dead hand' provision could serve is to discourage future acquisition activity by making any proxy contest to replace incumbent board members an exercise in futility."

In response, the defendants contended that the rights plan did not force shareholders to vote for the incumbent board and it did not preclude or interfere with a proxy contest as a means to gain control over the

ownership of 15% or more of the company's outstanding common shares (the "Stock Acquisition Date"), or (b) ten business days after the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 15% or more of the company's outstanding common shares.

Id. The rights were to remain exercisable, unless earlier redeemed by the company, until June 12, 2007, 10 years after the adoption of the Rights Plan. Id.

Id. The "flip over" provision of the rights plan entitled the Rights holders to purchase common stock of the acquiring company at half price if, after the stock acquisition date, the company is made a party to a merger in which Toll Brothers is not the surviving corporation, or in which it is the surviving corporation and its common stock is changed or exchanged. Id. at 1183-84.

Id. at 1184.

Toll Bros., 723 A.2d at 1184. Under the definition of a "continuing director," any board member that at the time of adoption or any one which the board recommended and approved, who was affiliated or associated with an acquiring person could not redeem the rights. Id.

Id.

Id.

Id.

Toll Bros., 723 A.2d at 1184.
company.\textsuperscript{163} Therefore, the defendants claimed that the rights plan was not invalid per se.\textsuperscript{164} Additionally, the defendants proffered that even if the dead hand provision did give more power to one category of directors over another, this was tantamount to a board delegating the power to perform specific tasks to a special committee — a valid exercise of the board's power under Delaware statutory law.\textsuperscript{165} These powers, the defendants noted, need not be defined in the certificate of incorporation.\textsuperscript{166} Next, the defendants argued that the adoption of the dead hand provision did not violate the board's fiduciary duties because the adoption satisfied the applicable standards developed under \textit{Unocal/Unitrin} or \textit{Blasius}.\textsuperscript{167} Finally, the defendants contended that the dead hand provision of the rights plan did not interfere with shareholder voting rights because it did not prevent shareholders from electing a new board, "and even though that board may be unable to redeem the Rights, that violates no fiduciary duty, because even \textit{Blasius} permits a board to interfere with the voting process in sufficiently compelling circumstances."\textsuperscript{168}

4. The Court of Chancery Decision

The court of chancery held that the dead hand poison pill provision was subject to legal challenge under Delaware law.\textsuperscript{169} Initially, the court analyzed the claim that the dead hand feature violated Delaware General Corporation Law section 141(a) and (d).\textsuperscript{170} First, the court noted that, under section 141(d),\textsuperscript{171} distinctions between board members can only be created where there is a classified board and where the certificate of incorporation contains the restrictions on the specified class of director's voting power.\textsuperscript{172}

\begin{footnotesize}
\begin{enumerate}
\item Id. at 1190.\textsuperscript{163}
\item Id.\textsuperscript{164}
\item Id.\textsuperscript{165}
\item \textit{Toll Bros.}, 723 A.2d at 1190.\textsuperscript{166}
\item Id.\textsuperscript{167}
\item Id.\textsuperscript{168}
\item Id.\textsuperscript{169}
\item \textit{Toll Bros.}, 723 A.2d at 1191. See \textsc{Del. Code Ann.} tit. 8, §§ 141(a), (d) (1991).\textsuperscript{170}
\item Section 141(d) provides that:
[t]he certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation. The terms of office and voting powers of the directors elected in the manner so provided in the certificate of incorporation may be greater than or less than those of any other director or class of directors.\textsuperscript{171}
\item \textsc{Del. Code Ann.} tit. 8, § 141(d) (1991).\textsuperscript{172}
\item \textit{Toll Bros.}, 723 A.2d at 1190.\textsuperscript{173}
\end{enumerate}
\end{footnotesize}
The court determined that, under section 141(d), if distinctive voting rights are given to some board members, but not others, "those distinctive voting rights must be set forth in the certificate of incorporation," and it was alleged that the Toll Brothers' certificate did not contain such distinctions.\(^\text{173}\)

Second, the court found the complaint stated a claim that the dead hand provision of the rights plan was *ultra vires* and therefore invalid.\(^\text{174}\) Under section 141(d), shareholders have the right to elect directors that may have more or less voting power than others.\(^\text{175}\) The court noted, however, that "[a]bsent express language in the [certificate of incorporation], nothing in Delaware law suggests that some directors of a public corporation may be created less equal than other directors, and certainly not by unilateral board action."\(^\text{176}\) The court noted that because the dead hand provision interfered with the shareholders' right to elect directors who would have the power to redeem the pill, and because it was alleged that this power was not contained in the Toll Brothers certificate of incorporation, the complaint stated a claim that the continuing directors provision was invalid.\(^\text{177}\)

Third, under section 141(a), the court found that "the complaint state[d] a claim that the dead hand provision would impermissibly interfere with the directors statutory power to manage the business and affairs of the corporation."\(^\text{178}\) Since the rights could only be redeemed by the continuing directors, a newly elected board's power to enter into a business combination would be severely limited because it could not redeem the rights without the consent of the "continuing directors."\(^\text{179}\) Thus, it was claimed that "the 'dead hand' provision would interfere with the board's power to protect fully the

