SUGAR & CYANIDE: The Combinatory Effects of Poison Pills and Dual-Class Structures on Shareholder Rights

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"I am not a destroyer of companies. I am a liberator of them! The point is . . . greed, for lack of a better word, is good." – Gordon Gekko[1]

INTRODUCTION

Corporations represent a strategic compromise by which ownership is separated from management. This structure has numerous legal and economic benefits; however, the corporate structure is especially adept in diversifying ownership. Shares, a type of security which are also often referred to as stock or common stock, represent a portion of ownership of a corporation. Shares of publicly traded corporations are available for purchase on stock exchanges throughout the world allowing virtually any entity to purchase ownership in a corporation. Typically, shareholders receive various rights through share ownership, including the right to vote for directors, who represent the diversified ownership in major decisions. A corporation's management generally consists of a chief executive officer and various other officers, as well as intermediate and lower level management who do not necessarily have any ownership interest in the corporation.

The demarcation between officers and directors of a corporation, in terms of their duties, decision making capabilities, and overall roles is the subject of substantial literature and debate. The matter is significantly complicated in the context of an attempted takeover. In theory, an outside entity can take over a publicly traded corporation by purchasing all or a majority of its outstanding shares, but in practice, corporate boards have numerous tools at their disposal to block a takeover. These antitakeover measures have evolved continuously since the 1980s and continue to be the subject of litigation and

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1. WALL STREET (20th Century Fox 1987).

all manner of disputes. Importantly, antitakeover measures can operate to prevent shareholders, the true equity owners of a corporation, from selling their shares to an offeror. Thus, the present state of antitakeover measures allowed by Delaware jurisprudence overly restricts takeover attempts.

Instead, the Courts should recognize the importance of takeovers in the modern economy and reevaluate the consequences of modern Delaware takeover jurisprudence. Ultimately, the current director-centric approach to takeover law improperly subordinates the interests of equity owners to that of directors. To evaluate these problems, this Comment will review and examine modern antitakeover measures and their implications: Section I provides an overview of merger law with a close look at takeovers and antitakeover measures; Section II analyzes the implications of the modern scheme, addressing the effects of solitary and combined antitakeover measures; and Section III provides possible solutions to the U.S. scheme. Section IV concludes.

I. BACKGROUND

The law of mergers and acquisitions in the United States is an outgrowth of state corporate law.[2] This Section traces the fundamentals of merger law, including the underlying theories of control primacy, and examines specific issues of antitakeover measures and dual-class capital structures. This discussion is limited to the law of Delaware because more than fifty percent of U.S. corporations are incorporated in Delaware,[3] and the jurisprudence of the Delaware courts influences corporate law throughout the country.[4]

2. Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U. L. REV. 211, 212 (2007); *see, e.g.*, DEL. CODE ANN. tit. 8, § 251 (2014); MODEL BUS. CORP. ACT § 11.01–11.08 (AM. BAR ASS'N. 2005).

3. *See* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*; 150 U. PA. L. REV. 1795, 1815 fig.2 (2002) (showing that of over 7,000 public U.S. corporations, 50% are incorporated in Delaware); *see also* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973, 1975 (2009) "[H]alf of all publicly held companies are incorporated in Delaware . . . .").

4. Davidoff, *supra* note 2 (describing Delaware as the leader in developing takeover law).

A. Takeover Law

Mergers and acquisitions are a significant source of economic activity[5] in the United States and occur in a variety of forms.[6] Generally, acquisitions[7] are negotiated between companies and completed on mutually agreeable terms.[8] A small percentage of successful acquisition transactions, however, are hostile takeovers.[9] A hostile takeover[10] occurs when an outside bidder acquires a target corporation that does not wish to be acquired.[11] Specifically, an offer is hostile when a target corporation's board does not want to sell the corporation.[12]

Generally, a corporation's board of directors is responsible for the business decisions and activities of the corporation.[13] As a result, when corporations act as bidders or targets in an acquisition transaction, the board of directors, or some subset of directors, negotiate the deal.[14] This negotiation

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5. *See* ARTHUR FLEISCHER JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS §1.01 (7th ed. 2015) (noting that in the first nine months of 2014 alone, more than $1.7 trillion in deals were announced globally).

6. A business combination or acquisition can take many forms, from the statutory merger to the forward and reverse triangular merger. In addition, some business combinations may occur as a sale of assets or through the purchase of stock. In general, the structure of business combinations is beyond the scope of this Comment. *See, e.g.*, THERESE H. MAYNARD, MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS 40–47, 860–72 (Vicki Been et al. eds., 3rd ed. 2013) (providing a summary and diagrams of some different transactional structures for business combinations).

7. The term "acquisitions" is used in lieu of "mergers" because "merger" can refer specifically to a statutory merger whereas acquisitions refers broadly to any sort of business combination.

8. EDWIN L. MILLER JR., MERGERS AND ACQUISITIONS 24–25 (2008).

9. *Id.* at 26.

10. Throughout the text "hostile takeover" and "takeover" are used interchangeably, as distinguished from a negotiated acquisition.

11. *See* Paul H. Edelman & Randall S. Thomas, *Selectica Resets the Trigger on The Poison Pill: Where Should the Delaware Courts Go Next?*, 87 IND. L.J. 1087, 1092–93 (2012) (discussing the early inability to repel unsolicited tender offers as the beginning of hostile takeovers).

