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A New Look at Dead Hand Provisions in Poison Pills: Are They Per Se Invalid After Toll Brothers and Quickturn?

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A NEW LOOK AT DEAD HAND PROVISIONS IN POISON PILLS: ARE THEY *PER SE* INVALID AFTER *TOLL BROTHERS* AND *QUICKTURN*?

In 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.[1]

I. INTRODUCTION

Shareholder rights plans, often called poison pills,[2] were developed during the corporate takeover boom of the 1980s and are employed by target companies to combat hostile[3] tender offers[4] made by corporate raiders.[5]

1. Noted by Vice Chancellor Jack Jacobs of the Court of Chancery of Delaware in his recent opinion in Mentor Graphics Corp. v. Quickturn Design Systems, Inc., 728 A.2d 25, 27 (Del. Ch. 1998), *aff'd on other grounds sub nom.* Quickturn Design Systems, Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998).

2. A poison pill, in its basic form, is described as "a distribution to stockholders of a right which acquires significant economic value upon the occurrence of specified events involving a non-board-approved acquisition of a significant ownership position in the company." 1 ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE § 5.01[B][1], at 5-6 (5th ed. Supp. 1997). The economic value normally consists of an entitlement to purchase securities from the target company or from the raider at a substantial discount and excludes participation of the raider. *Id.*

3. "Hostile" refers to those takeovers initiated by the acquiring company that are actively opposed by a target company's board of directors, in contrast to "friendly" or "uncontested" takeovers which are supported or approved by the board of the target company. Robert A. Prentice, *Front-End Loaded, Two-Tiered Tender Offers: An Examination of the Counterproductive Effect of a Mighty Offensive Weapon*, 39 CASE W. RES. L. REV. 389, 393 (1989).

4. The tender offer is one of several corporate techniques used to acquire control of a target company in an effort to go around the management of a target company that resists a proposed acquisition. BLACK'S LAW DICTIONARY 1468 (6th ed. 1990). It is not defined by the Securities and Exchange Commission, but it usually involves a publicly announced offer for any or all of the shares of a target company at a premium over the prevailing market price, with fixed terms; the offer is normally valid for a limited period and is often contingent on the tender of a specified minimum number of shares; in the case of a partial bid, it is subject to a fixed maximum number of shares. *Id.* The offer is made by the acquiring company directly to the stockholders of the target company and is communicated to them by means of newspaper advertisements and, if the

Invented by Martin Lipton of the law firm of Wachtel, Lipton, Rosen & Katz in 1984,[6] and upheld by the Delaware Supreme Court in *Moran v. Household International, Inc.*[7] in 1985, poison pills have become one of the most widely used defensive devices[8] and have proven to be one of the most effective in enhancing shareholder value.[9] To date, more than 2500 companies have adopted poison pills of some sort.[10] Poison pills have become "a pervasive aspect of the U.S. corporate landscape."[11]

The takeover frenzy in the 1980s and the substantial merger and acquisition activities commencing in the mid-1990s[12] have caused companies to look continuously for ways to protect themselves from the evolving tactics of hostile bidders.[13] Consequently, poison pills have continued to mutate rapidly and inventively.[14] The most recent innovations are the so-called "dead hand" poison pill and its variation the "no-hand" poison pill discussed below.

Widespread adoption of poison pills by target companies has greatly enhanced target companies' abilities to defeat hostile bidders' naked tender offers; in turn, hostile bidders have used more aggressive tactics.[15] One such tactic is the tender offer combined with a proxy contest or consent solicitation to replace the incumbent board of the target. The replacement of the board is

acquiring company can obtain the shareholders list, by a general mailing to all shareholders, with a view to acquiring control of the target company. *Id.*

5. Shawn C. Lese, *Preventing Control from the Grave: A Proposal for Judicial Treatment of Dead Hand Provisions in Poison Pills*, 96 COLUM. L. REV. 2175, 2175 (1996).

6. Babatunde M. Animashaun, *Poison Pill: Corporate Anti-Takeover Defensive Plan and the Directors' Responsibilities in Responding to Takeover Bids*, 18 S.U. L. REV. 171, 176 (1991).

7. 500 A.2d 1345 (Del. 1985).

8. After their debut in 1984, poison pills became especially prevalent by 1988. Kenneth J. Bialkin & Robert G. Wray, *Legal Developments: Poison Pills*, M&A LAW., May 1998, at 12. Substantial merger and acquisition activities in the mid-1990s led to another large wave of pill introduction. This wave is also attributable to renewal of rights plans adopted in the mid-1980's which hit their 10 year expiration point in mid-1990s. For example, they were adopted at a rate of about two per day in 1997. Martin Lipton, *Poison Pills Update*, M&A LAW., Jul./Aug. 1997, at 3.

9. A recent study was conducted by Georgeson & Company Inc., analyzing takeover data between 1992 and 1996 to determine the impact of poison pills on shareholder value. Jamil Aboumeri, *Mergers & Acquisitions: Poison Pills and Shareholder Value / 1992-1996*, GEORGESON RESEARCH, Nov. 1997, at 1. This study revealed that, on average, those target companies that had poison pills in place were paid premiums 26% higher than premiums paid to target companies not having poison pills. *Id.* This finding was also consistent with earlier studies done by Georgeson. *Id.*

10. Lipton, *supra* note 8, at 3.

11. Bialkin & Wray, *supra* note 8, at 12.

12. Dennis J. Block et al., *Defensive Measures in Anticipation of and in Response to Unsolicited Takeover Proposals*, 51 U. MIAMI L. REV. 623, 623 (1997).

13. Lese, *supra* note 5, at 2187.

14. *Id.* at 2208.

15. *Id.* at 2183.

intended to lead to removal of the pill so that the tender offer can proceed.[16] In response, target companies have sought to strengthen the defensive attributes of the poison pill through the "dead hand" provision.[17] Thus, the pill is known as the dead hand pill. The dead hand feature allows the pill to be redeemed *only* by the "continuing directors," that is, the directors who were in office when the pill was adopted or their approved successors.[18] A prominent variation of the dead hand provision is the so-called "no hand" provision. The no hand feature prohibits *any* directors (whether the incumbent or continuing directors or the hostile bidder's newly elected slate) from redeeming the pill for a limited period of time, for example, six months.[19] Dead hand provisions were included in many pills adopted in the early to mid-1990s[20] to combat the increasingly common strategy of hostile bidders, that is, combining a tender offer with a proxy contest or consent solicitation.[21]

As Vice Chancellor Jacobs noted in *Mentor Graphics Corp. v. Quickturn Design Systems, Inc.*,[22] each variation and innovation generates new litigation.[23] The dead hand poison pill is no exception. The validity of the dead hand feature has been questioned and challenged on many legal grounds, including claims that it violates state corporate statutes and that its use involves a breach of directors' fiduciary duties.[24] Scholars and commentators have written articles regarding these challenges.[25] Surprisingly, prior to *Carmody v. Toll Brothers, Inc.*,[26] few courts had spoken on the validity of the dead hand feature. In fact, only two courts applying New York law and Georgia law, respectively, had squarely addressed the dead hand feature. They reached

16. *Id.* at 2183-84, 2187.

17. Bialkin & Wray, *supra* note 8, at 12.

18. *Id.*

19. Lese, *supra* note 5, at 2210.

20. JOY M. BRYAN, CHARLES E. SIMON & CO., CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE Intro.-1 (1999 ed.).

21. Lese, *supra* note 5, at 2187-89.

22. 728 A.2d 25, *aff'd on other grounds sub nom.* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998).

23. *Id.* at 27.

24. Lese, *supra* note 5, at 2177.

25. *See, e.g.*, Lese, *supra* note 5, at 2175; Bialkin & Wray, *supra* note 8, at 12; Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills and Shareholder Adopted By-Laws: An Essay for Warren Buffett*, 19 CARDOZO L. REV. 511, 531 (1997); Daniel A. Neff, *The Impact of State Statutes and Continuing Director Rights Plans*, 51 U. MIAMI L. REV. 663, 671 (1997); Meredith M. Brown & William D. Regner, *Shareholder Rights Plans: Recent Toxopharmological Developments*, 11 NO. 10 INSIGHTS 2, 3 (1997); John Elofson, *Should Dead Hand Poison Pills Be Sent to an Early Grave?* 25 SEC. REG. L.J. 303, 303 (1997).

26. 723 A.2d 1180 (Del. Ch. 1998). The decision was handed down by the Delaware Chancery Court on July 24, 1998. This is the first Delaware court opinion that squarely addressed the dead hand feature. *Id.*

opposite holdings.[27] The two cases are *Bank of New York v. Irving Bank Corp.*[28] and *Invacare Corp. v. Healthdyne Technologies, Inc.*[29] This dearth of judicial opinions on the dead hand poison pill contrasts sharply with the plethora of cases treating the "ordinary" poison pill.[30]

Ascertaining the validity of the dead hand provisions in poison pills is even more critical at this juncture because most poison pills adopted in the 1980's are continuing to approach their expiration dates.[31] Companies are considering adopting new pills, or renewing or amending old pills.[32] The uncertainty regarding the validity of the dead hand feature substantially affects their strategic planning in pill adoption or renewal. In addition, the lack of both guidance and authoritative decisions has generated speculation among scholars and commentators,[33] and has placed the dead hand poison pill in the spotlight.

Recently, the validity of dead hand provisions in poison pills was reviewed by the Delaware courts in *Carmody v. Toll Brothers*[34] and *Quickturn Design Systems, Inc. v. Shapiro.*[35] Dead hand provisions have also been reviewed under Pennsylvania law in *AMP Inc. v. Allied Signal Inc*.[36] The holdings in these decisions were not in agreement.[37] In the Delaware courts, the first challenge of the dead hand and no hand features ended with victory for opponents of these features.[38] In contrast, a federal court in Pennsylvania issued an opinion, which represents a victory for those in the opposite camp.[39] These most recent cases have gained rapt attention from the corporate

27. *See* Bank of New York v. Irving Bank Corp., 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988) (holding that the dead hand pills are invalid under New York law). *But cf.* Invacare Corp. v. Healthdyne Technologies, Inc. 968 F. Supp. 1578 (D.C.N. Ga. 1997) (upholding the validity of the dead hand pills under Georgia law).

28. 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988) (invalidating the dead hand pill under New York law).

29. 968 F. Supp. 1578 (N.D. Ga. 1997) (upholding the validity of the dead hand pill under Georgia law).

30. *See* cases cited *infra* notes 125, 136-37.

31. Typically, poison pills are given limited lives of 10 years. Bialkin and Wray, *supra* note 8, at 12.

32. JOY M. BRYAN, CHARLES E. SIMON & COMPANY, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE Intro-1 (1998 ed.).

33. *See* sources cited *supra* note 25.

34. 723 A.2d 1180 (Del. Ch. 1998). This is the first Delaware court opinion that squarely addressed the dead hand poison pill.

35. 721 A.2d 1281 (Del. 1998), *aff'g on other grounds* Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25 (Del. Ch. 1998) (invalidating the no hand feature of a poison pill under Delaware law).

36. Civ. A. Nos. 98-4405, 98-4058, and 98-4109, 1998 WL 778348, at *1 (E.D. Pa. Oct. 8, 1998) (upholding the validity of the no hand pill under Pennsylvania law).

37. *See infra* Parts III.C, III.D.

38. *See infra* Part III.C.

39. *See infra* Part III.D.

community and have afforded much needed guidance, though some questions remain open.[40]

Against this background, this Comment will examine the development of the dead hand provision and its variations, challenges to the validity of the dead hand feature, and judicial review of this feature. This Comment will conclude that dead hand provisions in poison pills are *per se* invalid under Delaware law in the absence of provisions to the contrary stated in the certificate of incorporation. This was the finding of the Delaware Supreme Court in its New Year's Eve decision in *Quickturn*. Nevertheless, this Comment takes the position that *Toll Brothers* and *Quickturn* do not render every dead hand poison pill *per se* invalid, because each state has its own corporate statutes. Indeed, some states' corporate statutes differ substantially from Delaware's. For some non-Delaware corporations, the dead hand poison pill, especially one of limited duration, may continue to be one of the most effective defensive measures available to fend off a hostile bidder's tender offer joined with a proxy contest. This Comment will also explore alternative defensive measures available to Delaware corporations in light of the unavailability of the dead hand poison pill to them and discuss the aftermath of these recent cases for non-Delaware corporations.

Section II of this Comment examines the origin and attributes of the poison pill and its variations, challenges to its validity, the legal standard governing the use of the poison pill as an anti-takeover defensive measure, recent statutory development, and judicial review of the adoption, use, and redemption of the poison pill. This section also provides a historical background concerning the development of dead hand provisions in poison pills and discusses the controversy surrounding the dead hand feature. Section III analyzes how courts of different jurisdictions have reviewed the dead hand provision and its variations, with an emphasis on the way in which their reasoning compares and contrasts with that of the *Toll Brothers* and *Quickturn* courts. Section IV then discusses the likely impact of these recent rulings on corporate governance and suggests alternative anti-takeover measures for Delaware corporations to fend off the perceived coercion arising from the joint tender offer and proxy contest without running afoul of *Toll Brothers* and *Quickturn.* Finally, this section also discusses legal developments after these cases and legal implications of the recent rulings for corporations incorporated elsewhere.

40. *See, e.g.*, Herbert Henryson II, *Is Unocal Alive and Well in Pennsylvania?* M&A LAW., Mar. 1999, at 16; Kevin G. Abrams & J. Travis Laster, *A Mentor's Teachings: Lessons and Implications of the Delaware Dead Hand Decisions*, M&A LAW., Feb. 1999, at 1; *Delaware Supreme Court Rules That Delayed Redemption Poison Pill Unlawfully Constrains Director's Discretion*, 21 BANK & CORP. GOVERNANCE L. REPORTER 1188 (1999).