\(^{173}\) Id. at 1191.
\(^{174}\) Id.
\(^{175}\) Id.
\(^{176}\) Toll Bros., 723 A.2d at 1191.
\(^{177}\) Id.
\(^{178}\) Id. Section 141(a) provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." Del. Code Ann. tit. 8, § 141(a) (1991).
\(^{179}\) Toll Bros., 723 A.2d at 1191. In determining that the complaint stated a claim that the dead hand provision was invalid under Delaware statutory law, the court cited Bank of New York Co. v. Irving Bank Corp., 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988), as support. Toll Bros., 723 A.2d at 1191. Though the relevant statutory provisions of Delaware and New York differ, the court noted that both statutes required that "limitations upon the directors' power be expressed in the corporation's charter." Id. at 1192. It was alleged that the Toll Brothers certificate of incorporation contained no such limitation. Id. In addition, the court distinguished the decision in Invacare Corp. v. Healthdyne Technologies, Inc., 968 F. Supp. 1578 (N.D. Ga. 1997), which upheld the adoption of a continuing directors provision because there is no statutory requirement under Georgia law that limitations on directors' power be mandated in the certificate of incorporation. Toll Bros., 723 A.2d at 1192 n.38.
corporation's (and its shareholders') interests in a transaction that is one of the most fundamental and important in the life of a business enterprise.\footnote{180}

In assessing the plaintiff's fiduciary duty claims, the court first addressed whether the dead hand provision of the Rights Plan was subject to legal challenge on the basis that its adoption violated the directors' fiduciary duty of loyalty.\footnote{181} The complaint alleged that, under \textit{Blasius}, the dead hand provision was unlawful because it "purposefully interfere[d] with the shareholder voting franchise without any compelling justification."\footnote{182} The more exacting \textit{Blasius} standard was applicable to the board's adoption of the dead hand feature, because, according to the court, the plan purposely disenfranchised shareholders.\footnote{183} The court noted that disenfranchisement will occur because the shareholders will have no choice but to vote for incumbent directors in an election contest if they desire directors who have the power to accept a hostile bid, even if they do not agree with their policies, because only the continuing directors have the power to redeem the rights and accept a bid.\footnote{184} Further, the court stated that "[a] claim that the directors have unilaterally 'create[d]' a structure in which shareholder voting is either impotent or self defeating' is necessarily a claim of purposeful disenfranchisement."\footnote{183} The court acknowledged that the Delaware Supreme Court upheld the adoption of the poison pill because the shareholders could replace the board if it refused to redeem the pill.\footnote{186} In addition, the court noted that the justification for allowing a board of directors to reject a hostile bid that may be favored by the shareholders is the latter's power to resort to the ballot box and replace the board.\footnote{187} Finally, the court reiterated that the shareholder vote is of utmost importance in the "system of corporate governance because it is the 'ideological underpinning upon which the legitimacy of directorial power rests."\footnote{188} Under this framework, the court

\begin{footnotesize}
\begin{enumerate}
\item \textit{Toll Bros.}, 723 A.2d at 1191.
\item \textit{Id.}
\item \textit{Id.} at 1193.
\item \textit{Id.} at 1193.
\item \textit{Id.} The court quoted the Delaware Supreme Court's interpretation of the \textit{Blasius} standard from \textit{Stroud v. Grace}, 606 A.2d 75 (Del. 1992): "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.'" \textit{Toll Bros.}, 723 A.2d at 92 n.3.
\item \textit{Toll Bros.}, 723 A.2d at 1193.
\item \textit{Id.} (quoting Gordon, \textit{supra} note 115, at 540).
\item \textit{Id.} (citing Moran v. Household Int'l, Inc., 500 A.2d 1346, 1355 (Del. 1985)).
\item \textit{Id.} (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985)).
\item \textit{Toll Bros.}, 723 A.2d at 1193 (quoting Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988)).
\end{enumerate}
\end{footnotesize}
found the complaint stated a claim that the board breached its fiduciary duty under *Blasius*.  

Next, the court examined the plaintiff's contention that the dead hand provision was an "unreasonable defensive measure within the meaning of *Unocal*," and concluded that the complaint stated a legally cognizable claim on this basis.  

"A defensive measure is disproportionate . . . if it is either coercive or preclusive." The complaint alleged the dead hand feature was coercive because it interfered with the shareholders' rights by forcing them to vote for the incumbent directors if they desired a board equipped with their full powers, including the power to redeem the Rights Plan. In addition, the complaint alleged the dead hand feature was preclusive in that it makes a bid for the company remote since a proxy contest will not be effective for a potential acquiror because any newly elected directors would not have the power to redeem the pill. According to the complaint, any contest for control over Toll Brothers would be "prohibitively expensive and effectively impossible." Therefore, the complaint stated a claim that the dead hand provision is disproportionate and unreasonable under *Unocal* because it makes a proxy contest "realistically unattainable."

B. Quickturn Design Systems, Inc. v. Shapiro

1. Introduction

Following the court of chancery's decision in *Toll Brothers*, the Delaware courts were again confronted with a new and controversial mutation of the poison pill. Less than six months after determining that the dead hand provision of a shareholders' rights plan was subject to legal challenge under Delaware law, the validity of a new variation of the poison pill was contested: the no hand delayed redemption provision. In *Mentor*

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189 Id. at 1194.
190 Id. The court noted that, under the *Unocal* standard, "the board has the burden to satisfy the Court that the board (1) 'had reasonable grounds for believing that a danger to corporate policy and effectiveness existed,' and (2) that its 'defensive response was reasonable in relation to the threat posed.'" Id. (quoting *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (citing *Unocal*, 493 A.2d at 955).
191 Id. at 1195.
192 *Toll Bros.*, 723 A.2d at 1195.
193 *Id.*
194 *Id.*
195 Id.
196 The term no hand refers to the fact that no directors can redeem the poison pill, not even the continuing directors. In addition, the particular no hand poison pill provision at issue in *Mentor* was of a limited duration because it did not operate for the entire duration of the poison pill, but only
Graphics Corp. v. Quickturn Design Systems, Inc.,\textsuperscript{197} the court of chancery, in a decision by Vice-Chancellor Jacobs, held that the no hand delayed redemption provision adopted by Quickturn's board of directors was invalid on fiduciary duty grounds.\textsuperscript{198} While affirming the court of chancery's decision, the Delaware Supreme Court took a different approach, determining that the no hand delayed redemption provision was invalid on statutory grounds.\textsuperscript{199} The reasoning of these decisions and the factual circumstances in which they arose will be discussed in the following sections.