12. *See id.* at 1093 (noting how the introduction of the poison pill and other defensive measures may be implemented by directors without shareholder approval); *see also* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 69–70 (Del. Ch. 2011) (detailing the Air Products tender offer as an effort to gain control of Airgas, despite opposition by Airgas's board). Here, the Air Products tender offer represented an attempt to launch a takeover after negotiations with the board failed.

13. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2014) (outlining the powers of directors); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N. 2005) (vesting all corporate powers in the board of directors and mandating that business affairs be managed by or under direction of the directors).

14. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (2014) (requiring that the board of directors of a corporation wishing to merge adopt a resolution approving an agreement of merger); MODEL BUS. CORP. ACT § 11.04(a) (AM. BAR ASS'N. 2005) (explaining that a plan of merger or share exchange must be adopted by the board). For practical purposes, the requirement that the board

allows the bidder and target to come to a mutually beneficial agreement and control the structure of the transaction.[15] The structure of an acquisition is critical for a variety of reasons including corporate governance and tax considerations.[16]

However, when a corporation's directors do not want a bidder to acquire it, they may prevent the acquisition through a director vote.[17] Notably, this decision may be made without shareholder input,[18] despite the requirement that a target corporation's shareholders must approve an acquisition transaction.[19] Thus, directors may prevent the corporation's acquisition at their discretion.[20] To overcome this resistance, a determined bidder may bypass the directors and appeal to the shareholders directly.[21]

The process of soliciting shareholders directly in an attempt to acquire a corporation, known as "going hostile,"[22] became particularly popular during the 1980s merger wave.[23] During this time, the popular method for a hostile takeover bid was to solicit shareholders directly through a tender offer.[24] A

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adopt the merger agreement is a requirement that the board, or some subset of directors, engage in the negotiation of the merger agreement.

15. *Cf. Airgas*, 16 A.3d at 63–68 (tracing the negotiation process between Air Products and Airgas, particularly in regard to Air Products' stated willingness to adjust price or structure). The discussion contained, *supra* note 6, regarding the various structures a deal may take, highlights the many options available to negotiating parties.

16. *See* Shannon D. Kung, *The Reverse Triangular Merger Loophole and Enforcing Anti-Assignment Clauses*, 103 NW. U. L. REV. 1037, 1044–47 (2009) (discussing how organizing a transaction into a forward triangular merger can avoid anti-assignment clauses in contracts); *see also* Stephanie Hoffer & Dale A. Oesterle, *Tax-Free Reorganizations: The Evolution and Revolution of Triangular Mergers*, 108 NW. U. L. REV. 1083, 1085–86 (2014) (discussing how Section 368 of the Internal Revenue Code offers disparate treatment depending on merger form).

17. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (2014); MODEL BUS. CORP. ACT § 11.04(a) (AM. BAR ASS'N. 2005). The requirement that a board approve a merger plan combined with director voting rules requires a majority vote to engage in a merger and therefore may halt a merger by simply failing to vote, or voting against the merger.

18. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (2014); MODEL BUS. CORP. ACT § 11.04(a) (AM. BAR ASS'N. 2005).

19. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (2014); MODEL BUS. CORP. ACT § 11.04(b) (AM. BAR ASS'N. 2005). A target corporation's shareholders are only entitled to vote on a plan of merger, but have no voting rights when the board simply rejects a merger offer.

20. *See* Edelman & Thomas, *supra* note 11, at 1093.

21. *See Airgas*, 16 A.3d at 69–70 (detailing the Air Products tender offer as a direct appeal to shareholders); *see also* Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 907 (2002) (noting that a bidder or third party can appeal to shareholders through a proxy contest, in order to gain control of the board).

22. PATRICK A. GAUGHAN, MAXIMIZING CORPORATE VALUE THROUGH MERGERS AND ACQUISITIONS: A STRATEGIC GROWTH GUIDE 6 (2013).

23. *Id.* at 5.

24. *Id.* at 6.

tender offer consists of an open contract to purchase shares in a particular corporation at a particular price and up to a certain quantity, with the ultimate goal of acquiring at least 51% of a corporation's outstanding shares.[25] By acquiring a majority stake, the bidder may take control of the corporation and implement its business plan.[26]

Tender offers can vary widely in their structure and during the 1980s, some types of offers emerged which seemed to coerce shareholders into selling their shares.[27] One such offer stemmed from a significant takeover battle that emerged between Mesa Petroleum, led by its owner T. Boone Pickens,[28] and Unocal Corporation.[29] The attempted takeover would lead to the critical *Unocal Corp. v. Mesa Petroleum Co.* case which established an enhanced scrutiny for antitakeover measures.[30]

In 1985, Mesa Petroleum launched a complex tender offer for the outstanding shares of Unocal.[31] This offer consisted of a front loaded, two-tier approach for the outstanding shares of Unocal.[32] On the front end, Mesa offered $54 per share for just over 37% of Unocal's stock.[33] On the back end, the offer proposed to acquire the remaining outstanding shares in exchange for highly subordinated securities valued at $54.[34] Mesa Petroleum only revealed the subordinated nature of the back end securities after a court order mandated disclosure.[35] In other words, Mesa's offer effectively left Unocal shareholders with no choice but to sell to Mesa.[36] In response, Unocal elected

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25. *Id.* at 6–7.

26. *Id.* at 7.

27. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949–51 (Del. 1985) (tracing conditions of the tender offer leading up to the case); *see also* Edelman & Thomas, *supra* note 11, at 1095 (describing the background and lead up to the *Unocal* case).

28. During the 1980s, Pickens had developed a reputation for pursuing 'greenmail' from publicly traded companies. Essentially, Pickens would target a corporation, purchase a substantial minority stake, and then threaten a hostile takeover unless his shares were bought back at a substantial premium. *See* Edelman & Thomas, *supra* note 11, at 1095. Pickens' reputation for greenmail provides context to *Unocal*, suggesting that his ultimate goal was not actually to take over the corporation and enhance its value. but to quickly cash out. However, the pursuit of greenmail is now strongly discouraged by the Internal Revenue Code, which taxes such gains substantially. *See* 26 U.S.C. § 5881 (2012).

29. *See* Edelman & Thomas, *supra* note 11, at 1095.

30. *See, e.g.*, Bebchuk et al., *supra* note 21, at 905 (explaining that antitakeover measures, such as the poison pill, are subject to review under the *Unocal* standard); Edelman & Thomas, *supra* note 11, at 1095.

31. *Unocal*, 493 A.2d at 949.

32. *Id.*

33. *Id.*

34. *Id.* at 949–50.

35. *Id.* at 949.

36. The dilemma can be explained as follows: If a shareholder chooses to tender their shares to Mesa immediately, they will receive at least $54 per share for 37% of their shares, assuming

to engage in a selective self-tender[37] at the price of $72 per share, if Mesa was successful in acquiring 37% of Unocal.[38] Later, Unocal partially amended this offer to allow shareholders to sell their shares to Unocal before Mesa reached the 37% threshold.[39] Importantly, Unocal's offer was conditioned to exclude Mesa from offering its own shares into the Unocal buy-back program.[40] Mesa challenged this discriminatory provision and took its challenge to the Supreme Court of Delaware.[41]

The Supreme Court of Delaware upheld Unocal's antitakeover measures, noting that a discriminatory self-tender was not a novel innovation, and that this self-tender differed only in that it discriminated against, rather than in favor of, a hostile acquirer.[42] The Court noted that although director decisions are typically analyzed under the business judgment rule,[43] that rule was insufficient to evaluate antitakeover measures.[44] Instead, the Court proposed a two-pronged test: first, it would determine whether the measure was preclusive or "draconian," and second, whether the measure was reasonable in relation to the threat posed.[45] If the antitakeover measure passed both elements of the test, then it would be entitled to the protection and deference of the business judgment rule.[46] If not, then the antitakeover measure would be removed through appropriate action by the court.[47]

Ten years later, the Supreme Court of Delaware returned to the *Unocal* test in *Unitrin, Inc. v. American General Corp.* to define what constitutes a draconian antitakeover measure.[48] The Court held that defensive measures which are either preclusive or coercive constitute draconian measures and are

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every shareholder tenders. If the shareholder refuses to tender but Mesa acquires 37% of Unocal from other shareholders, the shareholder will receive subordinated securities for 100% of their shares. Finally, if a shareholder tenders to Mesa and Mesa's offer fails, the shareholder will retain their Unocal shares as though no transaction ever occurred. Thus, to maximize their individual value, shareholders have no choice but to tender or rely on the other shareholders to not tender.

37. A self-tender is a tender offer for a corporation's own shares and could be thought of as a conditional buy-back program.

38. *Unocal*, 493 A.2d at 951.

39. *Id.*

40. *Id.*

41. *Id.* at 952.

42. *Id.* at 954, 958.

43. The business judgment rule, discussed in *Unocal*, is the general rule that a court will defer to the business judgment of a corporation's board of directors, absent fraud or corporate waste. *Id.* at 954. The rule is highly deferential and courts generally find in favor of a board of directors when evaluating decisions pursuant to this rule. *Id.*

44. *Id.* at 946–55.

45. *Id.* at 955–56.

46. *Id.* at 956.

47. *Id.*

48. *See* Edelman & Thomas, *supra* note 11, at 1096–97 (describing *Unitrin*'s analysis of draconian antitakeover measures).

per se illegal.[49] Expanding on this holding, the Court described the board of directors as "the defender of the . . . corporate bastion and the protector of the corporation's shareholders."[50] Moreover, because the board is the defender of the 'corporate bastion,' board approved antitakeover measures are not preclusive or coercive merely because they are adopted "before a bidder is at the corporate bastion's gate."[51] The Delaware Supreme Court in *Unitrin* concluded by holding that an antitakeover measure is preclusive when it renders a bidder's ability to wage a successful proxy contest and gain control either "mathematically impossible" or realistically unattainable.[52] Further, the Delaware Supreme Court held that an antitakeover measure is coercive and therefore *per se* illegal if it is aimed at forcing shareholders to accept a management sponsored alternative.[53]

Although the definition of coercive in *Unitrin* has been upheld, the *Unitrin* court's definition of preclusive has been revised.[54] In *Versata Enterprises, Inc. v. Selectica, Inc.*, the Court revisited its definition of a preclusive measure and held that, because the "mathematically impossible" determination may be subsumed within the "realistically unattainable" analysis, only the latter test should remain.[55] Thus, an antitakeover measure is *per se* illegal for preclusivity when it renders a bidder's ability to wage a successful proxy contest realistically unattainable.[56] However, if an antitakeover measure is not *per se* illegal, it is judged by the reasonableness standards under *Unocal*.[57]

B. Theories of Primacy

No analysis of antitakeover measures would be complete without considering the dominant theories of corporate control. While numerous theories of corporate governance exist,[58] this Comment focuses on the Director Primacy and Shareholder Primacy theories, each of which proposes

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49. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387–88 (Del. 1995).