II. HISTORY

A. Historical Background of the Poison Pill

1. Origin and Development of the Poison Pill As an Anti-Hostile-Takeover Measure

As corporate takeovers accelerated in the mid-1980s, hostile bidders developed a variety of takeover tactics to acquire target companies, including the bear hug;[41] the creeping tender offer;[42] the front-end loaded, two-tiered tender offer;[43] and other devices.[44] As takeover tactics evolved and increased in number and complexity, so did defensive measures employed by target companies to ward off hostile bids. Additional colorful names referring to these defensive measures have been invoked in practice and legal literature, including white knights,[45] shark repellents,[46] lock-up options,[47] sales of crown jewels,[48] and other wonderful devices.[49]

41. A "bear hug" refers to a takeover attempt consisting of a proposal made to the directors of a target company. It normally takes the form of a communication, typically a letter, in which a bidder proposes to enter into a negotiated transaction with the target company, accompanied by the implicit or explicit threat of a hostile takeover attempt if the bidder's offer is rejected. ROBERT W. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS: CASES AND MATERIALS 1142 (5th ed. 1994).

42. A "creeping tender offer" is a gradual accumulation of a substantial percentage of the stock of the target company through a series of open market or privately negotiated purchases. *Id.*

43. A "front-end loaded, two-tiered tender offer" is a two-step transaction: a higher offering price in the tender offer, which constitutes the first step, and a lower offering price in the subsequent merger, which constitutes the second step. The purpose is to encourage shareholders of a target company to tender their shares in the first step for fear that they will receive a lower price in the second step if they hold onto their stock. Lese, *supra* note 5, at 2184.

44. *Id.*

45. A "white knight" refers to a "friendly" party to whom a target company turns as an alternative to a hostile offeror. The white knight normally makes a competing offer. HAMILTON, *supra* note 41, at 1142.

46. "Shark repellents" refer to provisions inserted in the articles of incorporation or other governing documents of a potential target company that are intended to make the target less attractive or more difficult to be taken over. *Id.* at 1143. For example, shark repellents might include provisions establishing a classified board. *Id.*

47. A "lock-up" refers to a transaction entered into between a target company and a white knight in an effort to give the white knight a tactical advantage in making a bid in competition with a hostile bidder. *Id.* A lock-up will often involve either the sale of the stock of the target company or the issuance of an option to purchase such stock from either the target company or one of more of its major shareholders. *Id.* A lock-up may also involve an agreement by the target or a certain number of its shareholders to support the white knight's offer, not to seek other offers, or not to tender into any other offers. *Id.*

48. A "crown jewel" refers to the most prized or particularly significant portion of a target company's assets, which makes the company an attractive takeover target. *Id.* The sale of a

Among the above-mentioned takeover tactics, some place shareholders (especially individual shareholders) at a disadvantage. For example, the front-end loaded, two-tiered tender offer is one such tactic. Typically it operates as follows: the raider offers to buy only a portion of a target company's stock; later, a merger follows in which the remaining shareholders of the target company receive a lower price than that offered initially.[50] As a result, this front-end loaded, two-tiered tender offer may stampede shareholders of the target company into tendering their shares to the raider for fear of being left behind.[51]

In response, many companies found it desirable to consider additional protective measures, leading to the creation and adoption of the rights plan or "poison pill" as defined below.[52] The purpose of the pill is to encourage raiders to negotiate with the target board to acquire the company rather than making the acquisition through a tender offer or other unilateral action.[53] Because of the pill, the target board gains additional bargaining power against a bidder in negotiating a transaction in the best interest of all target shareholders.

2. Key Features of the Poison Pill

Although there are many variations as discussed below in detail, poison pills all share some common key features. One key feature is that when a "triggering event" occurs, the pill entitles all shareholders of the target company, *other than* the *hostile bidder*, to purchase stock of the target company or that of the bidder at a substantial discount compared to the then-current market price.[54] An exercise of this right results in a severe dilution of the hostile bidder's holdings.[55] The dilution is so substantial that hostile bidders are forced to negotiate with the target board instead of triggering the

crown jewel is to discourage a hostile bid by subjecting the bidder to the risk that even if its bid is successful, it will gain control of a target company which has been stripped of its crown jewels. *Id.*

49. Lese, *supra* note 5, at 2178 n.17 (citing 1 MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS §§ 6.03[1]-6.03[3], at 6-28 to 6-57; 6.60[4][k], at 6-238; 6.06[5][a], at 6-239 to 6-241; and 6.06[3], at 6-128 to 6-129 (1995)).

50. *Id.* at 2184-85. To illustrate, the bidder might offer to buy 51% of the outstanding common stock of the target company at $120 per share in cash; however, upon acquiring control of the target company, the bidder will offer to buy the remaining shares at only $80 per share.

51. *Id.* at 2185.

52. For a definition of the poison pill, see *infra* text accompanying notes 63-65.

53. Lese, *supra* note 5, at 2185.

54. Bialkin & Wray, *supra* note 8, at 12; *see also* F. Dean Copeland, *Advance Planning and Structural Defenses for Financial Institutions*, *in* FINANCIAL INSTITUTIONS MERGERS AND ACQUISITIONS 1997, at 685, 703 (PLI Corp. Law & Practice Course Handbook Series No. B4-7179, 1997).

55. *Id.*

pill since typically the board is the only body entitled to redeem the pill.[56] In the case of a dead hand poison pill, only the continuing directors can redeem.[57] In any event, in the absence of elimination of the pill, the bidder can proceed with the acquisition only by suffering a massive dilution.[58]

Another key feature of the poison pill is that it generally is adopted by board action alone and requires no shareholder approval.[59] This is a major advantage that the poison pill offers over many other defensive measures.[60] The board might seek shareholder advisory votes regarding adopting, amending, or redeeming a pill; however, the board usually acts on its own.[61] Furthermore, poison pills can be adopted by the target board as a pre-offer defensive technique or as a defensive measure in the face of a threat or an actual hostile offer.[62]

3. Basic and Various Forms of the Poison Pill

A poison pill, in its basic form, is described as:

> [A] distribution to stockholders of a right which acquires significant economic value upon the occurrence of specified events involving a non-board-approved acquisition of a significant ownership position in the company. Since this economic value consists of an entitlement to receive money or property from the company or the raider, and the acquisition cannot be consummated without triggering this entitlement, 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.[63]

The "right" is triggered upon the occurrence of specified events relating to a change or threatened change in control of the target company. The triggering event normally occurs when an acquirer obtains a certain percentage of a company's outstanding voting stock, generally fifteen to twenty percent (in some cases as low as ten percent).[64] Prior to the occurrence of the specified triggering event, the rights remain economically valueless.[65]

56. Copeland, *supra* note 54, at 703.

57. Bialkin & Wray, *supra* note 8, at 13.

58. *Id.* at 12.

59. FLEISCHER & SUSSMAN, *supra* note 2, § 5.01[B][2], at 5-8. This assumes that there is adequate authorized stock available, either common or preferred, to support the issuance of the rights. *Id.*

60. For example, a staggered board requires an amendment to the company's charter and has to be approved by shareholders. RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 736-37 (2d ed. 1995).

61. Lese, *supra* note 5, at 2181.

62. Block, *supra* note 12, at 638.

63. FLEISCHER & SUSSMAN, *supra* note 2, § 5.01[B][1], at 5-6.

64. Lese, *supra* note 5, at 2180.

65. FLEISCHER & SUSSMAN, *supra* note 2, § 5.01[B][1], at 5-6.

Since their initial introduction in the mid-1980s, poison pills have mutated into diverse forms with distinct operating features. The most common type incorporates both "flip-in" and "flip-over" provisions. Under a flip-in feature, target shareholders are allowed to exercise a right to buy stock of the target company at a substantially discounted price, most often fifty percent of the market rate, when a bidder crosses a certain ownership threshold of the target's outstanding stock.[66] The crossing of the ownership threshold by the acquirer triggers the flip-in provision regardless of the acquirer's intentions with respect to the use of the shares.[67] At that time, rights vest in all shareholders *other than the acquirer*, entitling these rights-holders to acquire additional shares of voting stock of the target company at the discounted price.[68] Flip-in plans operate on the theory that a bidder will be reluctant to trigger such a rights plan due to the consequent dilution of its equity in the target when the rights plan takes effect.[69] Under a flip-over feature, target shareholders are given rights to buy shares of the bidder at a discounted price, again most often at half the then-current market price, if the bidder is able to obtain control of the target and completes the merger.[70] The bidder then is obligated to honor the rights and sell shares in the merged company to the target's shareholders at the discounted price.[71] This obligation results in a substantial dilution of the holdings of the acquirer's original shareholders.[72]

Variations of the common flip-in provisions exist, including the "adverse person" provision,[73] "double flip-in" plans,[74] and exchange provisions.[75] In

66. Block, *supra* note 12, at 638.

67. Lese, *supra* note 5, at 2180.

68. *Id.*

69. Block, *supra* note 12, at 638.

70. *Id.*

71. *Id.*

72. *Id.*

73. Victor I. Lewkow & William A. Groll, *"Poison Pills" and Other Structural Defenses: Uses and Abuses in the Age of Saying "No," in* CONTESTS FOR CORPORATE CONTROL 1991, at 417, 424 (PLI Corp. Law & Practice Course Handbook Series No. B4-6954, 1991). An "adverse person" provision gives the target board discretion, in the event it determines that an "adverse person" is accumulating stock, to reduce the percentage flip-in threshold (*e.g.*, from 30% to 15% or 10%). *Id.* An "adverse person" is one who, in the opinion of a majority of the target's outside directors, is deemed likely to be seeking "greenmail" or other short-term financial gain not in the target's long-term interest, or whose ownership bloc is itself reasonably likely to cause a material adverse impact on the target's business or prospects. *Id.* In some variations, the board can simply reduce the triggering threshold if it deems that appropriate, without a specific finding that a potential acquirer is "adverse." *Id.*

74. *Id.* at 425. The "double flip-in" plan contains two triggering percentages, such as in the rights plan adopted by Ducommun, Inc. *Id.* During the period between 10 days after an acquirer reaches an initial 17% threshold and 60 days after such date, all stockholders other than the acquirer automatically become entitled to purchase 50% of Ducommun's outstanding common stock at 20% of the then-current market price unless the acquirer delivers to Ducommun, at least

addition to the common flip-in and flip-over plans, less common forms exist such as convertible preferred stock dividend plans,[76] "put" plans,[77] "back-end" or debt provision plans,[78] and disproportionate voting provision plans.[79] In practice, companies often use various combinations of different poison pill provisions. A flip-in provision is virtually always accompanied by a flip-over provision.[80]

20 days prior to attaining the first trigger level, a disclosure statement which discloses its intentions, the total number of shares it intends to purchase, the price to be offered, and the proposed financing. *Id.* Additionally, the acquirer must agree (1) not to acquire over 25% of Ducommun's stock without board approval; (2) not to take any action inconsistent with the disclosure statement; (3) only to effect a merger with board approval; and (4) not to attempt to elect more than one director to the board. *Id.* In the event that the acquirer purchases beyond a second trigger level (*i.e.*, 25%) without filing the disclosure statement, assuming it can bear the costs of buying through the initial 17% trigger, the rights plan provides that all stockholders except the acquirer have the right to purchase shares of the target at one-half of the market price. *Id.* A "fair" all-cash tender offer (as determined by the target company's investment banker) would not trigger either "flip-in" percentage. *Id.*

75. *Id.* "Exchange provisions" allow the target board, following occurrence of a flip-in event, to elect to call each outstanding right (other than the rights held by the triggering shareholder, which are voided) in exchange for one share of the target's common stock. *Id.* The purpose of this provision is to give the board the option of causing an insurgent to be diluted without relying upon the stockholders to put up cash to exercise their rights. *Id.* Of course, such dilution would not be as great (depending upon the exercise price of the rights and the then-current market value of the common stock) as it would be if all rights were exercised pursuant to the standard flip-in provision. *Id.* Exchange provisions frequently can be implemented only by the board if the insurgent owns less than 50% of the company's common stock. *Id.*

76. Animashaun, *supra* note 6, at 177. "Convertible preferred stock dividend plans" entitle common stock of the target company to a pro-rated dividend consisting of special redemption and conversion privileges. *Id.*

77. Block, *supra* note 12, at 639. "Put plans" entitle target shareholders to sell their shares back to the target at a designated price (or a price set by formula) if a bidder buys a majority, but not all, of the target's shares. *Id.* By giving shareholders the option of selling back to the target, put plans allow shareholders to avoid the effect of the second step in a two-tiered front-end loaded offer. *Id.* The price payable pursuant to the put may also discourage shareholders from selling into the first step tender offer, if the price offered is less than the put price, thereby forcing a bidder to pay a higher price to accomplish the acquisition. *Id.*

78. *Id.* The "back-end provision" plan grants shareholders the right to redeem their shares for cash or debt securities once a hostile bidder obtains a certain percentage of the corporation's outstanding stock. The redemption price is generally significantly higher than the current market value of the stock. Back-end provisions serve as a defensive mechanism by establishing a minimum takeover price. *Id.*

79. *Id.* "Disproportionate voting provisions" are calculated to give large shareholders inferior voting rights. They operate by issuing a preferred class of stock that carries favored voting rights (such as multiple voting rights) to current shareholders. Any shareholder acquiring shares after the date the preferred stock is issued does not obtain the superior voting rights, and thereby has diminished voting status. *Id.*

80. Animashaun, *supra* note 6, at 176.

B. Development and Attributes of the "Dead Hand" Poison Pill

The latest variations of the poison pill are the so-called dead hand poison pill and its variation, the no hand poison pill.[81] As noted earlier, on one hand, widespread implementation of poison pills by target companies has greatly enhanced the ability of these companies to delay or defeat hostile bidders' naked tender offers.[82] On the other hand, bidders have added more weapons to their arsenal to gain control of target companies.[83] One such weapon is to combine a tender offer with a consent solicitation or proxy contest to unseat the incumbent board.[84] The bidder's nominees, once elected, may then redeem the existing poison pill.[85] Therefore, the standard poison pill become powerless in the face of such a combined approach. To combat this tactic, some companies have expanded and strengthened defensive capacities of the pill by adding a dead hand provision.[86]

1. The "Pure" Dead Hand Provision

In its pure form, a dead hand provision mandates that only "continuing directors" and no one else can redeem the poison pill during the entire pill's life.[87] For example, the pills adopted by Healthdyne in *Invacare* and by Toll Brothers in *Toll Brothers* are of this type.[88] A pure dead hand poison pill can be redeemed freely as long as the incumbent directors or their chosen successors remain in office.[89] Even if a slate of directors nominated by the hostile bidder replaces the incumbent directors through a proxy contest, the newly elected directors would not qualify as "continuing directors" and therefore would lack the power to redeem the pill.[90] Thus, the pure dead hand provision defeats a potential bidder's strategy of dismantling a pill through waging a proxy contest. Also, it precludes a sale of the company for the entire life of the pill if no continuing director remains in office after the proxy contest.[91]

In sum, the pure dead hand provision strengthens the defensive attributes of a poison pill by emphasizing the redemption power of the incumbent board

81. For descriptions of the dead hand and no hand poison pills, see *supra* text accompanying notes 18-21.

82. *See supra* text accompanying notes 15-17.