2. Facts

Plaintiff, Mentor Graphics Corp. (Mentor), filed suit against Quickturn Design Systems, Inc. (Quickturn), challenging the validity of the no hand poison pill provision of its shareholders' rights plan, which had been adopted in response to Mentor's hostile tender offer and proxy contest.\textsuperscript{200} Quickturn, a Delaware corporation, markets and manufacturers logic emulation technology,\textsuperscript{201} controlling sixty percent of the world market and an even larger percentage of the national market.\textsuperscript{202} Mentor, an Oregon corporation, manufactures and markets electronic design automation software and hardware.\textsuperscript{203} Recently, Mentor attempted to reenter the emulation market, but has been prevented from doing so in the United States because its products have been adjudged to infringe upon patents held by Quickturn.\textsuperscript{204} This difficulty led Mentor to contemplate an acquisition of

for a period of six months. Therefore, it is referred to as a no hand delayed redemption provision.

\textsuperscript{197}728 A.2d 25 (Del. Ch. 1998).
\textsuperscript{198}Id. at 28.
\textsuperscript{199}Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998).
\textsuperscript{200}Mentor Graphics, 728 A.2d at 35-36.
\textsuperscript{201}Id. at 29. Logic emulation technology is used by the makers of electronics systems and silicon chips to verify their design. \textit{Id}.
\textsuperscript{202}Id.
\textsuperscript{203}Id. at 28.
\textsuperscript{204}Mentor Graphics, 728 A.2d at 30. Interestingly, in 1992, Mentor sold its patents and hardware emulation assets to Quickturn. \textit{Id}. Then, in 1995, Mentor acquired Meta Systems (Meta), a French company which manufactures emulation products. \textit{Id}. After Mentor began to market Meta's emulation products in the United States, Quickturn initiated proceedings with the International Trade Commission (ITC), alleging that Mentor was infringing upon Quickturn's patents. \textit{Id}. The ITC ruled in favor of Quickturn and ordered Mentor to refrain from importing, selling, or marketing Meta's products in the United States. \textit{Id}. Attempting to avoid the mandate of the ITC, Mentor began to manufacture Meta's emulation products in the United States. \textit{Id}. This attempt, however, was nullified when the United States District Court of Oregon issued an injunction preventing Mentor from selling or manufacturing its emulation products in the United States. \textit{Id}.
Quickturn.205  
Mentor decided that an acquisition of Quickturn would be in its best interests and began researching such a possibility.206 Initially, Mentor could not afford to acquire Quickturn, but in the spring of 1998, Quickturn's earnings began to decline and its stock price fell to a point where an acquisition was financially possible.207 As a result, on August 12, 1998, Mentor announced an unsolicited cash tender offer for all of Quickturn's outstanding common stock, coupled with a proxy solicitation to replace the Quickturn board.208  
Quickturn's board deemed Mentor's offer inadequate and adopted two defensive measures.209 First, the board amended the corporation's bylaws to delay a shareholder's meeting, called by a shareholder owning ten percent or more of the corporation, for 90-100 days.210 Second, the board revised Quickturn's shareholders' rights plan, removing the dead hand provision211 and replacing it with a no hand212 delayed redemption provision.213 The  

205Id. at 31. By acquiring Quickturn, Mentor would become the owner of all Quickturn's patent rights, thereby allowing Mentor to seek rescission of the injunction in effect against Mentor. Id.  
206Id. A report conducted on behalf of Mentor analyzed "whether Mentor would create more value by selling Meta or by purchasing Quickturn." Id. The report concluded that a sale of Meta could net $50 million and would relieve Mentor of Meta's forecasted losses of $3.4 million in 1998, whereas purchasing Quickturn could "provide Mentor $610-$640 million of value." Id.  
207Id. at 29-32. While Quickturn has been a growth company since 1989, its stock prices and earnings levels began to drop in the spring of 1998 due to a decline in the Asian semiconductor market, which represented 30%-35% of Quickturn's annual sales. Id. at 29.  
208Mentor Graphics, 728 A.2d at 33. The $12.125 per share offer price "represent[ed] an approximate 50% premium over Quickturn's immediate pre-offer price, and a 20% discount from Quickturn's February 1998 stock price levels." Id. The first step of the Mentor tender offer "would be followed by a second step merger in which Quickturn's nontendering stockholders would receive, in cash, the same $12.125 per share tender offer price." Id.  
209Id. at 35.  
210Id.  
211The dead hand provision that was in place before the shareholders' rights plan was modified had a limited "continuing directors" feature that became operative only if an insurgent that owned more than 15% of Quickturn's common stock successfully waged a proxy contest to replace a majority of the board. In that event, only the "continuing directors" (those directors in office at the time the poison pill was adopted) could redeem the rights.  
212In its entirety, the no hand provision provided that: in the event that a majority of the Board of Directors of the Company is elected by stockholder action at an annual or special meeting of stockholders, then until the 180th day following the effectiveness of such election (including any postponement or adjournment thereof), the Rights shall not be redeemed if such redemption is reasonably likely to have the purpose or effect of facilitating a Transaction with an Interested Person.
combined effect of these two defense measures was to delay any possible acquisition of Quickturn by Mentor for at least nine months.\textsuperscript{214}