50. *Id.* at 1388.

51. *Id.*

52. *Id.* at 1388–89.

53. *Id.* at 1387; *see also* Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154–55 (Del. 1990).

54. *See* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 601 (Del. 2010) (altering the *Unitrin* test as to preclusiveness and endorsing the coerciveness formulation).

55. *Id.*

56. *Id.*

57. *Id.* at 605.

58. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547–49 (2003) (discussing various theories of corporate governance).

an answer to the question: who should decide how to respond to a takeover attempt?

Proponents of director primacy argue that directors are the key decision makers for a corporation, and that control rests with the board.[59] This theory is distinct from earlier managerial theories, which posit that managers possess control greater than what the board has delegated.[60] Instead, the director primacy theory acknowledges the rising trend in board activism, where directors remove high profile managers.[61] These actions, the director primacy theory argues, are a consequence of court action, director compensation being paid in stock, increased shareholder litigation, and an active market for corporate control.[62] Although director primacy advocates accept shareholder profit maximization as the proper goal of corporate decision making, they maintain that shareholders are not entitled to direct or indirect control.[63]

In contrast, the shareholder primacy theory suggests that shareholders are principals for whom corporate governance is organized and operates.[64] Advocates of this theory differ as to whether shareholders own the firm itself or are simply residual claimants to the corporation.[65] In either case, shareholders are given ultimate decision-making power through their voting rights.[66]

Although each theory presents its own view about how corporate law should be, existing Delaware law more closely resembles directorprimacy theory. First, Delaware law provides that directors are the decision makers for all aspects of a corporation's business.[67] Second, Delaware courts have firmly decided that selling a corporation or responding to a takeover attempt is ultimately a business decision, and therefore under the authority of the board of directors.[68] However, directors are still bound by their fiduciary duties to shareholders and are responsible for maximizing profits.[69]

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59. *Id.* at 563.
60. *Id.* at 561–62.
61. *Id.* at 562–63.
62. *Id.*
63. *Id.* at 563.
64. *Id.*
65. *Id.* at 564.
66. *Id.* at 564–66 (discussing the difference between Agency Cost and Traditional Ownership theories of Shareholder Primacy).
67. *See* DEL. CODE ANN. tit. 8, § 141(a) (West 2014) (outlining the powers of directors to manage business affairs).
68. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (discussing the board's power to act against a takeover bid); *see also* DEL. CODE ANN. tit. 8, § 251(b) (West 2014) (requiring that directors approve a plan of merger).
69. *See Unocal*, 493 A.2d at 954, 958 (Del. 1985) (discussing directors' fiduciary duties in the takeover context and generally); *see also* Bainbridge, *supra* note 58, at 563 (suggesting that

While director primacy is reflected through the jurisprudence of the Delaware courts, shareholder primacy is described as the standard model for academics.[70] These competing theories serve as the underpinnings for debates regarding corporate control; however, this Comment suggests a narrow solution that may not clearly fall into either theory.

C. Antitakeover Measures

This subsection discusses the development of antitakeover measures since the 1980s, emphasizing the development of the shareholder rights plan and related jurisprudence. In addition to traditionally conceived antitakeover measures, the extent to which a staggered board may serve as an antitakeover measure is discussed. Finally, alternative antitakeover measures are discussed to provide context to the discussion of specific antitakeover measures.

The first widespread antitakeover measure emerged in the 1980s: the shareholder rights plan.[71] It quickly became an effective and powerful antitakeover measure.[72] More colorfully known as "poison pills," these plans are designed to discourage hostile takeovers through a tender offer.[73] In essence, the poison pill gives shareholders the ability to purchase additional shares of the adopting corporation at a substantial discount or to purchase discounted shares of the acquiring corporation.[74] These abilities are represented in the flip-in and flip-over provisions of a poison pill.[75]

The flip-in provision of a poison pill typically allows shareholders to purchase shares in the adopting corporation for one half their market price, or less.[76] However, this ability is only activated when the poison pill is triggered.[77] The flip-in provision is triggered whenever a single shareholder acquires more than a certain percentage of the adopting corporation's

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director primacy rejects shareholder decision making ability while accepting profit maximization as the proper goal of decision making).

70. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440 (2001).

71. *See* Joseph M. Grieco, *The Ever-Evolving Poison Pill: The Pill in Asset Protection and Closely-Held Corporation Cases*, 36 DEL. J. CORP. L. 625, 628 (2011).

72. *Id.*; *see also* Brian J. McTear, *Has the Evolution of the Poison Pill Come to an End?—Carmody v. Toll Brothers, Inc.; Mentor Graphics, Inc. v. Quickturn Design Systems, Inc.*, 24 DEL. J. CORP. L. 881, 882–83 (1999).

73. *See* McTear *supra* note 72, at 882; *see also* Edelman & Thomas, *supra* note 11, at 1093.

74. *See* Moran v. Household Intern., Inc., 490 A.2d 1059, 1065–66 (Del. Ch. 1985) (explaining the shareholder rights plan (poison pill)).