83. *Id.*

84. *Id.*

85. Lese, *supra* note 5, at 2187.

86. *Id.*

87. Elofson, *supra* note 25, at 309.

88. *See infra* Part III.B-C.

89. Elofson, *supra* note 25, at 310.

90. *Id.*

91. Brown & Regner, *supra* note 25, at 3.

of the target company.[92] The other features of the pill, including the triggering event, typically remain the same.

2. Modified Dead Hand Provisions

Some pills contain a milder form of the dead hand feature. For instance, a less extreme type of the dead hand provision provides that *only* directors who were elected with a supermajority shareholder vote have the power to redeem the pill. For example, in *Bank of New York*,[93] only directors elected with a *two-thirds* vote of the shareholders (as well as the continuing directors) can redeem the pill.[94] Theoretically, the impact of this type of provision is less severe than that of a pure dead hand provision. The only additional hurdle it raises is the requirement that the raider slate wins two-thirds, rather than a mere majority, of the vote before it can redeem the pill.[95]

Another less extreme version is the dead hand provision of limited duration, also known as the delayed redemption provision or no hand provision. The no hand provision enables a board newly elected through a proxy contest waged by a hostile bidder to redeem the pill, but *only after* a waiting period, for example, 180 days.[96] During the waiting period, none of the directors (whether continuing or newly elected) has the power to redeem the pill.[97] The pill recently challenged in *Quickturn* contained such a feature.[98] The no hand poison pill would not preclude a sale of the company. But, it could delay the sale effectively for a period of six months, despite of the replacement of the incumbent board.[99] The no hand pill appears milder when compared with the pure dead hand pill, whose "waiting period" can be up to ten years.[100]

The judicial review of dead hand provisions in poison pills by different courts will be discussed in depth in Section III below.

92. Elofson, *supra* note 25, at 310.

93. 528 N.Y.2d 482 (N.Y. Sup. Ct. 1988).

94. In *Bank of New York*, Irving Bank adopted a pill which allowed redemption only if (1) the board had a majority of continuing directors; (2) the non-continuing directors had been elected by a two-thirds majority; or (3) the non-continuing directors had been elected when no merger proposal was pending. *Id.* at 483.

95. Elofson, *supra* note 25, at 311.

96. *Id.* at 311 (noting that Commercial Intertech adopted such a pill and successfully warded off United Dominion's takeover attempt).

97. *Id.*

98. *Quickturn*, 721 A.2d at 1287-88. The Quickturn board adopted a no hand pill in response to Mentor's tender offer joined with a proxy contest to displace the board, providing that no newly elected board could redeem the poison pill for six months after taking office if the purpose or effect of the redemption would be to facilitate a business combination with someone who backed the election of new directors to the board. *Id.*

99. Elofson, *supra* note 25, at 311.

100. *Id.* at 311.

C. Validity of the Poison Pill

After the debut of the poison pill in 1984, uncertainty concerning its validity led to litigation. The first and leading decision was *Moran v. Household International, Inc*. handed down by the Delaware Supreme Court in November 1985, upholding a flip-over rights plan under Delaware law.[101] Thereafter, most other states, either through judicial decisions or legislation, have confirmed the legality of poison pills. The legal analysis first turns on what legal standard should be used when reviewing the validity of the poison pill.

1. Development of the Enhanced Business Judgment Rule

It is well established that, in taking any corporate action, directors generally owe fiduciary duties of care and loyalty to the corporation and its shareholders.[102] Traditionally, case law provided that the business judgment rule was the applicable legal standard for reviewing a board's actions taken in managing the business and affairs of the corporation pursuant to its duty of care.[103] Directors' actions normally enjoy a presumption of validity under the business judgment rule.[104]

Nevertheless, in the takeover context, when the board of a Delaware corporation takes action to resist a hostile bid for corporate control, the possibility of entrenchment exists and the board's defensive actions thus become subject to the "enhanced" judicial scrutiny established in *Unocal Corp. v. Mesa Petroleum Co.*[105] This is also known as the "enhanced" business judgment rule, applicable to all anti-takeover defensive actions adopted by a board of a Delaware corporation.

In *Unocal*, the Delaware Supreme Court articulated that defensive measures adopted by a board were subject to enhanced judicial scrutiny.[106] For a target board's actions to be entitled to the protection of the business judgment rule, the target board must first satisfy the *Unocal* two-prong test. First, the

101. *See infra* text and accompanying notes 112-24.

102. GILSON & BLACK, *supra* note 60, at 801. The duty of care requires that the directors must adequately inform themselves, entertain reasonable deliberation and make their decisions in good faith. *Id.* at 811-13. The duty of loyalty requires that the directors act for the corporation and its shareholders in a fair and open manner and with the utmost good faith. *Id.* at 813-15.

103. *Id.* at 801, 811.

104. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). The traditional business judgment rule is a court-created 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 interest of the company." *Id.* It does not apply to breach of the duty of loyalty by directors. CHARLES HANSEN, A GUIDE TO THE AMERICAN LAW INSTITUTE CORPORATE GOVERNANCE PROJECT 17-18 (1995).

105. 493 A.2d 946, 955 (Del. 1985).

106. *Id.* at 954.

target board must demonstrate (and therefore has the burden of propounding evidence) that it had reasonable grounds to believe that the hostile bid constituted a threat to corporate policy and effectiveness;[107] second, it must show that the defensive measures adopted were "proportionate," that is, reasonable in relation to the threat that the board reasonably perceived.[108]

The *Unocal* standard was later clarified in *Unitrin, Inc. v. American General Corp.*,[109] in which the Delaware Supreme Court explained that unless a defensive measure was "draconian," by being "coercive or preclusive,"[110] the board's actions would be upheld so long as they were within a "range of reasonable responses."[111]

2. The Legal Standard Governing the Poison Pill: Statutory Authorization and the Enhanced Business Judgment Rule—the Bases for the Poison Pill's Validity

Whether a target board will adopt a poison pill in the face of a hostile offer, or as a pre-planned defensive measure, involves a two-part analysis. First, the design of the pill must be valid under state corporate law and the board must have the statutory authority to adopt it. Whether the board has the statutory authorization turns on an interpretation of the statute. Without this authorization, no poison pill will be upheld in any state. Second, the action of the board in adopting the pill must be consistent with its fiduciary duties. That is, for the board of a Delaware corporation, the adoption, use, and redemption of the pill, an anti-takeover defensive measure, must satisfy the *Unocal* two-prong test of the enhanced business judgment rule before the board can be accorded the protection of the traditional business judgment rule.

a. Adoption of the Poison Pill

Several months after *Unocal*, the Delaware Supreme Court applied the two-part legal standard discussed above in analyzing the validity of a flip-over

107. *Id.* at 955. The board may satisfy the first prong "by showing good faith and reasonable investigation . . . ." *Id.*

108. *Id.* The court articulated that the second prong entails:

> An analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy 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 securities being offered in the exchange.

Id.

109. 651 A.2d 1361, 1372-74 (Del. 1995).

110. *Id.* at 1367, 1388-91.

111. *Id.*

poison pill adopted as "a preventive mechanism to ward off future advances" in *Moran*.[112]

Addressing corporate authority as a threshold issue, the court held that the board had the authority, under various provisions of the Delaware General Corporation Law, to issue both the rights and, upon the exercise thereof, the underlying stock.[113] The court emphasized that:

> Of course, the business judgment rule can only sustain corporate decision making or transactions that are within the power or authority of the [b]oard. Therefore, before the business judgment rule can be applied it must be determined whether the [d]irectors [a]re authorized to adopt the [r]ights [p]lan.[114]

Next, the court analyzed the action of the board under the *Unocal* two-prong test.[115] The court held that, despite the absence of an actual hostile offer, the board reasonably perceived a generalized threat arising from unfair or coercive acquisition techniques existing in the industry.[116] The court also held that the rights plan adopted by the board was a proportionate response to such threat because it was necessary, in the board's good faith belief, to protect the corporation from those coercive acquisition techniques.[117] Thus, the court concluded that the board was entitled to "receive the benefit of the business judgment rule in their adoption of the [r]ights [p]lan," and upheld the pill.[118]

Nevertheless, the *Moran* court established a fundamental condition to the validity of the poison pill, that is, the pill adopted by the board cannot undermine the shareholders' franchise.[119] The effect of any defensive measures, including the poison pill, upon proxy contests must be minimal.[120] This minimal effect of defensive measures upon the shareholders' franchise

112. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1348-50, 1355-57 (Del. 1985).

113. *Id.* at 1351-55 (citing §§ 151(g) and 157 of the Delaware General Corporation Law).

114. *Id.* at 1350.

115. *Id.* at 1355.

116. *Id.* at 1356-57.

117. *Moran*, 500 A.2d at 1356-57. The court noted that in fact, "[t]here [was] little change in the governance structure as a result of the adoption of the [r]ights [p]lan," and "[c]omparing the [r]ights [p]lan with other defensive mechanisms, it does less harm to the value structure of the corporation than do the other mechanisms" upheld by various courts. *Id.* at 1354.

118. *Id.* at 1357. The court specifically noted that:

> [P]re-planning for the contingency of a hostile takeover might reduce the risk that, under the pressure of a takeover bid, management will fail to exercise reasonable judgment. Therefore, in reviewing a pre-planned defensive mechanism it seems even more appropriate to apply the business judgment rule.

Id. at 1350 (citing Warner Communications v. Murdoch, 581 F. Supp. 1482, 1491 (D. Del. 1984)).

119. *Id.* at 1355.

120. *Id.*

was later confirmed in *Blasius Industries Inc. v. Atlas Corp.*,[121] in which the Delaware Chancery Court held that "[w]here boards of directors deliberately employ[] . . . legal strategies either to frustrate or completely disenfranchise a shareholder vote, . . . [t]here can be no dispute that such conduct violates Delaware law."[122] The *Blasius* court noted that the shareholder vote has primacy in corporate governance because it is the "ideological underpinning upon which the legitimacy of directorial power rests."[123] Without "a compelling justification," no defensive mechanism that purposefully interferes with the shareholder franchise can be sustained.[124]

Following Delaware's lead, numerous courts have upheld the validity of rights plans containing flip-over, flip-in, back-end, and other provisions under relevant state corporate codes.[125] These cases have supported the authority of the board of directors of a corporation to adopt rights plans and issue rights without any shareholder approval prior to or in the face of an actual hostile offer.

b. Statutory Developments: State Legislation Validating Poison Pills

The *Moran* case involved a flip-over rights plan, and not a flip-in plan. Under a flip-in plan, all shareholders of the target company, except the bidder, are entitled to exercise their rights to purchase stock of the target upon the occurrence of the triggering event.[126] Thus, a flip-in plan can create two new categories of shareholders of the target company—bidder shareholders and non-bidder shareholders—and treat each category differently. This proved not to be an issue in Delaware because Delaware law allows disparate treatment of

121. 564 A.2d 651 (Del. Ch. 1988).

122. *Id.* at 659-63.

123. *Id.* at 659.

124. *Id.* at 661.

125. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 181 (Del. 1986) (wherein the Delaware Supreme Court spoke approvingly of a flip-in rights plan in dicta); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829 (D. Minn. 1986), *aff'd in part on other grounds, and vacated in part*, 811 F.2d 414 (8th Cir. 1987) (wherein the District Court for the District of Minnesota refused to grant a preliminary injunction against a Minnesota corporation's rights plan under Minnesota law because the corporation's board adopted the plan in its sound business judgment); Harvard Indus. v. Tyson, No. 86-CV-74639-DT, 1986 WL 36295, at *1 (E.D. Mich. Nov. 25, 1986) (wherein the District Court for the Eastern District of Michigan refused to grant a preliminary injunction against a Michigan corporation's rights plan under Michigan law because the plan only discriminated among shareholders, not shares, and the corporation's board adopted the plan in its sound business judgment); Georgia-Pacific Corp. v. Great Northern Nekoosa Corp., 728 F. Supp. 807 (D. Me. 1990) (wherein the District Court for the District of Maine approved a flip-in rights plan after noting legislative intent underlining anti-takeover statutes in Maine and other states).

126. For a discussion of the features of a flip-in pill, see *supra* text accompanying notes 66-69.

different holders of shares of the same class.[127] Nevertheless, this discriminatory feature of the flip-in plan was a cause of concern to a number of courts in different jurisdictions and initially was held invalid in some.[128] In response, the legislatures of those states passed laws expressly upholding their legality.[129] These statutes often grant directors broad discretion to determine the terms of rights issued under poison pills. Some of them have been used to "justify yet stronger varieties of poison pills."[130]

c. Use and Redemption of the Poison Pill

Initially, litigation centered on the initial adoption of the pills.[131] In *Moran*, the Delaware Supreme Court emphasized that the legality of *adopting* a rights plan is an issue separate from the decision to *redeem* the rights in the face of a specific tender offer.[132] Noting that the decision to reject a request to redeem the rights will be judged by the same enhanced business judgment rule as it is applied to the use of any other defensive mechanism in the takeover context, the Delaware Supreme Court stated:

> [T]he Rights Plan is not absolute. When the Household Board of Directors is faced with a tender offer and a request to redeem the Rights, they will not be able to arbitrarily reject the offer. They will be held to the same fiduciary standards any other Board of Directors would be held to in deciding to adopt a defensive mechanism, the same standard as they were held to in originally approving the Rights Plan . . . .[133]
>
> The Board does not now have unfettered discretion in refusing to redeem the Rights. The Board has no more discretion in refusing to redeem the Rights than it does in enacting any defensive mechanism.[134]

127. Brown & Regner, *supra* note 25, at 5 n.3 (citing Providence & Worcester Co. v. Baker, 378 A.2d 121, 122-24 (Del. 1977); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

128. *Id.* at 5 n.4 (citing, *e.g.*, Topper Acquisition Corp. v. Emhart Corp., No. Civ. A. 89-0010-R, 1989 WL 513034, at *1 (D.C. Va. Mar. 23, 1989) (Virginia law); West Point-Pepperell, Inc. v. Farley Inc., 711 F. Supp. 1088 (N.D. Ga. 1989) (Georgia law); R.D. Smith & Co. v. Preway, Inc., 644 F. Supp. 868 (W.D. Wis. 1986) (Wisconsin law); Amalgamated Sugar Co. v. NL Indus., 644 F. Supp. 1229 (S.D.N.Y. 1986) (New Jersey law)).