3. Parties' Contentions

Mentor first argued that the adoption of the no hand provision was invalid on fiduciary grounds because it interfered with the shareholders' franchise "by purposely interfering with the Quickturn shareholders' right to elect a board of their choice, without compelling justification."\textsuperscript{215} Mentor contended that, even if Quickturn's shareholders favored a sale of the company to Mentor, those shareholders may be compelled to vote for the incumbent slate of directors — those that would have the power to effectuate a sale of Quickturn within six months.\textsuperscript{216} In addition, Mentor argued that the adoption of the no hand provision was invalid under the fiduciary standards articulated in \textit{Unocal} and \textit{Unitrin} because it "was a disproportionate response to any threat reasonably perceived by the Mentor bid."\textsuperscript{217} Finally, Mentor alleged that the no hand provision would prevent a newly elected board of directors "from redeeming the pill to facilitate a transaction that would serve the stockholders' best interests, even under circumstances where the board would be constrained to do so because of their fiduciary duty."\textsuperscript{218} In this respect, according to Mentor, the no hand provision would wrongly dispossess "a newly elected board of its core authority to manage the corporation under 8 Del. C. § 141(a)."\textsuperscript{219}

\textit{Mentor Graphics}, 728 A.2d at 43 n.71. An interested person was defined as a party that "directly or indirectly proposed, nominated or financially supported the election of the new board." \textit{Id.} at 35. Clearly, Mentor would have been deemed an interested person if it had been successful in having its nominees elected as a majority of Quickturn's board. \textit{Id.}

\textsuperscript{213}\textit{Id.} at 35.
\textsuperscript{214}\textit{Id.} at 36.
\textsuperscript{215}\textit{Id.} at 43-44.
\textsuperscript{216}\textit{Mentor Graphics}, 728 A.2d at 44.
\textsuperscript{217}\textit{Id.}
\textsuperscript{218}\textit{Id.}
\textsuperscript{219}\textit{Id.} In arguing that the no hand provision would interfere with a newly elected board's authority to manage the corporation, Mentor relied upon \textit{Toll Brothers}. \textit{Id.}
4. The Court of Chancery Decision

The court of chancery determined that the adoption of the no hand provision by the Quickturn board violated its fiduciary duties under the *Unocal/Unitrin* standard. The court first concluded that the Mentor offer constituted substantive coercion and was, therefore, a legally cognizable threat. The court reasoned that Quickturn's board adopted the no hand provision due to the concern that the shareholders might accept Mentor's inadequate offer, without realizing Quickturn's true value, and then elect a new board that would sell the company before it had time to "adequately inform itself of Quickturn's fair value and before the shareholders could consider other options." The court concluded, however, that the no hand provision failed the proportionality prong of the *Unocal/Unitrin* standard. The court rejected Mentor's argument that the no hand provision was coercive and preclusive under the circumstances, but determined that

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220 The court did not consider whether the no hand provision was invalid on statutory grounds. *Mentor Graphics*, 728 A.2d at 44. Vice-Chancellor Jacobs noted that this seemed to be the proper basis for consideration, but the parties had focused on the fiduciary arguments and did not fully develop the statutory issues. *Id.* at 44 n.73. In fact, the court acknowledged that, in order to develop a 'principle, or 'bright line' test, that will readily enable a court to determine the validity of a limited duration 'no hand' poison pill," would require a court to consider whether the no hand pill is invalid under DEL. CODE ANN. tit. 8, § 141(a) (1991), "because it temporarily deprives a newly elected insurgent board of a portion of its core authority that the board adequately may need (or have a fiduciary duty) to exercise during the period of deprivation." *Mentor Graphics*, 728 A.2d at 52 n.105.

221 *Mentor Graphics*, 728 A.2d at 44. The court of chancery began its analysis by noting that the actions of the Quickturn board would be subjected to enhanced judicial scrutiny under the standards set forth in *Unocal*. *Id.* at 44-45. See supra notes 52-59 and accompanying text (discussing the *Unocal* standard of enhanced judicial scrutiny applicable in the context of a hostile takeover).

222 *Mentor Graphics*, 728 A.2d at 45-46.

223 *Id.* at 46.

224 *Id.* at 51.

225 Mentor argued that the no hand provision was coercive in that it would force "a significant percentage of Quickturn's stockholders who favor a sale of Quickturn to Mentor to abstain from voting or to vote for the incumbent Quickturn board" because the newly elected board would not have the power to immediately accept the Mentor offer. *Id.* at 47-48. The court rejected this argument because, even if, as Mentor claimed, 10%-20% of the shareholders would cast their votes in favor of the current board because of the no hand provision, Mentor did not offer any persuasive evidence that this would ensure Mentor's defeat in the proxy contest. *Id.* at 48-49. Moreover, the court noted Mentor's argument was undercut by the fact that a majority of Quickturn's shareholders had already tendered their shares to Mentor. *Id.* at 49.