75. *Id.*

76. *Id.*

77. *Id.*

outstanding shares.[78] Traditionally, this level ranges from ten percent to twenty percent of a corporation's outstanding shares.[79] However, in recent years there have been cases examining significantly lower thresholds.[80]

The Delaware Supreme Court in *Moran v. Household International* was the first to endorse the poison pill.[81] In *Moran*, the target corporation, Household International, adopted a device which their counsel labeled a "shareholder rights plan."[82] The plan was the first of its kind, and was designed to prevent a successful hostile takeover of Household International.[83] The Delaware Supreme Court approved of the plan over the objection of Mr. Moran, concluding that its adoption was protected by the business judgment rule.[84] Moreover, the Court determined that the poison pill did not prevent shareholders from receiving tender offers or restrict proxy contests.[85]

After *Moran*, poison pills became increasingly popular and varied.[86] One variation on the poison pill was the addition of the Delayed Redemption Provision, otherwise known as a "no hand" provision.[87] Quickturn Design adopted a no-hand provision in the face of a hostile takeover bid, the effect of which was to prevent newly elected board members from removing the pill for at least six months after taking office.[88] Combined with other changes to Quickturn's antitakeover measures, the cumulative effect of the no-hand poison pill would delay a takeover by at least nine months after a successful proxy contest.[89] The Delaware Supreme Court struck down the no hand provision of the pill, noting that the provision would effectively prevent a

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78. *See id.* at 1348–49. The Delaware Court in *Moran* outlines the triggering conditions for the first poison pill, which includes actual acquisition of shares as well as the announcement of a tender offer. Ultimately, the result is the same, as any tender offer to establish control will trigger the poison pill.

79. *Id.*

80. *See* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 602 (Del. 2010) (endorsing a trigger threshold of 5% under certain circumstances).

81. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 95 (Del. Ch. 2011).

82. *Moran*, 490 A.2d at 1065–66.

83. *Id.*

84. *Id.* at 1357.

85. *Id.*

86. *See, e.g.*, Quickturn Design Systems, Inc. v. Shapiro, 721 A.2d 1281, 1289–90 (Del. 1998); Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1184 (Del. Ch. 1998).

87. *Quickturn Design Systems*, 721 A.2d at 1289–90. The Delayed Redemption Provision is so named because it prevents board members from removing a poison pill by redeeming the associated rights. For clarity, "removal" is used in place of "redemption" throughout this Comment when discussing the removal of a poison pill through redemption of the Shareholder Rights Plan.

88. *Id.*

89. *Id.* at 1290.

new Quickturn board from managing the corporation by improperly limiting the power of directors.[90]

Recently, poison pills with a new trigger level have been endorsed by the Delaware Supreme Court.[91] This variety of poison pill is designed to protect net operating loss (NOL) carry-forward credits in the hopes that a corporation will return to profitability.[92] NOLs have potential value for their entire twenty-year lifetime, contingent upon a firm's future profitability.[93] Therefore, a corporation may protect its NOLs as assets for a considerable length of time.[94] As a result of section 382 of the Internal Revenue Code,[95] NOLs are frequently protected by poison pills with a 4.99% threshold, rather than the traditional levels seen in *Moran*.[96]

In *Versata Enterprises, Inc. v. Selectica, Inc.*, the Supreme Court of Delaware approved the use of low threshold NOL poison pills.[97] In this case, Versata's attempts to launch a hostile takeover of Selectica threatened Selectica's NOL carry-forwards, which were the company's only significant asset.[98] While the Court was careful to note that the legality of a particular poison pill is context specific, the Court also noted that the 4.99% threshold was not *per se* illegal, because it did not render a proxy contest realistically unattainable.[99] The Court concluded that, as in the deployment of any antitakeover measure, the measure must be proportionate to the threat posed.[100]

While poison pills are highly effective at discouraging tender offers, Delaware courts have noted repeatedly that other avenues for a takeover exist.[101] Notable among these is the proxy contest, whereby an investor may

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90. *Id.* at 1292–93.

91. Edelman & Thomas, *supra* note 11, at 1101–03.

92. *Id.* at 1089 n.23, 1098.

93. *Id.* at 1098–99.

94. *Id.* at 1098.

95. 26 U.S.C. § 382. Section 382 of the Internal Revenue Code provides a description of how net operating losses are generated and how far they may carry forward. Importantly, Section 382 also defines ownership changes however, the exact boundaries of an ownership change are unclear. Section 382 makes repeated reference to changes in the stock of a shareholder owning five percent or more of outstanding shares as a triggering condition for an ownership change, as such, disallowing such an accumulation seems prudent when attempting to protect net operating loss (NOL) carry forwards.

96. Edelman & Thomas, *supra* note 11, at 1098–99.

97. *See* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 606 (Del. 2010) (upholding Selectica's use of the five percent threshold poison pill to protect its NOLs).

98. *Id.* at 599–600.

99. *Id.* at 603.

100. *Id.* at 606–07.