129. *Id.* at 5 n.5 (citing, *e.g.*, GA. CODE ANN. § 14-2-624 (1989); N.J. STAT. ANN. § 14A:7- 7 (West Supp. 1992); N.Y. BUS. CORP. LAW § 505 (McKinney Supp. Ann. 1992); WIS. STAT. ANN. § 180 (West 1992); HAWAII REV. STAT. § 415-20 (1988)).

130. *Id.* at 2.

131. *Id.*

132. *Moran*, 500 A.2d at 1354.

133. *Id.*

134. *Id.*

i. Judicial Reluctance to Order the Pill Redemption

In judging a board's decision not to redeem a rights plan or to redeem it for one bidder but not for another, courts generally adopt the same analytical framework established by *Unocal*. A number of courts, applying Delaware law, have ruled on motions for preliminary injunctions, which sought to enjoin the operation or to compel the redemption of a poison pill. Because the "prudent deployment" of the pill had proven to be beneficial to the shareholders,[135] the courts generally deferred to the board's discretion and were extremely reluctant to order the redemption of poison pills on fiduciary duty grounds.[136]

Courts applying Delaware law have held that even a fully financed, "all-cash, all-shares" premium offer can present a threat such that refusing to disarm a rights plan may be a reasonable response.[137] The rationale is that "a target board facing a proxy contest joined with a hostile tender offer could, in good faith, employ non-preclusive defensive measures to give the board time to explore transactional alternatives;" nonetheless, a board could not "erect defenses that would either preclude a proxy contest altogether or improperly bend the rules to favor the boards' continued incumbency."[138]

135. As observed by the *Toll Brothers* court, the prudent deployment of the pill often resulted in a bidding contest, which culminated in an acquisition on terms superior to the initial hostile offer. Carmody v. Toll Bros., 723 A.2d 1180, 1186 (Del. Ch. 1998).

136. *See, e.g.*, Unitrin. Inc. v. American General Corp., 651 A.2d 1361 (1995) (refusing to enjoin the operation of a rights plan with flip-in and flip-over provisions); Tate & Lyle PLC v. Staley Continental Inc., No. Civ. A. 9813, 1988 WL 46064 (Del. Ch., May 9, 1988) (wherein the Delaware Chancery Court refused to enjoin a shareholder rights plan with both flip-over and flip-in (20% trigger) provisions and refused to order redemption of rights under plan); BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D.C. Del. 1988) (wherein the district court refused to order directors of a Delaware corporation to redeem rights under a plan that had both flip-in and flip-over rights); CRTF Corp. v. Federated Dept. Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988) (wherein the New York district court, applying Delaware law, upheld the validity of a rights plan containing both flip-in and flip-over provisions and refused to order the board to redeem rights); Buckhorn Inc. v. Ropak Corp., 656 F. Supp. 209 (S.D. Ohio 1987) (holding that a back-end plan was a reasonable response to an offer the court characterized as being, in effect, a two-tier offer, but striking down the specific plan in question because of a lack of sufficient care in setting the exercise price); Dynamics Corp. of Am. v. CTS Corp., 635 F. Supp. 1174 (N.D. Ill. 1986) (wherein the Illinois district court refused to grant an injunction blocking the operation of a back-end plan adopted by an Indiana corporation).

137. *See, e.g.*, Moore v. Wallace Computer, 907 F. Supp. 1545 (D.C. Del. 1995) (wherein the district court refused to order a Delaware corporation to redeem its rights plan in the face of a tender offer despite the fact that nearly 75% of the corporation's shareholders tendered their shares; the court concluded that (1) the board's decision not to redeem the pill was a reasonable response to the takeover threat because the shareholders were uninformed about the promising financial prospects of the company and (2) the board's actions were designed to protect the shareholders from what the board considered to be a lowball offer).

138. *Toll Bros.*, 723 A.2d at 1186-87.

ii. Limited Exception

There have been exceptions to the judicial reluctance to order the pill redemption, but such exceptions are very limited and have only been applied in a few cases. For example, in *City Capital Associates v. Interco Inc.*,[139] the Delaware Chancery Court enjoined the use by Interco of a poison pill to protect a corporate restructuring plan undertaken by the Interco board as a defense to an unsolicited all-cash tender offer.[140] The court held that the continued use of the poison pill served the purpose of only "preclud[ing] the shareholders from exercising a judgment about their own interests that differs from the judgment of directors" and ordered Interco to redeem its pill.[141] Some commentators opined that the *Interco* conclusion was short-lived[142] and was effectively overruled, one year later, by the Delaware Supreme Court in *Paramount Communications, Inc. v. Time, Inc.*[143] Some other commentators view the *Interco* decision as an illustration of the differing conclusions courts have reached at different times based on different facts. In their view, *Interco* simply represented the prevailing thought at the time, though case law has since been more protective of directors' actions.

D. Controversy Surrounding Dead Hand Provisions in Poison Pills

In a nutshell, the scholarly debate and controversy surrounding dead hand provisions in poison pills centers on discrimination between incumbent and future boards created by continuing director provisions and the negative effect on shareholders' voting rights.[144]

Opponents of dead hand provisions attack them primarily on both statutory and fiduciary duty grounds. They question their validity because these provisions create two classes of directors—those who can redeem the pill, and those who cannot. The effect of this division is that continuing directors have the power to limit the discretion of future directors.[145] Such limitation on

139. 551 A.2d 787 (Del. Ch. 1988).

140. *Id.* at 787. Interco had determined they would implement a restructuring plan that the board's financial advisor estimated to be valued at $76 to the stockholders in the face of a $74 all-cash offer for all shares by Rales Brothers. *Id.* at 790.

141. *Id.* at 798. First, the court felt that the threat posed by the tender offer was primarily economic rather than coercive. *Id.* Although the economic threat was sufficient to justify the use of a poison pill for a period of time in order to negotiate a better deal, once that period ended, the legitimate role of the poison pill was fully satisfied. *Id.* Then, the court determined that Rales Brothers had made their "final" offer and, for that reason, the bidding contest had reached the "end-stage." *Interco*, 551 A.2d at 798. The court also noted that there was a wide divergence of opinion as to the value to stockholders of the proposed restructuring. *Id.* at 798-800.

142. Elofson, *supra* note 25, at 320-21.

143. 571 A.2d 1140 (Del. 1989).

144. Lese, *supra* note 5, at 2177.

145. Brown & Regner, *supra* note 25, at 3.

future boards conflicts with the corporate statutes of many states, including Delaware, whose statutes confer a *full* range of power to directors to manage the business and affairs of a corporation.[146] Some commentators further argue that the dead hand pill infringes upon a shareholders' franchise because shareholders will be "coerced" to vote for the incumbent directors even though they favor the new nominees, who are stripped of the power to redeem the pill for its entire life or for a crucial period.[147] A fundamental principle in corporate law is that the shareholders, through their power to elect directors, retain ultimate control over the use of pills and the future of their corporation.[148] Therefore, the dead hand provision cannot be justified because it has the effect of disenfranchising shareholders,[149] even though it could provide shareholders some limited benefits.[150]

Supporters of dead hand poison provisions, on the other hand, argue that continuing director provisions do not prevent shareholders from freely electing the directors of their choice, in spite of the fact that current directors have the power to limit the discretion of future directors.[151] Some state statutes embrace the "continuing directors" concept and/or expressly authorize directors' sole discretion to fix the terms and conditions of the poison pill.[152] In these states, adoption of continuing director provisions is within the boundary of powers granted to directors by such statutes.[153]

Supporters offer two additional justifications. First, continuing director provisions help defend shareholders against coercive two-tiered tender offers, which can be used to pressure shareholders into selling their shares to a hostile bidder.[154] Second, continuing director provisions give an incumbent board

146. *See infra* Parts III.A, III.C.

147. Lese, *supra* note 5, at 2177.

148. Brown & Regner, *supra* note 25, at 3.

149. *Id.*

150. Elofson, *supra* note 25, at 343.

151. Brown & Regner, *supra* note 25, at 3.

152. There are a number of states that have statutes which allow "continuing director" restrictions, for example, Georgia, *see* GA. CODE ANN. § 14-2-1111 (1981), Kentucky, *see* KY. REV. STAT. ANN. § 271B.12-220 (1984), and North Carolina, *see* N.C. GEN. STAT. § 55-9-03 (1987).

153. Brown & Regner, *supra* note 25, at 3.

154. *Corporate Law – Takeover Defenses – Northern District of Georgia Upholds Continuing Director Provision of Poison Pill* – Invacare Corp. v. Healthdyne Technologies, Inc., *968 F. Supp. 1578 (N.D. Ga. 1997)*, 111 HARV. L. REV. 1626, 1630 (1998) [hereinafter *Corporate Law*]. In a two-tiered tender offer, the bidder typically offers cash for a majority of the target's shares, and then acquires the remaining shares for a lower price through a "freeze-out" merger. *See* Lese, *supra* note 5, at 2184-85. Shareholders may feel compelled to tender their shares out of fear that the takeover will succeed and lead to a "freeze-out" that will victimize those shareholders who did not tender immediately. *Id.* at 2185. This threat was the justification for the original development of the poison pill. JESSE H. CHOPER & JOHN C. COFFEE ET AL., CASES AND MATERIALS ON CORPORATIONS 903 (4th ed. 1995).

time to look elsewhere for a better offer when a potential acquirer attempts to stampede shareholders into a hasty decision.[155] Nonetheless, opponents counter-argue that these two justifications are based on the same rationale offered to support ordinary poison pills.

The section below discusses the judicial review of dead hand provisions by different courts under different state laws.

III. RECENT DEVELOPMENTS: JUDICIAL REVIEW OF DEAD HAND PROVISIONS – A MIXED RECORD

Although poison pills have generally been held valid by state courts, the dead hand pill and its variations have received little judicial scrutiny until recently[156] and have had a mixed reception in courts.[157] Despite the debate among scholars and commentators regarding the validity of dead hand provisions,[158] and the position of some scholars calling for a *per se* invalidation,[159] or for imposition of severe limitations on their use,[160] so far, only six decisions have squarely addressed the validity of dead hand provisions. The courts were unable to reach a consensus as to the validity of the dead hand feature. All of the arguments discussed above were advanced by both sides and were carefully considered by the courts in each of the six cases. This section analyzes the mixed reception of the dead hand feature, pure and modified, in different courts applying different state laws.

A. New York: Invalidated in Bank of New York v. Irving Bank

The first challenge to the validity of the dead hand pill was brought in the New York Supreme Court in 1988.[161] The pill, adopted by Irving Bank, mandated that it could be redeemed only by continuing directors or directors

155. FLEISCHER & SUSSMAN, *supra* note 2, §5.01[A], at 5-5 (explaining that poison pills "enabl[e] target companies' boards to respond to hostile bids in a deliberative and unfrenzied manner"). These considerations most likely explain the references to continuing directors in the Georgia Fair Price and Business Combination statutes, which the court cited to establish that continuing director provisions are "not contrary to public policy in Georgia." *Invacare*, 968 F. Supp. at 1580-81. *See also* CHOPER & COFFEE ET AL., *supra* note 154, at 1054 (noting that state "fair price" statutes are "[d]irected against the two-tier takeover"); *Corporate Law*, *supra* note 154, at 1630.

156. *Corporate Law*, *supra* note 154, at 1626.

157. *Id*.

158. *See* sources cited *supra* note 25.

159. Lese, *supra* note 5, at 2177. *See generally* Randall S. Thomas & Kenneth J. Martin, *The Impact of Rights Plans on Proxy Contests: Reevaluating* Moran v. Household International, 14 INT'L REV. L. & ECON. 327 (1994); Irwin H. Warren & Kevin G. Abrams, *Evolving Standards of Judicial Review of Procedural Defenses in Proxy Contests*, 47 BUS. L. 647 (1992).

160. Elofson, *supra* note 25, at 303.

161. *Bank of New York*, 528 N.Y.S.2d 482.

elected by a supermajority vote of two-thirds of the shareholders.[162] Essentially, this provision created "several different classes of directors—having different powers or having to be elected by different majorities to exercise all of the powers."[163]

The court held that the provision involved "illegal discrimination." The court reached this conclusion by distinguishing between the power of a board that consisted of continuing directors or those elected by supermajority and the power of a board otherwise validly elected by a plurality as provided in the statute.[164] The court noted that, pursuant to the New York Business Corporation Law, any restriction on the power of the board must be placed in the certificate of incorporation.[165] In the absence of contrary provisions in

162. *Id.* at 483. The relevant portion of Irving Bank's rights plan reads as follows:

> [T]he Board of Directors of the Company shall be entitled so to redeem the Rights only if it consists of a majority of Continuing Directors (as hereinafter defined) or, if the Board of Directors of the Company is not so constituted, only if the members of the Board of Directors of the Company who are not Continuing Directors were elected to immediately succeed Continuing Directors and either (i) were elected by the affirmative vote of the holders of at least two-thirds of the issued and outstanding Shares of the Company or (ii) in connection with the election of the members of the Board of Directors of the Company who are not Continuing Directors, no merger, consolidation, liquidation, business combination or similar transaction or series of transactions with respect to the Company is or was adopted. The term "Continuing Director" shall mean a director who either was a member of the Board of Directors of the Company prior to March 15, 1988 or who subsequently became a director of the Company and whose election, or nomination for election by the Company's shareholders, was approved by a vote of a majority of the Continuing Directors then on the Board of Directors of the Company.