226 Mentor contended the no hand provision was preclusive because it would force Mentor to "withdraw its offer before the six month nonredemption period expires." *Mentor Graphics*, 728 A.2d at 48. The court reasoned that there was no evidence that would guarantee Mentor would be forced to withdraw its offer before the expiration of the six month period. *Id.* at 49. The court noted that Mentor was in a position where it needed to acquire Quickturn in order to compete in the
the no hand provision was outside the range of reasonable responses to Mentor's hostile bid, and was therefore disproportionate.\textsuperscript{227} The court reasoned that, since the no hand provision operated to preclude a sale of the company by the newly elected board, for a six month period, to an interested person, in this case Mentor, but did not preclude a sale to any other potential acquiror, it was outside the "range of reasonableness."\textsuperscript{228}

5. The Delaware Supreme Court Decision

On appeal, the Delaware Supreme Court affirmed the court of chancery's decision that the no hand provision of the Quickturn shareholders' rights plan violated Delaware law.\textsuperscript{229} The supreme court, however, analyzed the propriety of the provision under statutory grounds, holding that the no hand provision was invalid under section 141(a).\textsuperscript{230}

The court began by noting that one of the most basic principles of Delaware corporate law is that the "board of directors has the ultimate responsibility for managing the business and affairs of a corporation."\textsuperscript{231} According to the court, the no hand provision would interfere with this fundamental duty of a newly elected board for a period of six months.\textsuperscript{232} While it was recognized that the no hand provision would only restrict one aspect of the board's authority in discharging its duties — the power to effectuate a sale of the corporation — the court deemed this "an area of fundamental importance to the shareholders."\textsuperscript{233} In this respect, the court found that the no hand provision "impermissibly circumscribe[d] the board's statutory power under Section 141(a)."\textsuperscript{234}

Furthermore, the court found that the no hand provision would "prevent[] a newly elected board of directors from completely discharging its fiduciary duties to protect fully the interests of Quickturn and its stockholders."\textsuperscript{235} The court determined that "no defensive measure can be sustained which would require a new board of directors to breach its emulation market. \textit{Id.} In addition, the court added that the directors nominated by Mentor, if elected, could immediately enter into a binding agreement to sell Quickturn to Mentor in six months. \textit{Id.}

\textsuperscript{227}Id.
\textsuperscript{228}Id. at 49-50.
\textsuperscript{229}Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1283 (Del. 1998).
\textsuperscript{230}Id. at 1293; DEL. CODE ANN. tit. 8, \S 141(a) (1991). \textit{See also supra} notes 170-78 and accompanying text (discussing \S 141(a)).
\textsuperscript{231}Quickturn Design Sys., 721 A.2d at 1293. \textit{See} DEL. CODE ANN. tit. 8, \S 141(a) (1991).
\textsuperscript{232}Quickturn Design Sys., 721 A.2d at 1291.
\textsuperscript{233}Id. at 1291-92.
\textsuperscript{234}Id. at 1293.
\textsuperscript{235}Id. at 1292.
fiduciary duty.\textsuperscript{236} With the no hand provision in place, a newly elected board would be prevented from redeeming the shareholders' rights plan, even where the board's fiduciary duty required it to do so "for the benefit of Quickturn and its stockholders."\textsuperscript{237} Therefore, the no hand provision impermissibly constrained "the directors' ability to fulfill their concomitant fiduciary duties," and was thus found to be invalid.\textsuperscript{238}

**IV. Evaluation**

The court of chancery's decision in *Toll Brothers* effectively outlined why a dead hand poison pill provision is invalid under Delaware law.\textsuperscript{239} This ruling laid the foundation for the Delaware courts to forbid director action which would preclude any possibility of a hostile takeover. While the court did not definitively decide that the dead hand provision violated Delaware law, for the reasons outlined in Parts A and B,\textsuperscript{240} it seems likely that this permutation of the poison pill would suffer the same fate as that of the no hand delayed redemption provision.\textsuperscript{241}

Collectively, the *Toll Brothers* and *Mentor Graphics* decisions severely restrict the expansion of the poison pill. In so doing, Delaware courts have maintained the feasibility of corporate mergers through hostile acquisitions. While both decisions have essentially the same effect, there are important differences between the dead hand and the no hand provisions, and how the courts analyzed them, which could impact future board action in the corporate takeover context, particularly the incarnation of further variations of the poison pill. These dissimilarities, and the bond that renders both invalid under Delaware law, will be discussed in Part B, *infra*.

\textsuperscript{236}Quickturn Design Sys., 721 A.2d at 1292.

\textsuperscript{237}Id.

\textsuperscript{238}Id. at 1293.

\textsuperscript{239}Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998).

\textsuperscript{240}Discussion of the validity of the dead hand provision under § 141 will be considered in Part B of this evaluation.

\textsuperscript{241}In fact, the Delaware Supreme Court has indicated that this discussion may already be moot. Reciting Mentor's initial argument, the court stated:

According to Mentor, the [no hand provision], like the "dead hand" feature in the Rights Plan that was held to be invalid in *Toll Brothers*, will impermissibly deprive any newly elected board of both its statutory authority to manage the corporation under § 8 Del. C. §141(a) and its concomitant fiduciary duty pursuant to that statutory mandate. We agree.

*Quickturn Design Sys., 721 A.2d at 1291.*
A. The Invalidation of Dead Hand and No Hand Provisions in Shareholders' Rights Plans

The Delaware Supreme Court noted in Unocal, upholding the use of an antitakeover defense, that Delaware's corporate law "is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs." It seems that, for a board's adoption of defensive measures in the context of a hostile takeover, the evolution has come to a halt. Under the analysis set forth by the court of chancery in Toll Brothers, it is unlikely a dead hand provision of a shareholders' rights plan will withstand judicial review under Delaware law. Additionally, according to the Delaware Supreme Court's analysis in Quickturn, a dead hand provision, even one of limited duration that may arguably comply with a board's fiduciary mandates, will be held invalid because it interferes with the board's power to manage the business and affairs of the corporation under section 141(a).