101. *Id.* at 602–03 (discussing the evidence of NOL pills and the possibility of launching a proxy contest); *see also* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1354 (Del. 1985)

nominate its own slate of directors to replace the current board of the target.[102] Using the corporate voting process, these insurgent nominees may take over the board and then use their position to make a takeover possible.[103] A newly elected insurgent board may negotiate directly with the acquirer or simply remove a poison pill to allow a tender offer.[104]

Corporate defenses have not remained static in the face of this alternative avenue for a takeover. Instead, corporate boards have implemented a "staggered board" to make a successful acquisition through a proxy contest more difficult.[105] Delaware law allows for staggered boards, meaning directors may be organized into several classes, each elected in a different year.[106] If a corporation elects to follow this model, then electing the majority of a board would take two separate successful votes over the course of two years.[107]

The Delaware Supreme Court recently approved the staggered board as an antitakeover mechanism.[108] In *Versata*, the target corporation, Selectica, maintained a poison pill and staggered board of directors to ward off hostile takeover attempts.[109] The Court examined this combination and determined that Selectica's defenses were valid and appropriate.[110] In approving the staggered board, the Court relied on its earlier precedent to make clear that delaying takeover of a board is not sufficient to be preclusive under *Unitrin*.[111] In its subsequent analysis, the Court applied the second step of *Unocal* in assessing the reasonableness of Selectica's actions during Versata's takeover

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(discussing alternatives to a direct tender offer including, *inter alia*, several variations of proxy contest).

102. *See Moran*, 500 A.2d at 1354 (discussing the proxy contest as a method to nominate a new board of directors).

103. *Id.* (specifically suggesting that the new directors could redeem a poison pill and allow a takeover).

104. *Id.*; *see also* Bebchuk et al., *supra* note 21, at 903–04 (discussing the history of proxy contests before the poison pill and upon its introduction).

105. *See* Bebchuk et al., *supra* note 21, at 912–13 (discussing the "effective staggered board" as a method of delaying removal of the poison pill).

106. DEL. CODE ANN. tit. 8, § 141(d) (West 2014). Section 141(d) provides that directors may be divided into three classes such that each class holds a term of office for three years and one third of the directors is elected in any given year.

107. *See* Bebchuk et al., *supra* note 21, at 913.

108. *See* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010) (discussing Selectica's staggered board and Versata's arguments about overcoming two proxy contests).

109. *Id.* at 595, 604.

110. *Id.* at 604 ("The fact that a combination of defensive measures makes it more difficult . . . to obtain control of a board does not make such measures . . . preclusive.").

111. *Id.* at 603.

attempt.[112] The Court ultimately concluded that Selectica's defenses were reasonable, taken alone or in combination.[113]

Beyond the Delaware Supreme Court's decision, there have been changes to the use of staggered boards in publicly traded companies.[114] In the early 1990s, approximately 34% of public companies in the United States used staggered boards.[115] By 1998, staggered boards could be found in 59% of companies and three years later, in 2001, 70% of all publicly traded companies had staggered boards in place.[116] While it is impossible to explain precisely why so many companies adopted staggered boards, they serve as an antitakeover measure regardless of why they were implemented.[117] Some commentators have produced data showing that staggered boards are particularly powerful defenses that make a successful takeover practically impossible.[118] However, in recent years, business observers have noted a sharp decline in staggered boards as investor activism has increased and institutional shareholders have become more common.[119]

Beyond poison pills and staggered boards, a panoply of antitakeover measures exists and may be implemented by a corporate board. These measures can be divided into two groups: shark repellant, designed to make a company less attractive generally, and active measures, employed when a takeover bid is looming.[120] Among these are the white knight and white squire, each of which has survived the scrutiny by the Delaware courts.[121] The white knight strategy essentially consists of seeking another bidder whose offer is more attractive than the initial bidder.[122] While this method has the

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112. *Id.* at 605.

113. *Id.* at 606.

114. Bebchuk et al., *supra* note 21, at 889–90.

115. *Id.* at 889.

116. *Id.*

117. Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010); *see also* Bebchuk et al., *supra* note 21, at 896–99 (outlining a variety of takeover and non-takeover justifications for staggered boards).

118. Bebchuk et al., *supra* note 21, at 890.

119. Liz Hoffman, *In Allergan Case and Others, Hostile Bidders Are Making the Most of Firms' Weakened Defenses*, WALL ST. J. (Aug. 25, 2014, 5:13 PM), http://online.wsj.com/articles/in-allergan-case-and-others-activist-investors-are-making-the-most-of-firms-weakened-defenses-1408998772 (describing the shift from three-year terms and strict annual meeting schedules to regimes where directors can be replaced at virtually any time within the majority of U.S. companies).

120. *See* FLEISCHER & SUSSMAN, *supra* note 5, § 6.01 (explaining the various types of structural charter amendments known as "shark repellants").

121. *See* Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 957 (Del. 1985); *see also* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 55 (Del. Ch. 2011).

122. *See* FLEISCHER & SUSSMAN, *supra* note 5, § 9.05 (explaining the white knight defenses and its variant, the Pac-Man defense).

potential to drive up a bidder's costs and even the possibility of a second bidder may deter some takeovers, it necessarily results in a change of corporate control. Furthermore, by taking the white knight approach, a corporation's directors may be judged under a different standard, because they have put the corporation on the auction block.[123] However, this Comment only considers corporate actions which do not currently trigger *Revlon* duties.