Id.

163. *Id.* at 484. The court noted that four classes of directors were created as follows:

> The first [group] are directors who were in office prior to March 15, 1988 [on which date the amended rights plan was adopted], and who have all rights of directors. The second group are directors who are elected after March 15, 1988 and whose election was approved by a vote of the majority of the first group. This group also has all the rights of directors.
>
> The third group are directors elected after March 15, 1988 and who have not postponed or agreed to certain actions relating to mergers. These are the actions which the first group has decided to block.
>
> The fourth and final group are directors who were elected by the vote of the holders of at least two-thirds of the shares. This group also has all the rights of directors.

Id. at 483-84.

164. *Id.* at 485.

165. *Id.* § 614 of the New York Business Corporation Law sets forth the voting requirements for the election of directors of a New York corporation as follows: "Directors shall, except as otherwise required by this chapter or by the certificate of incorporation as permitted by this chapter, be elected by a plurality of the votes cast at a meeting of shareholders by the holders of shares entitled to vote in the election." *Id.* § 620 provides that:

> A restriction of the board's power to manage the business of the corporation is invalid unless (1) all of the incorporators or all of the shareholders of record have authorized such

Irving Bank's certificate of incorporation, such a limitation on the future board's power ran afoul of New York statutory provisions.[166] In essence, as the court noted, "[a]t issue here [was] not the propriety of the adoption of the plan, but rather the legality of Section 23 [of the plan], the provision restricting the power of duly elected directors to conduct business of the corporation otherwise conductible by directors elected in a specified manner."[167] The business judgment rule was not an issue in this particular case. This decision thwarted the use of the dead hand poison pill in New York, and by analogy elsewhere for a number of years.[168]

B. Georgia: Upheld in Invacare v. Healthdyne Technologies

In mid-1997, nine years after *Bank of New York*, the validity of the dead hand provision again was challenged, this time under Georgia law, in *Invacare Corp. v. Healthdyne Technologies, Inc*.[169] In *Invacare*, the court rejected a challenge to the pure dead hand poison pill adopted by Healthdyne, a Georgia corporation, to fend off a tender offer joined with a proxy contest by Invacare, an Ohio corporation.[170] Healthdyne's poison pill provided that:

> [A]ny redemption or amendment of the rights plan [had] to be approved by one or more directors who were members of the board prior to the adoption of the rights plan, or who were subsequently elected to the board with the recommendation and approval of the other continuing directors.[171]

With the presence of such a pill, Invacare was effectively precluded from utilizing a proxy contest to unseat Healthdyne's incumbent directors for the purpose of redeeming the pill.[172] Thus, the hostile bid could not proceed unimpeded.[173]

Invacare sought a preliminary injunction declaring the invalidity of the continuing director provision and directing the Healthdyne board to remove the provision from its rights plan.[174] Invacare contended that the provision

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> provision on the certificate of incorporation; (2) subsequent shareholders have notice of the provision; and (3) no shares of the corporation are listed on a national securities exchange or in an over-the-counter market.

Id.

166. *See* N.Y. BUS. CORP. LAW § 614 (McKinney 1986).

167. *Bank of New York*, 528 N.Y.S.2d at 485.

168. Gordon, *supra* note 25, at 532. After *Bank of New York*, the dead hand pill apparently was used much less by companies, and was thus excluded from some recent compilations of anti-takeover defensive measures. *Id.*

169. 968 F. Supp. 1578 (N.D. Ga. 1997).

170. *Id.*

171. *Id.* at 1579.

172. *Id.*

173. *Invacare*, 968 F. Supp. at 1579.

174. *Id.*

involved an "improper limitation" on the future board's powers in violation of the Georgia statute which stated that *all* corporate powers should be exercised by the company's board of directors.[175]

The court upheld the validity of the continuing director provision, ruling that the provision was consistent with Georgia law and public policy.[176] In upholding the continuing director provision, the district court relied on sections 14-2-624(a) and (c) of the Georgia Business Corporation Code, which provided directors broad latitude and "sole discretion" to set the terms and conditions of a shareholder rights plan and stated that "[s]uch terms and conditions need not be set forth in the articles of incorporation."[177] The court also relied on references to the "continuing directors" concept in the Georgia Fair Price and Business Combination Statutes.[178] The court therefore

175. *Id.* at 1580. Specifically, Invacare contended that the provision violated §14-2-801(b) of the Georgia Business Corporations Code, which provides:

> All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation, bylaws approved by the shareholders, or agreements among the shareholders which are otherwise lawful.

Id. Invacare argued that the continuing director provision was illegal because it was a significant limitation on the power of board and the limitation was not set forth in Healthdyne's articles of incorporation or bylaws. *Id.*

176. *Id.* at 1580-81.

177. *Id.* Relevant parts of §§ 14-2-624(a) and (c) provide the following:

> A corporation may issue rights, options, or warrants with respect to the shares of the corporation whether or not in connection with the issuance and sale of any of its shares or other securities. The board of directors shall determine the terms upon which the rights, options, or warrants are issued, their form and content, the consideration for which they are to be issued, and the terms and conditions relating to their exercise, including the time or times, the conditions precedent, and the prices at which and the holders by whom the rights, options, or warrants may be exercised . . . . Nothing 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. (emphasis added). The court rejected Invacare's argument that the continuing director provision was illegal because it was a significant limitation on the power of the board and the limitation was not set forth in Healthdyne's articles of incorporation or bylaws. *Id.* at 1580.

178. *Invacare*, 968 F. Supp. at 1580-81. In particular, the Georgia Fair Price Statute provides that when a vote is needed to approve a business combination, that business combination must be:

> (1) unanimously approved by the continuing directors provided that the continuing directors constitute at least three members of the board of directors at the time of such approval; or (2) recommended by at least two-thirds of the continuing directors and approved by a majority vote entitled to be cast by holders of voting shares, other than voting shares beneficially owned by the interested shareholder who is, or whose affiliate is, a party to the business combination.

concluded that "the concept of continuing directors is an integral part of a takeover defense and is not contrary to public policy in Georgia."[179]

Invacare also contended that the continuing director provision violated directors' fiduciary duties and improperly interfered with the exercise of shareholder voting rights without any demonstration of a "compelling justification" for its adoption.[180] The court rejected Invacare's argument, noting, "Georgia law requires directors to perform their duties in good faith in a manner believed to be in the best interest of the corporation."[181] The court held that a "compelling justification" requirement conflicted with the standard set forth in the Georgia statute.[182] The court concluded that, unlike the situation in *Blasius*, the continuing director provision in Healthdyne's rights plan did not interfere with shareholder voting rights; nor was it coercive, because it did not infringe on the shareholder's right to elect a new board.[183]

The *Invacare* court distinguished *Bank of New York*, pointing out that the prior case was decided on the basis of a New York statute containing a general prohibition on restrictions of the board's power to manage the corporation.[184] The Georgia statutes contained no such prohibition.[185]

The *Invacare* decision spawned extensive scholarly comments.[186] Some commentators predicted that the *Invacare* holding was likely to lead to "a new found popularity of this defense measure even though the particular decision

Id. (quoting O.C.G.A. § 14-2-1111). The Georgia Business Combination Statute provides that a bylaw opting into the statute cannot be repealed without "the affirmative vote of at least two-thirds of the continuing directors . . . ." *Id.* (quoting O.C.G.A. § 14-2-1133(b)).

179. *Id.* at 1581.

180. *Id.*

181. *Id.* (quoting O.C.G.A. § 14-2-830(a)(1)).

182. *Id.*

183. *Invacare*, 968 F. Supp. at 1581.

184. *Id.* at 1580.

185. *Id.*

186. *See, e.g.*, Neil C. Rifkind, *Should Uninformed Shareholders Be a Threat Justifying Defensive Action by Target Directors in Delaware: "Just Say No" After* Moore v. Wallace, 78 B.U. L. Rev. 105, 151 (1998); Gordon, *supra* note 25, at 552; *Corporate Law*, *supra* note 154, at 1631; Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism By Labor Unions*, 96 MICH. L. REV. 1018, 1094 (1998); Robert C. Schwenkel & Judith R. Thoyer, *Advising the Board of Directors in the M&A Context*, *in* ADVANCED DOING DEALS: A STRATEGIC APPROACH TO COMPLETING THE TRANSACTION, at 7, 35 (PLI Corp. Law & Practice Course Handbook Series No. B4-7235, 1998); Kenneth J. Bialkin & Robert G. Wray, *Recent Developments in Mergers & Acquisitions*, *in* CORPORATE GOVERNANCE INSTITUTE: BLUEPRINT FOR GOOD GOVERNANCE IN THE 1990'S, at 649, 679 (PLI Corp. Law & Practice Course Handbook Series No. B0-000X, 1998); Wolcott B. Dunham, Jr. & James C. Scoville, *Mergers and Acquisitions in the Insurance Industry: Preparing For and Responding to a Hostile Bid*, *in* INSURANCE M&A: A PRACTICAL APPROACH TO STRUCTURING COMPLEX TRANSACTIONS, at 391, 404 (PLI Corp. Law & Practice Course Handbook Series No. B4-7217, 1997).

relied on peculiar features of Georgia law."[187] On the other hand, they also observed that "[o]pponents of continuing director provisions may be expected to continue to argue against them, based on their impact on directorial discretion and shareholder voting rights."[188]

While commentators and corporate practitioners were still determining the impact that *Invacare* would have on courts in other states; while they were determining what advice to give to their corporate clients; and while they were speculating how Delaware courts would rule on this issue, a year later, the Delaware courts finally were given an opportunity to articulate a position on this unsettled issue in *Toll Brothers* and *Quickturn*, as discussed below.

C. Delaware: Invalidated in

1. Carmody v. Toll Brothers: A Cognizable Claim is Stated Against the "Pure" Dead Hand Provision

The first challenge in Delaware to the adoption of a pure dead hand poison pill was brought to the Delaware Chancery Court for review in *Carmody v. Toll Brothers*.[189] On July 24, 1998, the court handed down its decision refusing to dismiss a claim asserting the invalidity of the dead hand poison pill adopted by Toll Brothers.[190] The court decided that the claim asserted, if proven, would provide a basis for judicial relief.[191]

In addition to the standard "flip-in" and "flip-over" features, Toll Brothers' rights plan contained a distinctive dead hand feature, authorizing only

187. Brown & Regner, *supra* note 25, at 4 ("Companies incorporated in those states may, however, attempt to use the decision to justify adopting rights plans with continuing director provisions, or adding continuing director provisions to existing pills."). *See also* Gordon, *supra* note 25, at 533.

188. Brown & Regner, *supra* note 25, at 4.

189. 723 A.2d 1180 (Del. Ch. 1998).

190. *Id.* at 1182. On June 12, 1997, the board of directors of Toll Brothers, a Pennsylvania based Delaware corporation, adopted a rights plan. *Id.* at 1183-84. The plan was adopted as a preventive measure to protect against the risk of a hostile takeover that is inherent in the line of business in which Toll Brothers engages. *Id.* A "continuing director" in Toll Brothers' rights plan is defined as the following:

> (i) any member of the Board of Directors of the Company, while such person is a member of the Board, who is not an Acquiring Person, or an Affiliate [as defined] or Associate [as defined] of an Acquiring Person, or a representative or nominee of an Acquiring Person or of any such Affiliate or Associate, and was a member of the Board prior to the date of this agreement, or (ii) any Person who subsequently becomes a member of the Board, who is not an Acquiring Person, or an Affiliate [as defined] or Associate [as defined] of an Acquiring Person, or a representative or nominee of an Acquiring Person or of any such Affiliate or Associate, if such Person's nomination for election or election to the Board is recommended or approved by a majority of the Continuing Directors.

Id. at 1184.

191. *Id.* at 1182.

"continuing directors" to redeem the pill.[192] A dispute over the legality of this pure dead hand provision prompted the lawsuit.

Plaintiff contended that the continuing director provisions of Toll Brothers' poison pill were invalid because (1) they violated sections 141(a) and (d) of the Delaware General Corporation Law by interfering with the directors' statutory power to manage the business and affairs of the corporation; (2) they were adopted "solely or primarily for entrenchment purposes" and were "a disproportionate defensive measure," in contravention of the principles of *Unocal* and *Unitrin*; and (3) they "purposefully interfere[d] with the shareholder voting franchise without any compelling justification, in derogation of the principle articulated in *Blasius* . . . ."[193]

First addressing plaintiff's statutory claim, the court concluded that the dead hand provision in Toll Brothers' rights plan was statutorily invalid because it ran afoul of sections 141(a) and (d) of the Delaware General Corporation Law for several reasons.[194] First, the court found that the dead hand provision created different classes of directors—those who could redeem the pill and those who could not—and made different voting power distinctions among directors until the rights would expire on June 12, 2007.[195] This interference with the directors' statutory power to manage the business and affairs of the corporation violated section 141(d) of the Delaware General Corporation Law in the absence of an explicit authorization in Toll Brothers' certificate of incorporation.[196] Second, the court noted that section 141(d) mandated that the right to impose limitations on the directors' power is reserved to shareholders, not to directors or a subset thereof.[197] The dead hand provision, by vesting the pill redemption power exclusively in the continuing directors, transgressed the statutorily protected shareholder right to "elect the directors who would be so empowered."[198] Third, the court held that the dead

192. *Id.* at 1183-84.

193. *Id.* at 1189-90.

194. *Toll Bros.*, 723 A.2d at 1190-92.

195. *Id.* at 1190.

196. *Id.* at 1191. The pertinent portion of §141(d) provides as follows:

> The certificate of incorporation may confer upon holders of any class or series of stock the right to elect one 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.