1. Dead Hand and No Hand Provisions Do Not Survive Unocal/Unitrin Enhanced Scrutiny Analysis

The dead hand and no hand provisions of a shareholders' rights plan do not survive the enhanced scrutiny test enunciated in Unocal. Initially, however, under the reasoning set forth by the Delaware Supreme Court in Moran, the adoption or retention of a dead hand or no hand provision is not a valid exercise of a board's authority. As previously discussed, a major basis for the validation of a poison pill was the finding that it did not interfere with a hostile acquiror's chances of accomplishing a hostile takeover through a proxy contest. While it has been argued that a poison pill does indeed have a substantial impact on the chances of a hostile bidder succeeding in a proxy contest a shareholders' rights plan with a dead hand or no hand provision certainly goes well beyond a poison pill in its effects on a proxy contest. Since dead hand and no hand provisions have such a negative impact on shareholder voting, their effect on a proxy contest is

244Id. at 955-56.
246Id. See also Neff, supra note 114, at 675 (suggesting that a dead hand provision does not totally preclude a hostile takeover because a hostile bidder could still conceivable initiate a tender offer on the condition that the rights be redeemed but such action is impractical considering the board's power to deny redemption of the rights).
247See generally Neuwirth, supra note 85, at 459 (discussing evidence that proxy contests do have a negative impact on a bidder's chances of succeeding in a proxy contest).
much more significant than that of a regular poison pill, and these provisions do not survive enhanced scrutiny analysis as a result.\textsuperscript{247}

Under \textit{Unitrin}'s interpretation of the enhanced scrutiny test, a defensive measure adopted by a board of directors will fail the proportionality prong if it is preclusive or coercive.\textsuperscript{248} It has been argued that a dead hand provision is coercive because it interferes with the shareholders' voting rights.\textsuperscript{249} If shareholders desire a board that has the power to enter into a merger, shareholders will be coerced into voting for the incumbent directors.\textsuperscript{250} Therefore, it is likely that the dead hand provision would coerce those shareholders who favor a sale of the corporation, even those who favor a sale to the hostile acquiror, to vote for the incumbent directors who have the power to accomplish a sale of the corporation. Similarly, where a no hand provision is operational, shareholders who favor a sale of the corporation have little incentive to vote for a potential acquiror's slate of directors because no directors have the power to redeem the pill. In this respect, dead hand and no hand provisions may block any possibility of a hostile takeover, "cramming down" a management sponsored alternative on shareholders,\textsuperscript{251} and therefore be considered coercive.

In addition, dead hand and no hand provisions are preclusive under the second prong of the proportionality test. The \textit{Unitrin} court defined as preclusive a defensive measure that makes a hostile bidder's success either "mathematically impossible or realistically unattainable."\textsuperscript{252} Under this reasoning, dead hand and no hand provisions do make proxy contests realistically unattainable and are therefore preclusive. Since "an acquiror cannot maintain a proxy contest to install directors who can redeem the pill (thus opening the way for a transaction)," a hostile transaction is precluded.\textsuperscript{253}  

\textsuperscript{247}See \textit{Recent Cases}, 111 HARV. L. REV. 1626, 1630 (1998) (commenting that it is unlikely the Delaware Supreme Court considered the effects of a dead hand provision in a shareholders' rights plan due to the relative infancy of the provision at the time).


\textsuperscript{249}See \textit{Lese}, supra note 9, at 2207.

\textsuperscript{250}See \textit{Gordon}, supra note 115, at 541 (noting that "[a] shareholder who favors a control transaction may well be whipsawed into voting for the incumbents, because only they have the power to accomplish it"). See also \textit{Lese}, supra note 9, at 2207 (arguing that dead hand provisions coerce shareholders into voting for the incumbent board "by preventing a bidder from replacing the incumbent board and redeeming the target's poison pill").

\textsuperscript{251}\textit{Unitrin}, 651 A.2d at 1387.

\textsuperscript{252}\textit{Id.} at 1388-89.

\textsuperscript{253}See \textit{Gordon}, supra note 115, at 541. Under these circumstances, an: acquiror's only alternative is to elect a partial slate of replacement directors, and to hope that this shareholder signal combined with the new directors' boardroom persuasiveness will change the minds of a sufficient number of continuing directors. Otherwise no transaction will be possible. This highly speculative
2. Dead Hand and No Hand Provisions Inhibit the Shareholder Franchise

Shareholders' rights plans containing dead hand provisions have been condemned primarily for their effects on shareholder voting rights. A dead hand or no hand provision prevents shareholders from acting in favor of a merger they may believe is in their best interest, thereby entrenching the board members and preserving their positions. Under Blasius, a board must show a compelling justification for action taken that has the purpose of infringing upon the shareholder franchise. The Blasius analysis applies where a board has taken action "for the primary purpose of impeding the exercise of stockholder voting power." While some cases have indicated that director action that merely affects the shareholder franchise will not be subject to Blasius scrutiny, the court in Toll Brothers opined that purposeful disenfranchisement will occur whenever directors unilaterally act to create a situation where "shareholder voting is either impotent or self defeating." Within this framework, which seems to capture the intended purpose of Blasius scrutiny, a dead hand provision is invalid.

It is well stated that it is the prerogative of the shareholders to turn the incumbent board out if the shareholders do not agree with the board's policies. Although the dead hand and no hand provisions do allow for a shareholder vote, they render that vote meaningless. Where a board has implemented a dead hand provision, shareholders may be forced to vote for the incumbent directors because only they have the power to redeem the rights and allow the merger. Even if shareholders do exercise their rights to replace the board, the newly elected directors will have no power to effectuate a merger because the power to redeem the rights plan is

avenue places a very large burden on a potential acquirer. Moreover, it bears repeating, the deadhand pill has precluded a hostile bid. At most the bidder now has a better chance to persuade the board — meaning to specially persuade the continuing directors — to do a consensual transaction.