A similar antitakeover measure, the white squire, also relies on a trusted third party but does not require a change of corporate control.[124] A white squire is an outside stock purchaser who is allowed to acquire a significant minority interest in a target corporation facing a takeover bid.[125] Through acquiring this sizable minority interest, the white squire is capable of creating a number of significant difficulties for a bidder.[126] Among other things, a white squire's stake can make proxy contests difficult to win and tender offers impractical by decreasing the public float of a corporation.[127] As a practical matter, a white squire may later divest its holdings after the danger of a takeover has passed, thereby decreasing the level of commitment required for a successful defense.[128]

D. Dual-Class Capital Structures

Thus far, this Comment has treated shareholders as interchangeable entities with rights proportionate to their equity stake in a corporation. But under Delaware law, and indeed, under most corporate codes in the United States, shareholders do not necessarily have equal rights. For example, shareholders may have different voting rights depending on the type of shares they hold.[129] This variance in voting rights is dependent on the capital structure of the corporation, which may vary substantially.[130] A single-class

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123. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (explaining that "[t]he whole question of defensive measures became moot. The director's role changed from defenders of the corporate bastion to auctioneers . . ."). The standard set forth in *Revlon* requires directors to pursue the best price for the corporation's shareholders. *Id.* Unlike the *Unocal* standard, *Revlon* presumes that the corporation will be sold and therefore may force the directors to ultimately negotiate with the hostile bidder, assuming that the white knight is outbid by the hostile bidder. *Id.* at 184.

124. *See* Edelman & Thomas, *supra* note 11, at 1115–17.

125. *Id.* at 1115 n.208.

126. *Id.* at 1116–17.

127. *Id.*

128. *Id.*

129. DEL. CODE ANN. tit. 8, § 151(a) (West 2015); *see also* MODEL BUS. CORP. ACT § 6.01(a) (2006).

130. *See* Tian Wen, Comment, *You Can't Sell Your Firm and Own It Too*, 162 U. PA. L. REV. 1495, 1496 (2014).

capital structure consists of a single type of shares, common stock, with identical voting rights, dividends, and prices.[131] In contrast, a dual-class capital structure consists of common stock and preferred stock, where the preferred stock possesses greater voting rights.[132]

Corporations may implement and maintain dual-class structures for a variety of reasons;[133] however, this Comment focuses exclusively on their effect in the takeover context. A recent corporation to adopt a dual-class capital structure is Facebook, Inc., which offered Class A stock in its IPO while privately selling Class B stock.[134] These stock classes are identical in every respect, except for voting and conversion rights.[135] Each share of Class A stock is entitled to one vote, while each share of Class B stock is entitled to ten votes.[136] Additionally, Class B stock may be converted at any time to Class A stock.[137] Class B stock was issued only to a select group of shareholders, including Facebook's founder and its initial investors and supporters.[138]

Facebook is not alone in adopting this type of capital structure; Google, Manchester United, Alibaba,[139] and many others have created their own dual-class capital structures.[140] Prior to its adoption by many foreign and technology companies, this type of dual-class capital structure was popular during the 1980s to prevent takeovers by giving managers and directors greater voting power.[141] While the SEC once employed a rule[142] to make such structures illegal, that rule was struck down by the D.C. Circuit and has not

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131. *See id.* at 1501.

132. *See* Tamara C. Belinfanti, *Shareholder Cultivation and New Governance*, 38 DEL. J. CORP. L. 789, 831–32 (2014). For the purpose of this Comment, capital structures are divided into those with homogenous voting rights and those with disparate voting rights, specifically where one class has more than one vote per share. For simplicity, shares and other types of securities which do not grant voting rights are ignored in order to focus on the issue of low equity, high voting shares in relation to common stock.

133. *See generally* Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST. JOHN'S L. REV. 863 (1994).

134. *See* Belinfanti, *supra* note 132, at 831–32; *see also* Wen, *supra* note 130, at 1505.

135. *See* Belinfanti, *supra* note 132, at 831–32.

136. *Id.* at 832.

137. *Id.*

138. *Id.*

139. *See generally* Wen, *supra* note 130.

140. *See* FLEISCHER & SUSSMAN, *supra* note 5, § 6.01 (noting that as of 2013, 8.88% of companies listed on the S&P 500 used unequal voting systems).

141. *See* Wen, *supra* note 130, at 1496.

142. *See generally* FLEISCHER & SUSSMAN, *supra* note 5, § 6.04 (explaining the history of SEC Rule 19c-4).

been revived.[143] Presently, a company with a dual-class structure may list on the NYSE, NASDAQ, and other stock exchanges in the United States "as long as the dual-class structure was in place during the initial public offering."[144] In contrast, stock exchanges outside of the United States, such as the London and Hong Kong stock exchange do not allow listing by companies with dual-class capital structures.[145]

E. The European Takeover Regime

A decade ago, the European Union established the 2004 Takeover Directive, based on the United Kingdom's longstanding Takeover Code.[146] Although the European Union and the United Kingdom in particular have similar corporate laws and markets to the United States, their approach to takeovers is sharply divergent.[147] Simply put, the United Kingdom and European Union prohibit post bid takeover defenses without prior shareholder authorization.[148] The United Kingdom also prohibits poison pills in a takeover context.[149]

The manner in which the European Takeover Directive accomplishes these changes is somewhat complex and results in a distinctive takeover regulatory scheme.[150] Article Five of the European Takeover Directive mandates bidding once an individual or legal entity has acquired a specified percentage of a corporation's shares, to be set by each member state.[151] In the United Kingdom, this mandatory bid threshold is set to thirty percent.[152] Article Five additionally requires the bidder to offer an equitable price as outlined by the European Takeover Directive and codified by member

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143. *See* Stephen M. Bainbridge, *The Short Life and Resurrection of SEC Rule 19c-4*, 69 WASH. U. L. REV. 565, 565–68 (1991); *see generally* FLEISCHER & SUSSMAN, *supra* note 5, § 6.04.