Id. Under § 141(d), such a distinction may be created only under explicit provisions in the certificate of incorporation. *Id.*

197. *Id.*

198. *Id.* Absent explicit language in Toll Brothers' 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." *Id.*

hand provision would impermissibly interfere with the directors' statutory power to manage the business and affairs of the corporation conferred by section 141(a) of the Delaware General Corporation Law, which states as follows:

> The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation . . . .[199]

The interference was apparent because a newly elected future board would be deprived of the power to achieve a business combination due to its lack of authority to redeem the pill without obtaining the consent of the continuing directors.[200]

The court also cited the 1988 New York Supreme Court opinion in *Bank of New York* for support.[201] The court concluded that although the relevant language of the Delaware and New York statutes was not identical, the underlying intent of both statutes was the same: both required that limitations upon the directors' power be expressed in the certificate of incorporation.[202] The Court distinguished *Toll Brothers* from *Invacare* on the basis that the Delaware statutes contained provisions materially different from those in the Georgia statute.[203]

Toll Brothers contended that the dead hand provision in its poison pill did not "facially preclude or interfere with proxy contests as a means to gain control, or coerce shareholders to vote for or against any particular director slate."[204] It further contended that the dead hand provision was "tantamount to a delegation to a special committee, consisting of the [c]ontinuing [d]irectors, of the power to redeem the pill."[205] However, the court disagreed with these contentions and concluded that Toll Brothers' arguments had no merit because the first contention was not a response to the statutory claim and the second rested on the wrong analogy.[206]

Turning to plaintiff's fiduciary claims under *Blasius*, the court noted that "[t]he validity of antitakeover measures [was] normally evaluated under the Unocal/Unitrin standard."[207] Nevertheless, defensive measures that

199. *Toll Bros.*, 723 A.2d at 1191.

200. *Id.*

201. *Id.* at 1191-92. The Delaware court stated that "[t]he statutory analysis employed, and the result reached here, are consistent with and supported by Bank of New York Co. v. Irving Bank Corp." *Id.* at 1191.

202. *Id.* at 1192.

203. *Id.* at 1192 n.38.

204. *Toll Bros.*, 723 A.2d at 1192.

205. *Id.*

206. *Id.*

207. *Id.* at 1193.

purposefully interfere with shareholders' franchise must be evaluated under the *Blasius* standard and cannot be sustained without a "compelling justification."[208] The court particularly noted that a fundamental condition supported by the decision in *Moran* involved the ability of shareholders to replace the board with directors willing to redeem the pill.[209] In this case, Toll Brothers' shareholders would be powerless to elect a board that was both willing and able to accept the bid, and they could be forced to vote for incumbent directors.[210] Observing that the individual shareholder's vote had primacy in Delaware's scheme of corporate jurisprudence and corporate governance, and that any attempt to interfere with the shareholder's voting rights was difficult to justify,[211] the court concluded that the *Blasius* claim was cognizable under Delaware law.[212]

Plaintiff also alleged that the dead hand provision would either preclude a proxy contest altogether or coerce shareholders supporting a hostile bid to vote for the incumbent directors opposing the bid.[213] The court held that such an allegation also supported plaintiff's *Unocal/Unitrin* claim that the dead hand provisions were disproportionate and unreasonable defensive measures.[214]

For these reasons, the court concluded that the complaint stated legally sufficient claims that survived the motion to dismiss.[215] Although the ruling took the form of a denial of Toll Brothers' motion to dismiss, it was virtually a denial on the merits of the validity of the pure dead hand provision. The statutory analysis of the validity of the dead hand feature employed by the court and the holding of the case proved to be consistent with that of the Delaware Supreme Court in *Quickturn.*

2. Quickturn Design Systems, Inc. v. Shapiro: The Modified Dead Hand Provision Is Held Invalid

On December 31, 1998, the Delaware Supreme Court rendered a sweeping decision in *Quickturn*, concluding that the no hand provision in a poison pill was invalid as a matter of Delaware law.[216] This holding establishes a "bright line" principle that *any* dead hand provision, in whatever form, is *per se* invalid under Delaware law.

208. *Id.* (citing Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992) (articulating the *Blasius* standard)).

209. *Toll Bros.*, 723 A.2d at 1193.

210. *Id.*

211. *Id.* at 1193-94

212. *Id.* at 1192-94.

213. *Id.* at 1194-95.

214. *Toll Bros.*, 723 A.2d at 1194-95.

215. *Id.* at 1195.

216. Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1283 (Del. 1998).

In *Quickturn*, in response to Mentor's tender offer and proxy contest to replace the Quickturn board,[217] the board enacted two defensive measures.[218] The first was an amendment to the bylaws, delaying the holding of any special stockholders meeting for ninety to one hundred days after the receipt and determination of the validity of the stockholders' request by Quickturn.[219] The second was an amendment to the existing shareholder rights plan, eliminating its dead hand feature and replacing it with a no hand feature; that is, a delayed redemption provision (a "DRP").[220] Under the DRP, no newly-elected board could redeem the poison pill for six months after taking office if the purpose or effect of the redemption would be to facilitate a business combination with an "Interested Person," that is, someone who backed the election of new directors to the board, which in this case was Mentor.[221]

On December 3, 1998, the Chancery Court, applying the *Unocal* two-prong test to the two defensive measures, upheld Quickturn's bylaw amendment[222] but declared that the adoption of the DRP was invalid because it was a disproportionate response to the threat the board reasonably perceived because it created an unjustified additional delay.[223] After concluding that the

217. *Id.* at 1285-87. On August 12, 1998, Mentor Graphics Corp. announced an unsolicited cash tender offer for all outstanding common shares of Quickturn, and its intent to wage a proxy contest to replace the incumbent board by calling for a special shareholders' meeting pursuant to the provisions of Quickturn's bylaws. *Id.* at 1285-86. The Quickturn board, after three meetings, rejected Mentor's offer as inadequate. *Id.* at 1286-87.

218. *Id.* Mentor challenged the two newly adopted anti-takeover measures in the Delaware Chancery Court seeking declarative and injunctive relief. *See* Mentor Graphics v. Quickturn Design Sys., 728 A.2d at 25, 36 (Del. Ch. 1998). Mentor sought (1) a declaratory judgment that Quickturn's newly adopted takeover defenses were invalid and (2) an injunction requiring the Quickturn board to dismantle those defenses. *Id.* Mentor advanced virtually the same contentions as the ones in *Toll Brothers. Id.* at 37-38.

219. *Quickturn*, 721 A.2d at 1287.

220. *Id.*

221. *Id.*

222. *Mentor*, 728 A.2d at 38-43.

223. *Id.* at 43-52. Applying the *Unocal/Unitrin* test to Quickturn's defensive measures, the court first concluded that the board reasonably perceived a cognizable threat because "Quickturn shareholders might mistakenly, in ignorance of Quickturn's true value, accept Mentor's inadequate offer, and elect a new board that would prematurely sell the company before the new board could adequately inform itself of Quickturn's fair value and before the shareholders could consider other options." *Id.* at 46. The court further concluded that the DRP was not coercive because, under the facts, a majority of Quickturn's shareholders actually tendered their shares to Mentor. *Id.* at 47-49. If there was "coercion," it had worked to the benefit of Mentor. *Id.* at 49. Additionally, it was not preclusive because the DRP could only delay the sale of the company for six months; while under the facts, Mentor had obtained a "secure financing commitment that is effective for three years – a period far longer than the six month delay that the DRP would occasion." *Id.* Nonetheless, the court found that the adoption of the DRP was a disproportionate response to Mentor's bid under the circumstance. *Id.* It was disproportionate because the bylaw amendment already would delay the holding of a special shareholders' meeting for three months

DRP was invalid under the fiduciary duty ground, the court stated that it was unnecessary to address the plaintiff's statutory claim that the DRP was *ultra vires* under section 141(a) of the Delaware General Corporation Law.[224]

On appeal,[225] the Delaware Supreme Court declared that the no hand feature violated fundamental Delaware law, and "[o]n that alternative basis," it affirmed the judgment of the Delaware Chancery Court.[226] This was the first ruling of the Delaware Supreme Court in which the court squarely addressed the illegality of the no hand provision in the poison pill.

The Delaware Supreme Court stated that "[o]ne of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation."[227] The court noted that it was this inherent power of the board conferred by section 141(a) of the Delaware General Corporation Law[228] that constituted the basis upon which the adoption of the rights plan in *Moran* was upheld as a legitimate exercise of business judgment by the board.[229] The court emphasized that section 141(a) required any limitation on the board's authority be set out in the certificate of incorporation.[230] Because there were no such limitations in Quickturn's charter, the board exceeded its authority in adopting the DRP, under which a newly elected board of directors would be prevented "from

so as to enable the Quickturn board and shareholders to seek other alternatives. *Id.* at 50. There is no justified reason to delay the redemption of a poison pill for six *additional* months by adopting the DRP. *Id.* at 52.

224. *Id.* at 44.

225. On December 28, 1998, Quickturn filed an expedited appeal from the final judgment entered by the Chancery Court, alleging that the court erred in finding that the adoption of the DRP by the board was a violation of the board's fiduciary duty. *Quickturn*, 721 A.2d at 1282-83. Mentor, on the other hand, argued that the court's ruling should be affirmed because the DRP was invalid in that it violated § 141(a) of the Delaware General Corporation Law by "impermissibly depriv[ing] any newly elected board of both its statutory authority to manage the corporation [there]under and its concomitant fiduciary duty pursuant to that statutory mandate." *Id.* at 1291.

226. *Id.* at 1283, 1290-93. The Delaware Chancery Court did not rule on the statutory ground whether the no hand poison pill violated Delaware law. *Mentor*, 728 A.2d at 44. Instead, the Chancery Court applied the *Unocal* two-prong test and concluded that the no hand pill was invalid because it was not a proportionate response to the threat reasonably perceived by the Quickturn board. *Id.* at 49-52.

227. *Quickturn*, 721 A.2d at 1291.

228. § 141(a) of the Delaware General Corporation Law states as follows:

> The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.

DEL. STAT. ANN. § 141(a).

229. *Quickturn*, 721 A.2d at 1291.

230. *Id.*

completely discharging its fundamental management duties to the corporation and its stockholders for six months."[231] The court observed the following:

> While the [DRP] limits the board of directors' authority in only one respect, the suspension of the Rights Plan, it nonetheless restricts the board's power in an area of fundamental importance to the shareholders – negotiating a possible sale of the corporation. Therefore, we hold that the [DRP] is invalid under Section 141(a), which confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation.[232]

The court also noted that the directors have a fiduciary duty to the corporation and its shareholders, which extends to board conduct in a contest for corporate control.[233] Moreover, "no defensive measure can be sustained which would require a new board of directors to breach its fiduciary duty."[234] The DRP is no exception. The DRP "tends to limit in a substantial way the freedom of [newly elected] directors' decisions on matters of management policy," therefore, "it violates the duty of each [newly elected] director to exercise his own best judgment on matters coming before the board."[235]

In sum, the Delaware Supreme Court concluded that the no hand provisions, by restricting the directors' ability to discharge their duties, even if only for six months, violated Delaware law. Intellectually, even a one-day delay is unsustainable. Applying the *Quickturn* reasoning to other types of dead hand provisions, pure or modified, none would survive judicial scrutiny because all of them discriminate between incumbent and future boards and restrict the latter's ability to discharge its duties. Essentially, this New Year's Eve decision by the Delaware Supreme Court put an end to the use of the dead hand pill, in whatever form, by Delaware corporations.[236]

D. Pennsylvania: Upheld in AMP v. Allied Signal

On October 8, 1998, prior to *Quickturn* but after *Toll Brothers*, the District Court for the Eastern District of Pennsylvania, applying Pennsylvania law, upheld the validity of a no hand poison pill adopted by AMP Incorporated, a

231. *Id.*

232. *Id.* at 1291-92 (emphasis added by the court).

233. *Id.* at 1292.

234. *Quickturn*, 721 A.2d at 1292.

235. *Id.* at 1292 (quoting Abercrombie v. Davies, 123 A.2d 893, 899 (Del. Ch. 1956), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957)). Nevertheless, the court specifically noted that Mentor's slate of directors, upon being elected at a shareholders' meeting, would be bound to discharge an "unremitting" fiduciary duty to manage the corporation for the benefit of Quickturn and its shareholders, and not for the sole benefit of Mentor. *Id.*

236. Steven Lipin, *Delaware Supreme Court Ruling Bans Quickturn Tactic to Fend Off Mentor*, WALL ST. J., Jan. 4, 1999, at A18.

Pennsylvania corporation.[237] The no hand feature of AMP's poison pill provided that the pill was non-redeemable and non-amendable by a newly elected board for a limited duration of 15 months.[238]

In *AMP*, in response to Allied Signal's tender offer joined with a consent solicitation and two proposed bylaw amendments, the AMP board amended its existing poison pill by removing the pure dead hand feature.[239] This made the pill absolutely non-redeemable and non-amendable for a fifteen-month period (until November 6, 1999) if a hostile bidder gained majority representation on the AMP board or if Allied Signal's three-person committee proposal was adopted by AMP's shareholders.[240]

The federal district court ruled in AMP's favor, upholding AMP's amendments to its poison pill.[241] The court noted that (1) under Pennsylvania corporate law, broad deference is accorded to a target board when it adopts shareholder rights plans[242] and (2) the board's adoption of defensive measures to resisting unsolicited takeovers are subject to the "ordinary" business judgment rule.[243]

Citing section 2513(a) of the Pennsylvania Business Corporation Law, the court stated that directors had substantial authority to fix the terms of a shareholder rights plan and shareholders were bound by those terms.[244]

237. AMP Inc. v. Allied Signal Inc., Civ. A. Nos. 98-4405, 98-4058, and 98-4109, 1998 WL 778348, at *1, *12-*13 (E.D. Pa. Oct. 8, 1998).

238. *Id.* at *2-*3.