Id.

254See Gordon, supra note 115, at 540 (noting that "[t]he disenfranchisement in a deadhand pill comes in the board's unilateral decision that even in an election contest fought over the issue of the bid, the shareholders will be powerless to elect a board that is both willing and able to accept the bid").


256Id.

257See supra notes 102-10 and accompanying text.


260See Recent Cases, supra note 247, at 1631 (recognizing that dead hand provisions "effectively render the election of a new board meaningless").

261See Lese, supra note 9, at 2203-04.
specifically reserved to the continuing directors or their approved successors. For these reasons, dead hand provisions have been criticized as a tool to entrench management. Similarly, a no hand provision prevents all directors from redeeming the rights plan. Therefore, shareholders who favor a sale of the corporation may be dissuaded from voting for a new slate of directors since they will be powerless to redeem the poison pill and accomplish a sale of the corporation. In this respect the no hand provision has rendered the shareholder vote meaningless. Since a poison pill offers all the protection shareholders may need from coercive action by potential raiders, the dead hand and no hand provisions, which preclude shareholders from affecting a merger through a voting contest if they deem it desirable, cannot be upheld under a claim of a compelling justification. The dead hand and no hand provisions provide no extra protection for shareholders, they merely serve to entrench the board of directors.

B. No Hand and Dead Hand Provisions Compared

Important distinctions exist between the operation and effects of the dead hand and no hand poison pill provisions. For example, a dead hand poison pill, such as the Toll Brothers provision, creates two classes of directors: those who have the power to redeem the poison pill and those who do not. Therefore, in the context of a hostile acquisition, if an insurgent were successful in having a majority of its nominees elected to the target's board, those directors would not have the power to redeem the poison pill and accomplish a sale of the corporation with any prospective

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262See Meredith M. Brown & William D. Regner, Shareholder Rights Plans: Recent Toxopharmacological Developments, 11 INSIGHTS 2, 3 (1997) (noting that "dead hand" provisions — permit poison pill rights to be redeemed only by directors who were on the board before the pill's adoption, or who were subsequently elected with the recommendation of the other continuing directors" which means that "a potential bidder cannot dismantle a pill by waging a proxy contest to elect a slate committed to redeeming the pill — because the bidder's nominees, if elected, would not be 'continuing directors,' and so would lack the power to redeem the pill"). See also Gordon, supra note 115, at 540 (arguing that dead hand pills "corrupt[] the free choice that is bound up with the idea of voting: shareholders may be forced to vote for directors whose policies they reject because only those directors have the power to change them").

263See Recent Cases, supra note 247, at 1631 (arguing that a dead hand provision does not really act to protect shareholders, but serves to protect the incumbent board who adopted the provision).

264See Lese, supra note 9, at 2203-04 (asserting that proponent arguments that dead hand provisions are required because they operate to protect shareholders from coercive bids by preventing a bidder from gaining control over the board and redeeming the pill are fallacious in light of the fact that shareholders faced with a tender offer coupled with a proxy contest, when a poison pill is in place, are not confronted with any risks).

265See id.

bidder, for the duration of the pill. Hence, the election of a majority of directors to the target board, who are not nominated or approved by the present board, will effectively prevent the sale of the corporation to any potential acquiror.

On the other hand, a no hand poison pill, such as the Quickturn provision, would prevent all directors from redeeming the rights plan. Interestingly, the Quickturn provision prevented a newly elected board from accomplishing a sale only with a potential acquiror who was directly or indirectly responsible for the nomination of the new directors. In contrast the to Toll Brothers provision, the Quickturn provision would allow the newly elected board to redeem the poison pill to effectuate a sale of the target corporation to any bidder other than an "interested person." Therefore, practically speaking, these provisions would have different effects if triggered: the Toll Brothers provision would preclude the sale of the corporation to anyone while the Quickturn provision would preclude a sale to an "interested person." In addition, the dead hand poison pill gives the power to redeem the rights to some board members but not all, while the no hand poison pill restricts the authority of all directors to redeem the rights. Although these provisions operate in different manners and have a slightly different impact, there are common elements that render these variations, and all similar variations, invalid: they restrict the power of the board of directors to discharge their statutory duty to manage the affairs of a corporation, and they inhibit the board's ability to uphold its fiduciary duties to the corporation and its shareholders.

The responsibility for managing the business and affairs of a Delaware corporation is vested in the board of directors, unless the corporation's certificate of incorporation provides otherwise. This is one of the most basic and fundamental principles under Delaware corporate law. Accompanying this statutory mandate is the well-established

268Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 35 (Del. Ch. 1998). A much stronger version of the no hand provision may be employed where the directors of the target corporation may not redeem the poison pill until it expires, thus preventing a sale of the corporation to anyone.
269See Del. Code Ann. tit. 8, § 141(a) (1991). See also Gordon, supra note 115, at 538 (recognizing that because a dead hand poison pill provision limits a future boards "capacity to accomplish a business combination (because it cannot redeem the pill), it directly interferes with the future board's core statutory power to manage the business and affairs of the corporation in the best interests of the corporation and its shareholders").
271See Paramount Communications Inc., v. QVC Network Inc., 637 A.2d 34, 41-42 (Del. 1993) (recognizing "the fundamental principle that the management of the business and affairs of a Delaware corporation is entrusted to its directors, who are the duly elected and authorized representatives of the stockholders").
principle that "the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."\textsuperscript{272} The board of directors, in discharging their statutory duty, have a fiduciary obligation to act in the best interests of the corporation.\textsuperscript{273} This duty is "unyielding" and cannot be compromised.\textsuperscript{274}