239. *Id.* On August 4, 1998, Allied Signal, a Delaware corporation, announced an all-cash tender offer for all outstanding common shares of AMP, and declared its intention to initiate a consent solicitation to acquire control of AMP. *Id.* at *1-*2. Despite the seemingly broad support of AMP's shareholders for Allied Signal's tender offer (as of September 14, 1998, 72% of AMP's shareholders had tendered their shares), the AMP board rejected Allied Signal's offer as inadequate. *Id.* To achieve its objective of gaining control of AMP's 11-member board and dismantling AMP's existing poison pill, which contained a pure dead hand feature, Allied Signal proposed a consent solicitation seeking, among other things, an amendment to AMP's bylaws. *Id.* Under Allied Signal's bylaws amendment proposal, the AMP board would be expanded to 28 members so that Allied Signal's 17 nominees, upon being elected to the board, would constitute a majority thereof. *Id.* at *2. In response, the AMP board amended its poison pill, removing the dead hand feature and making the pill absolutely non-redeemable and non-amendable for a 15-month period (ending November 6, 1999) in the event that a hostile bidder gained majority representation on the AMP board. *Id.* Allied Signal responded by proposing another bylaws amendment that would remove all control over the poison pill from the AMP board and give it to a three-person committee to be formed later. *Id.* at *3. The AMP board again amended its poison pill to make the non-redemption and non-amendment provisions applicable if the three-person committee proposal were adopted by AMP's shareholders. *Id.*

240. *Id.*

241. *AMP*, 1998 WL 778348, at *11.

242. *Id.* at *4 *citing* 15 PA. CONS. STAT. ANN. § 2513.

243. *Id.* at *5 *citing* 15 PA. CONS. STAT. ANN. § 1715(d).

244. *Id.* at *4-*5. Section 2513 (a) of the Pennsylvania Business Corporation Law provides that a Pennsylvania corporation may set forth "such terms as are fixed by the board of directors,"

Moreover, under Pennsylvania law, shareholders do not have the power to strip the board of its authority to adopt a poison pill through amendments to bylaws or otherwise.[245]

Furthermore, the court held that AMP's amendments to the poison pill were "presumed to be in the best interests of the corporation" and therefore did not constitute a breach of fiduciary duty.[246] The amendments were designed to "counter an anticipated unlawful act by Allied Signal and other shareholders to take away statutory board authority."[247] The court noted that, unlike the board of a Delaware corporation which is subject to the *Unocal* enhanced scrutiny test, the actions of the AMP board (consisting of a majority of disinterested directors) were entitled to the protection conferred by the traditional business judgment rule.[248]

Specifically, the court emphasized the finite nature of the non-redemption and non-amendment provisions, which were applicable for only fifteen months.[249] The court articulated that:

> Were this not so, it would mitigate towards a finding of lack of good faith or self-dealing. Being finite in time, the duration must be viewed in light of the *ordinary business judgment rule* that is allowed directors, as well as the presumptions of good faith for disinterested majorities established in Section 1715(d) In [sic] matters dealing with potential or proposed acquisition of control of the corporation.[250]

The court concluded that the AMP board, in amending the poison pill, validly exercised its authority under Pennsylvania law. The board did not engage in an *ultra vires* act because a poison pill under Pennsylvania law may contain any terms fixed by the board.[251] The AMP board, by statute, was not required to redeem the pill in order to comply with its fiduciary duties.[252] The directors of a Pennsylvania corporation owe a fiduciary duty to the corporation itself and are "not required to act solely because of the consideration that might be paid to shareholders in the event of an acquisition."[253]

including, but not limited to, "conditions that preclude or limit any person or persons owning or offering to acquire a specified number or percentage of the outstanding common shares . . . from exercising, converting, transferring or receiving the shares . . . ." *Id.* at *5.

245. *Id.* at *5.
246. *Id.* at *7.
247. *Id.*
248. *Id.* at *5, *8, *10.
249. *AMP*, 1998 WL 778348, at *8.
250. *Id.* (emphasis added).
251. *Id.* at *6.
252. *Id.*
253. *Id.* at *5-*6.

IV. ANALYSIS AND SOLUTIONS

A. Comparison of Disparate Holdings and Statutes: Different Jurisdictions, Different Approaches

Bank of New York, *Toll Brothers* and *Quickturn*, on one hand, and *Invacare* and *AMP*, on the other, represent two different approaches to analyzing the validity of dead hand provisions in both pure and modified poison pills. The logic for the two approaches rests on different legislative schemes existing in different states. Both the Georgia and Pennsylvania legislature have expressly granted directors sole or substantial discretion to undertake defensive measures, including adopting rights plans, to fend off hostile takeovers.[254] These states have deliberately enacted statutes providing greater protection to directors' actions in takeover contexts than that is provided under Delaware law.[255] In particular, the Pennsylvania legislature has explicitly rejected Delaware's view that a board owes a fiduciary duty to both the corporation and its shareholders.[256] Under Pennsylvania law, as the court emphasized in *AMP*, the directors of a Pennsylvania corporation owe a fiduciary duty only to the corporation.[257]

Delaware courts, on the other hand, have emphasized that directors cannot ignore shareholders' interests since they owe fiduciary duties to both the corporation and its shareholders.[258] In a takeover contest involving a Delaware corporation as the target, directors' defensive actions are subject to *enhanced* judicial scrutiny before they may be afforded the protection of the traditional business judgment rule.[259] Furthermore, when upholding the first poison pill, the *Moran* court emphasized:

> Of course, the business judgment rule can only sustain corporate decision making or transactions that are within the power or authority of the [b]oard. Therefore, before the business judgment rule can be applied it must be determined whether the [d]irectors [a]re authorized to adopt the [r]ights [p]lan.[260]

The New York Supreme Court noted the same in *Bank of New York*:

> At issue here [was] not the propriety of the adoption of the plan, but rather the legality of Section 23 [of the plan], the provision restricting the power of duly

254. *See supra* Parts III.B, III.D.
255. *See* discussion *supra* Parts III.B, III.D.
256. *AMP*, 1998 WL 778348, at *5.
257. *Id.* at *5-*8.
258. *See supra* Part III.C.
259. *See supra* Part II.C.
260. *Moran*, 500 A.2d at 1350.

> elected directors to conduct business of the corporation otherwise conductable by directors elected in a specified manner.[261]

Dead hand and no hand provisions in poison pills are invalid under Delaware and New York law because they violate the statutory provisions before the enhanced business judgment rule can even be applied.[262]

In contrast, directors of Pennsylvania and Georgia corporations have broader latitude to fix the terms and conditions of poison pills.[263] Moreover, directors of Pennsylvania corporations are not subject to enhanced judicial scrutiny and are protected under the traditional business judgment rule.[264]

B. Comparison of the Delaware Courts' Approaches

Even within Delaware, approaches to the no hand provision vary to some extent. The Delaware Chancery Court and the Delaware Supreme Court did not address the no hand provision in the same manner. Although the Supreme Court's decision controls, it is still worth discussing the different rulings of the two courts.

In a footnote in *Toll Brothers*, the Chancery Court specifically stated that its decision did not represent an opinion on "the validity of a 'dead hand' provision of limited duration."[265] In *Quickturn*, the same court adopted a case-by-case approach and applied the *Unocal/Unitrin* and *Blasius* tests to determine whether each defensive measure was valid.[266] After determining that the adoption of the no hand provision was invalid, the court stated that it was unnecessary to rule on the statutory claim advanced by Mentor.[267] These two decisions clearly indicate that the Chancery Court adopted a case-by-case, fact-sensitive approach and was somewhat reluctant to hold the no hand provision *per se* invalid. Perhaps, as one commentator suggested, "it should be acknowledged that per se invalidation of any kind of business decision is a dramatic step that courts are properly reluctant to take."[268]

Nevertheless, in declining to declare that the no hand feature violated state law, the Chancery Court left open many questions. Might a different result have been reached if the DRP was the *only* defensive measure adopted? What if the DRP provided only a three-month delay, a two-month delay, a one-month delay, or a one-day delay?

261. *Bank of New York*, 528 N.Y.S.2d at 485.
262. *See supra* Parts III.A, III.C.
263. *See supra* Parts III.B, III.D.
264. *See supra* Part III.D.
265. *Toll Bros.*, 723 A.2d at 1195 n.52.
266. *Mentor*, 728 A.2d at 37-43.
267. *Id.* at 40.
268. Elofson, *supra* note 25, at 326.

If the Chancery Court left the door ajar, the door was closed completely by the Delaware Supreme Court. The Supreme Court, without explicitly endorsing or disapproving of the Chancery Court's fiduciary duty analysis,[269] ruled directly on Mentor's statutory claim. The Supreme Court held that the no hand provision was invalid as a matter of Delaware law, and "on that alternative basis," affirmed the Chancery Court's holding, similar to its ruling in *Quickturn*.[270] After declaring the no hand provision invalid as a matter of law, there was no need for the court to discuss the second part involved in the poison pill validity analysis, that is, the application of the *Unocal/Unitrin* and *Blasius* tests to determine the propriety of the adoption of the plan. Simply put, under *Quickturn*, a board cannot adopt an illegal rights plan. It is this conflict with the statutes that renders dead hand provision, in whatever form, *per se* invalid under Delaware law.

C. Aftermath of Toll Brothers *and* Quickturn *for Delaware Corporations*

Well-known for the preeminence in America's corporate jurisprudence, opinions of Delaware courts have always been closely followed by business and legal communities. The *Toll Brothers* and *Quickturn* opinions are no exception. Newspapers and journals timely reported these decisions; corporate practitioners quickly informed their clients of these rulings.[271]

If *Invacare* and *AMP* somehow encourage companies to consider adopting a dead hand poison pill or adding the dead hand feature to their existing pills, then *Toll Brothers* certainly cautions the dead hand provision adopters and would-be-adopters to reconsider this option. Shortly after *Toll Brothers*, many corporations, including both Delaware and non-Delaware corporations, voluntarily eliminated continuing director provisions because the decision cast doubt on the validity of the dead hand provision.[272] Many companies,

269. Mentor did not file a cross-appeal, challenging the Chancery Court's decision upholding the validity of Quickturn's amendment to its bylaws, therefore, the Supreme Court held that the bylaw amendment was not an issue in the appeal and held that the Chancery Court's ruling thereon had become final. *Quickturn*, 721 A.2d at 1289.

270. *Id.* at 1293.

271. *See, e.g.*, Lipin, *supra* note 236, at A18; *De Sup. Ct. Affirms Quickturn Ruling, Bars Any Variant of Dead Hand Poison Pill*, ANDREWS DEL. CORP. LITIG. REP., Jan. 4, 1999, at 3; Elizabeth Kaplan, *Dead Hand Defenses: Ruling Leaves Fate of Poison Pills Unresolved*, N.Y. L.J., Dec. 10, 1998, at 5; *Courts Bars Quickturn's Use of Another Version of "Dead Hand" Poison Pill*, ANDREWS DEL. CORP. LITIG. REP., Dec. 7, 1998, at 3; Jef Feeley, *Dead-Hand Pills Being Dropped*, NAT'L L. J., Nov. 9, 1998, at B1; Steven Lipin, *Limited "Dead Hand" Poison Pill Is Tested*, WALL ST. J., Nov. 5, 1998, at B16; Jesse A. Finkelstein & C. Stephen Bigler, *Challenge to "Dead Hand" Poison Pill Rights Plan Sustained In Delaware*, INSIGHTS, Sept. 1998, at 16; Meredith M. Brown & William D. Regner, *Delaware Court Allows Challenge to "Dead Hand" Poison Pill* (visited Jan. 18, 2000) <http://www.debevoise.com> (click on "search" and type in "dead hand").

272. Feeley, *supra* note 271, at B1.

including some giants, simply were unwilling to take the risk.[273] Hilton Hotels Corporation, Texas Instruments Inc., Intuit, Inc., Aquila Pharmaceuticals, and Encad, Inc. were among these companies.[274] In the wake of *Toll Brothers*, shareholders even filed lawsuits in the Delaware Chancery Court, seeking to eliminate the dead hand poison pills adopted by the boards of their companies.[275] For those companies that were considering adopting a dead hand poison pill, a good suggestion was: "for a company not facing a takeover, there's no reason to buy yourself a lawsuit, and that's what you are doing by having one of these [dead hand] pills right now."[276] Several months later, *Quickturn* simply eliminated the adoption of any dead hand poison pill by Delaware corporations as a viable defensive measure.

A declaration of the illegality of the dead hand provision, including one of limited duration, renders poison pills a much less effective defense when a bidder joins its tender offer with a proxy contest or consent solicitation. The bidder's slate of directors, upon taking office, will be free to dismantle any pill immediately unless the target company has a staggered board.

Nevertheless, other viable devices are available that allow Delaware corporations to fend off hostile joint tender offers without running afoul of *Toll Brothers* and *Quickturn*. For example, target companies may amend their charters to (1) adopt a staggered board; (2) place limitations on shareholder's ability to remove directors; or (3) eliminate the right of shareholders to call special meetings or act by written consent.[277] Target companies may also either amend their bylaws to delay a shareholders' meeting calling for the election of directors or postpone an annual meeting to a later date so that the target board and management may explore alternatives to ward off hostile

273. *Id.*; *see also* Dennis J. Block & Jonathan M. Hoff, *Corporate Update: Mergers and Acquisitions*, N.Y. L.J., Nov. 18, 1998, at 5.

274. BRYAN, SIMON & CO., *supra* note 20, at Intro.-8.

275. For example, on September 4, 1998, a shareholder of Texas Instruments Inc. filed a complaint with the Delaware Chancery Court, asking the court to eliminate the dead hand pill, which was adopted by the board one month before the *Toll Brothers* decision. Kotin v. Texas Instruments Inc., No. 16626 (Del. Ch.), *noted in* ANDREWS DEL. CORP. LITIG. REP., *Dead Hand Poison Pills: Suit Challenges Texas Instrument Dead-Hand Pill in Wake of Carmody*, Sept. 21, 1998, at 4. The shareholder claimed that there was no valid business purpose for the board's adoption of the dead hand poison pill as a preventive measure upon the expiration of the old standard poison pill; thus, the board breached its fiduciary duty. *Id.*

276. Feeley, *supra* note 271, at B1.

277. John J. Demott, *Mergers and Acquisitions of Banks and Bank Holding Companies*, *in* INSTITUTE OF BANKING LAW AND REGULATIONS 1990, at 823, 904 (PLI Corp. Law & Practice Course Handbook Series No. B4-4314, 1990).

offers. The Delaware courts have upheld these measures taken by companies when they are fending off hostile tender offers.[278]

Among the alternatives mentioned above, a staggered board is the most effective defensive device to deter a hostile bidder's proxy contest to unseat the incumbent board. Statutorily permitted under Delaware law, a staggered board has only a portion (normally one-third) of its directors elected in a given year.[279] If a target company has a staggered board, a hostile bidder winning a proxy contest will only enjoy minority representation on the target board.[280] To gain control of the target board, two or more consecutive shareholders' meetings must be held.[281] Thus, having a staggered board renders the first proxy contest somewhat impotent and buys the target board and management more time to seek alternatives.[282] The staggered board has the effect of delaying an acquisition for at least one whole year (and up to two years) without entrenchment or violation of state corporate statutes. This result is more than the six-month delay afforded by a typical no hand poison pill.

Nonetheless, one significant obstacle to this strategy is that it requires an amendment to a corporation's charter. In other words, it requires shareholders' approval. This may not be obtained easily, especially in light of the recent opposition to such provisions by some institutional shareholders. It might prove to be extremely difficult for those companies that have already gone public to amend their charters. One major reason why poison pills have been so popular is because shareholder approval is not needed for the implementation.[283] In any event, despite the foregoing difficulty, it remains a good advice for companies just going public to adopt a staggered board. Indeed, it is quite common for companies to adopt a staggered board, and numerous companies have such a device in place.[284]

If a staggered board or other devices, which also require shareholder approval, are not feasible, another option remains: a board-adopted bylaw amendment requiring advance notice when any shareholder calls a special shareholders' meeting. Such an amendment recently has been upheld as a valid and reasonable defensive measure by the Delaware Chancery Court in *Quickturn*,[285] and the Delaware Supreme Court has not overturned the

278. *See, e.g.*, Kidsco Inc. v. Dinsmore, 674 A.2d 483 (Del. Ch. 1995) (upholding a delay of a shareholder-called special meeting); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990) (upholding a postponement of an annual meeting).

279. *Toll Bros.*, 723 A.2d at 1180, 1186 n.17 (Del Ch. 1998).

280. *Id.*

281. *Id.*

282. Block et al., *supra* note 12, at 635.

283. *See supra* text accompanying notes 59-61.

284. GILSON & BLACK, *supra* note 60, at 736-37.

285. Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 38-43 (Del. Ch. 1998).

Chancery Court's holding.[286] In *Quickturn*, an important issue arose concerning the validity of such a bylaw amendment. In response to Mentor's bid, the Quickturn board adopted the following amendment to section 2.3 of the corporation's bylaws (amended portion appears in *italics* for emphasis):

> A special meeting of the stockholders may be called at any time by (i) the board of directors, (ii) the chairman of the board, (iii) the president, (iv) the chief executive officer, or (v) *subject to the procedures set forth in this Section 2.3*, one or more stockholders holding shares in the aggregate entitled to cast not less than ten percent (10%) of the votes at that meeting.
>
> *Upon request in writing sent by registered mail to the president or chief executive officer by any stockholder or stockholders entitled to call a special meeting of stockholders pursuant to this Section 2.3, the board of directors shall determine a place and time for such meeting, which time shall be not less than ninety (90) nor more than one hundred (100) days after the receipt and determination of the validity of such request, and a record date for the determination of stockholders entitled to vote at such meeting in the manner set forth in Section 2.12 hereof. Following such receipt and determination, it shall be the duty of the secretary to cause notice to be given to the stockholders entitled to vote at such meeting, in the manner set forth in Section 2.4 hereof, that a meeting will be held at the time and place so determined*.[287]

The Chancery Court found that this bylaw amendment addressed the ambiguity in the original provisions.[288] The amendment explicitly made the Quickturn board responsible for "fixing the time, place, record date and notice of the special meeting," and mandated a delay of a period of ninety to one hundred days for a shareholder-requested special shareholders' meeting to elect directors.[289] The special delay period was chosen to match the "advance notice" provisions contained in the bylaws and was not arbitrarily set by the board for the sole purpose of precluding a takeover.[290]

Applying the *Unocal/Unitrin* and *Blasius* tests to the specific facts, the court concluded that the board's adoption of the bylaw amendment did not violate the principles embodied in *Unocal* and its progeny.[291] The court also noted that a longer delay period would have been more suspicious and likely would have been struck down.[292]

In sum, adopting a bylaw amendment such as the one in *Quickturn* is normally within a board's statutory power to manage the business and affairs of the corporation. An amendment will be upheld so long as it is reasonable in

286. *See supra* note 269 and accompanying text.
287. *Mentor*, 728 A.2d at 38-39 (emphasis added).
288. *Id.* at 39.
289. *Id.*
290. *Id.*
291. *Id.* at 39-43.
292. *Mentor*, 728 A.2d at 42-43.

relation to a reasonably perceived threat. Such an amendment has a big advantage, that is, the board normally can adopt it by unilateral action, *without shareholders' approval*. Also, it can be implemented quickly in the face of a hostile offer. This is virtually the same advantage that the poison pill has over other defensive measures. In the meantime, the delay of a special shareholders' meeting buys the target board time to explore alternatives.

D. Aftermath of Invacare *and* AMP *for Non-Delaware Corporations*

In *Invacare* and *AMP*, Georgia and Pennsylvania courts authorized the adoption of the dead hand provision in different forms.[293] Under these two state statutes, the dead hand provision, particularly one of limited duration, is not *per se* invalid. Georgia and Pennsylvania corporations may continue to adopt the dead hand provision in their poison pills as an effective defensive measure.

Although Georgia and Pennsylvania are not deemed as preeminent as Delaware in the area of corporate jurisprudence, the decisions of their courts should not and must not be underestimated. Indeed, not every state follows Delaware. Some state legislatures, similar to Georgia's legislature, have deliberately amended their corporate statutes and adopted provisions regarding a board's discretion to fix the terms and conditions of a poison pill. For example, such amendments were made to the Missouri corporate statute recently.

On April 26, 1999, both Houses of the Missouri Legislature passed a bill adopting the amendments discussed below to section 351.182.[294] In July 1999, the Missouri Governor signed the bill into law. The amendments became effective on August 28, 1999.

The previous section 351.182 of the Missouri General and Business Corporations Law provided virtually identical provisions to those of the Delaware General Corporation Law.[295] Specifically, if the dead hand or no

293. *See supra* Parts III.B, III.D.

294. S. 278, 90th Gen. Assembly, 1st Regular Sess. (Mo. 1999).

295. Section 157 of the Delaware General Corporation Law provides the following:

> Subject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock or other securities of the corporation, rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes, such rights or options to be evidenced by or in such instrument or instruments as shall be approved by the board of directors.
>
> The terms upon which, including the time or times which may be limited or unlimited in duration, at or within which, and the price or prices at which any such shares may be purchased from the corporation upon the exercise of any such right or option, shall be such as shall be stated in the certificate of incorporation, or in a resolution adopted by the board of directors providing for the creation and issue of such rights or options, and, in every case, shall be set forth or incorporated by reference in the instrument or instruments

hand provision in a poison pill had been challenged under Missouri law, the Missouri courts probably would have reached the same result as the Delaware courts. With the recent amendment, however, this conclusion is likely to change. The current section 351.182 now reads as follows:

> Subject to any provisions in the articles of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock or other securities of the corporation, rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes, such rights or options to be evidenced by or in such instrument or instruments as is approved by the board of directors. *If at the time the corporation issues rights or options, there is insufficient authorized and unissued shares to provide the shares needed if and when the rights or options are exercised, the granting of the rights or options shall not be invalid solely by reason of the lack of sufficient authorized but unissued shares.*
>
> The terms upon which[, including the time or times which may be limited or unlimited in duration, at or within which, and the price or prices at which] any such shares may be purchased from the corporation upon the exercise of any such right or option, shall be [such] as [is] stated in the articles of incorporation, or in a resolution adopted by the board of directors providing for the creation and issue of such rights or options, and, in every case, shall be set forth or incorporated by reference in the instrument or instruments evidencing such rights or options. *Such terms may include, but not limited to:*
>
> *(1)The duration of such rights and options, which may be limited or unlimited;*
>
> *(2)The price or prices at which any such shares may be purchased from the corporation upon the exercise of any such right or option;*
>
> *(3)The holders by whom such rights or options may be exercised;*
>
> *(4)The conditions to or which may preclude or limit the exercise, transfer or receipt of such rights or options, or which may invalidate or void such rights or options, including without limitation conditions based upon a specified number or percentage of outstanding shares, rights, options,*

evidencing such rights or options. In the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof shall be conclusive. In case the shares of stock of the corporation to be issued upon the exercise of such rights or options shall be shares having a par value, the price or prices so to be received therefor shall not be less than the par value thereof. In case the shares of stock so to be issued shall be shares of stock without par value, the consideration therefor shall be determined in the manner provided in section 153 of this title.

DEL. STAT. ANN. tit. 8, § 157 (1997).

> *convertible securities, or obligations of the corporation as to which any person or persons or their transferees own or offer to acquire; and*
>
> *(5)The conditions upon which such rights or options may be redeemed.*
>
> *Such terms may be made dependent upon facts ascertainable outside the documents evidencing the rights, or the resolution providing for the issue of the rights or options adopted by the board of directors, if the manner in which the facts shall operate upon the exercise of the rights or options is clearly and expressly set forth in the document evidencing the rights or options, or in the resolution.*
>
> In the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof *and the terms of such rights or options* shall be conclusive. In case the shares of stock of the corporation to be issued upon the exercise of such rights or options shall be shares having a par value, the price or prices so to be received therefor shall not be less than the par value thereof. In case the shares of stock so to be issued shall be shares of stock without par value, the consideration therefor shall be determined in the manner provided in section 351.185. *Nothing contained in subsection 1 of section 351.180 shall be deemed to limit the authority of the board of directors to determine, in its sole discretion, the terms of the rights or options issuable pursuant to this section.*[296]

The amended section 351.182 is based on the Georgia statute, where the court upheld the dead hand poison pill in *Invacare*. These amendments provide the board of a Missouri corporation broader latitude, that is, *sole discretion*, to fix the terms and conditions of a poison pill. If dead hand provisions were challenged under new section 351.182, the Missouri courts would likely follow Georgia's lead and uphold its validity. One commentator recently noted: "Interestingly, a large number of states, following different recent judicial precedent, may now offer greater protection for companies than Delaware, at least in the area of rights plans."[297]

On the other hand, it is noteworthy that in *AMP* the court particularly emphasized the limited duration of the no hand feature of the poison pill challenged therein.[298] Therefore, even under Pennsylvania law, arguably the strongest set of anti-takeover statutes in the nation,[299] the pure dead hand provision may not survive judicial scrutiny. Companies incorporated in states with statutes similar to those of Pennsylvania might find it prudent to follow *Toll Brothers* and *Quickturn*. If the state statutes permit the adoption of a

296. S. 278, 90th Gen. Assembly, 1st Regular Sess. (Mo. 1999) (amended portion in *italics*).

297. Paul T. Schnell, *From the Editor: 1998 in Review*, M&A LAWYER, Jan. 1999, at 2.

298. *AMP*, 1998 WL 778348, at *8.

299. WILLKIE FARR & GALLAGHER, *Client Memorandum: Pennsylvania Federal Court Upholds Validity of Controversial Poison Pill on October 8, 1998*, Oct. 14, 1998, at 4.

staggered board, companies should seriously consider doing so even if they do not face an immediate threat or an actual hostile bid. Among other alternatives, companies may also consider (1) amending their charters to place limitations on shareholder ability to remove directors, (2) requiring advance notice for shareholders to call for a special shareholders' meeting, (3) eliminating the right of shareholders to call special meetings, or (4) eliminating consent solicitation.

V. CONCLUSION

Takeover activities during the last two decades have introduced us to innovative takeover tactics and novel defensive measures. Likewise, the legal standard governing the use of various defensive measures has also evolved. As Justice Moore noted in *Unocal*, "our corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs."[300] This is evidenced by the enhanced business judgment rule and its application to the review of a target board's anti-takeover defensive measures, including the poison pill.

The controversy over the latest variations of the poison pill, i.e., the validity of dead hand provisions, centers on the fundamentals of our corporate jurisprudence and the interpretation of different states' statutory provisions. On one hand, shareholders have the right and authority to choose the ultimate destiny of the corporation. On the other hand, the board of directors has the statutory power to manage the business and affairs of the corporation. How do we strike a balance between the two? How do we treat the powers of incumbent and future boards?

Dead hand provisions in poison pills are invalid under Delaware and New York law because they restrict the power of the future board in the absence of an authorization in the corporation's charter. This is in direct violation of the statutory provisions under the laws of these two states. After *Toll Brothers* and *Quickturn*, corporate lawyers and scholars cannot help wondering: "What type of rights plans will Delaware companies adopt following the Toll Brothers and Quickturn decisions? Will hostile takeovers increase? Will Delaware companies look to reincorporate in Pennsylvania or other states that permit more favorable rights plans? Will the Delaware legislature take action to address this threat?"[301] Will we see an increased number of Delaware corporations amending their charters to adopt a staggered board or amending their bylaws to require advance notice for shareholders to call special meetings?

In the meantime, dead hand provisions are not *per se* invalid everywhere in the United States. Corporations incorporated in Georgia, Pennsylvania, and

300. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985).

301. Schnell, *supra* note 297, at 2.

other states that have similar statutes may continue to be able to employ the dead hand pill, particularly the no hand poison pill, as an effective defensive measure. Nonetheless, it may still be desirable for these corporations to also have a staggered board in its anti-takeover defensive measures arsenal.

As the sophistication of both raiders and targets develops, corresponding defensive measures will change to "counter such ever mounting threats."[302] The author of this comment believes that the unavailability of the dead hand poison pill to Delaware corporations will inspire more innovative mutations of the poison pill and perhaps additional alternative anti-takeover measures. In turn, our corporate law will grow and develop to address ever-evolving corporate concepts and needs.

XUEQING LINDA JI

302. *Unocal*, 493 A.2d at 957.