The inception of the poison pill and its acceptance by the Delaware courts\textsuperscript{275} has engendered much criticism and debate.\textsuperscript{276} During the evolution of the poison pill, it has been employed and transformed in a variety of ways, resulting most notably in the dead hand and no hand provisions. These are just the latest iterations of the most innovative takeover defense mechanism ever developed; given the history of the poison pill, these iterations are unlikely to be the last.\textsuperscript{277} Since the dawn of these antitakeover devices, particularly the dead hand provision, corporations have employed these mechanisms to protect themselves from hostile acquirors. In light of their demise, and corporate desire to protect itself from hostile acquisitions, it would be safe to assume corporations will soon develop new ways to thwart hostile takeover attempts.

The fate of these latest variations indicate, however, that any future modification of the poison pill that interferes with the statutory and fiduciary duties of directors to manage the corporation in the best interests of the company and its shareholders will be held invalid. Any further manipulation of the concepts underlying poison pill antitakeover defenses must acknowledge that any defense mechanism that interferes with the board's authority and fiduciary obligation to manage the corporation does not comply with Delaware statutory law, particularly where it involves the sale

\footnotesize{\textsuperscript{272}Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986).}
\footnotesize{\textsuperscript{273}See Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (stating that "[i]n carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders").}
\footnotesize{\textsuperscript{274}Id.}
\footnotesize{\textsuperscript{275}See Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (validating the use of a poison pill provision as a preplanned defensive measure in the context of hostile acquisitions).}
\footnotesize{\textsuperscript{276}See supra notes 38-46 and accompanying text.}
\footnotesize{\textsuperscript{277}In fact, Vice-Chancellor Jacobs noted that: [i]n the ever-evolving field of corporate takeover jurisprudence, the defensive mechanism that has mutated more rapidly than others, and has prompted the most widespread debate, is the "poison pill" rights plan. Since making its legal debut in 1985, the story of the poison pill has been a work-in-progress, with each variation and innovation generating new litigation and occasions for judicial opinion writing. This case involves the pill's most recent incarnation — a "no hand" poison pill of limited duration and scope. It marks the latest (but by no means the last) chapter of that work in progress.}

of the corporation. Indeed, by proceeding upon statutory grounds, the Delaware Supreme Court has foreclosed the possibility of corporations employing watered-down versions of these provisions. Under section 141(a), even a poison pill provision that has less deleterious effects upon the board's powers will be invalidated. For example, a dead hand provision of limited duration would be held invalid because its effects would interfere with the board's power to enter into a sale of the corporation. Even though the duration of the pill is limited, and its effects arguably less severe, it would still interfere with the board's statutory authority under section 141(a). Therefore, while it was theoretically possible for watered-down versions of the no hand and dead hand poison pills to survive fiduciary analysis, that prospect has been foreclosed under the section 141(a) analysis.

V. CONCLUSION

Under the analysis set forth by the court of chancery in Toll Brothers, a dead hand provision would not survive judicial scrutiny, particularly in light of the Delaware Supreme Court's ruling in Quickturn. While Toll Brothers suggested the dead hand provision was invalid under Delaware law, it left open the grounds upon which to base such a decision.

278See Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291-92 (Del. 1998) (noting that the no hand provision at issue "restricts the board's power in an area of fundamental importance to the shareholders — negotiating a possible sale of the corporation").

279In contrast to a regular dead hand provision of unlimited duration which would prevent non-continuing directors from selling the corporation for the life of the poison pill, a dead hand provision of limited duration would only operate for a specified amount of time, perhaps six months.

280For an argument that a dead hand provision of limited duration would fail fiduciary analysis, see Lese supra note 9, at 2211, reasoning that:

[t]he fact that the period during which the new directors are unable to redeem the pill is shortened to 180 days neither mitigates the preclusive impact the provision exerts during the time the provision is in effect nor ameliorates the coercion exerted on shareholders electing a board that supports the target's participation in a merger or acquisition transaction. For such shareholders, the decision to vote for the new slate of directors would be "chilled" if immediate execution of the desired transaction were not possible. Thus, this diluted provision, as well, does little to correct the shortcomings of [a dead hand provision of unlimited duration].

However, the no hand delayed redemption provision at issue in Mentor Design was not determined to be preclusive or coercive, under the circumstances. In addition, Vice-Chancellor Jacobs determination that the provision was outside the range of reasonable responses to Mentor's tender offer was based on its preclusion of a sale of Quickturn to Mentor, an interested person, and not to any other potential acquiror. Mentor Graphics, 728 A.2d at 50.

281It could be maintained that such a provision would survive fiduciary analysis under Unocal/Unitrin scrutiny because it is not totally preclusive or coercive and could be within a range of reasonable responses to a hostile threat. See supra Part IV.A.1 discussing Unocal and Unitrin enhanced scrutiny analysis.
The Delaware Supreme Court closed the door on this issue when it determined that the no hand delayed redemption provision in *Quickturn* violated Delaware statutory law because it interfered with the board's authority to manage the corporation under section 141(a). The result of this decision also seems to foreclose the possibility of implementing dead hand or no hand provisions of limited duration, since they too would impermissibly interfere with a board's statutory authority. Therefore, with respect to poison pill mutations that interfere with a board of directors' statutory authority under section 141(a), whether of unlimited or limited duration, the evolution has come to an end.

*Brian J. McTear*