144. *See* Wen, *supra* note 130, at 1496–97.

145. *Id.* at 1507. In particular, as fully discussed in Subsection E, *infra*, the London Stock Exchange prohibits dual-class firms from listing in accordance with its longstanding Takeover Code.

146. Alexandros Seretakis, *Hostile Takeovers and Defensive Mechanisms in the United Kingdom and the United States: A Case Against the United States Regime*, 8 OHIO ST. ENTREPRENEURIAL BUS. L.J. 245, 254–55 (2013).

147. *See id.* at 248–49.

148. *See id.* at 248, 259.

149. *See id.* at 262–63 (explaining that because two-tier tender offers are illegal, the only purpose of a poison pill would be to prevent a takeover in violation of fiduciary duties).

150. *See* Council Directive 2004/25, 2004 O.J. (L 142) 12 (EC).

151. *Id.*

152. Seretakis, *supra* note 146, at 262.

states.[153] Against this backdrop of mandatory bidding at an equitable price, Article 9 and Article 11 provide constraints on antitakeover measures. [154]

Article 9 provides that a board may not take action resulting in "frustration" of a bid, except to solicit alternative bidders, without prior authorization of a general meeting of shareholders assembled for that purpose.[155] Effectively, this provision of Article 9 prohibits all post bid defensive measures without shareholder authorization.[156] Article 11 establishes the "Breakthrough Rule," which is made conditionally voluntary by the European Takeover Directive's Article 12.[157] The Breakthrough Rule equalizes voting rights for the purpose of the general meeting where defensive measures are decided on by effectively giving each share one vote.[158] This result is accomplished by removing any restrictions on voting rights provided for in the articles of incorporation and setting the votes of any multiple-voting shares to one vote per share, for the purposes of the general meeting.[159] Thus, the European Union system, through the Breakthrough Rule, nullifies the shareholder rights problem in the context of general meetings, where a proxy fight for corporate control is most likely to take place. As such, the European Union's takeover market is much more shareholder and bidder friendly and avoids the preclusive combinatory effects discussed in this Comment.

II. ANALYSIS

The variety of antitakeover measures available to U.S. directors allows a board to act decisively against takeover efforts without shareholder input. The fundamental question is whether the balance of power in takeovers has shifted too far toward directors as a result of these complex antitakeover measures. This question can be answered by examining antitakeover

153. *See* Council Directive 2004/25, art. 5, 2004 O.J. (L 142) 12, 17 (EC). Article 5 provides that the bidder must pay the highest price paid by anyone acting in concert with the bidder over a period of 6 to 12 months, as determined by each member state. *Id.* Article 5 also provides that if a price higher than the offer price is paid by the bidder or anyone acting in concert with the bidder after the offer has been made, then the offer must be increased to this new price. *Id.*

154. *See id.* at arts. 9, 11.

155. *Id.* at art. 9.

156. Seretakis, *supra* note 146, at 258–59.

157. *See* Council Directive 2004/25, arts. 11–12, 2004 O.J. (L 142) 12 , 20–21 (EC).

158. *Id.* at art. 11.

159. *Id.* By removing voting restrictions and setting multi-vote shares to one vote per share, the Breakthrough Rule prevents loop holes from being built into the corporate structure while still allowing for completely non-voting shares. Non-voting shares are beyond the scope of this comment, however, they generally do not create the same problems as multi-vote versus single-vote shares as the purchasers are aware that they have no vote whatsoever.

measures separately and then looking to their combined effects. This Comment discusses poison pills and dual-class capital structures in isolation, then analyzes the combination of these measures. Next, the shareholder primacy arguments for increased shareholder autonomy are more closely scrutinized. Finally, several counter-arguments are addressed and a few potential solutions are proposed.

Poison pills are a substantial disincentive for bidders launching an unsolicited tender offer which might trigger the pill. Recent Delaware jurisprudence has shown that even if a bidder persists after a pill is triggered, the board may act to reinstate a new pill and once again dilute the bidder's acquisitions.[160] Thus, even if a bidder were to launch a tender offer that persisted after a poison pill was triggered, it seems that directors may re-implement the pill with few limitations.[161] As a result, poison pills are a substantial and potentially insurmountable roadblock to a traditional tender offer, which is likely why most bidders attempt to overcome pills through a proxy contest.[162] Without the proxy contest, directors operating under the *Airgas* jurisprudence could simply reload their poison pills indefinitely to render any tender offer ineffective so long as the pill remained.

Using a proxy contest, a bidder may overcome a poison pill in a single election, assuming the board has not installed additional antitakeover measures.[163] However, recent proxy contests have had little success.[164] While proxy contests may fail for a variety of reasons beyond the control of the board, combined measures can reduce the probability of an effective proxy contest. An effective proxy contest, in this context, is one which successfully results in removal of the poison pill. Notably, some bidders have mounted successful proxy contests only to have their slate of directors vote in favor of

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160. *See* Versata Enter., Inc. v. Selectica, Inc., 5 A.3d 586, 603 (Del. 2010).

161. *Id.* However, if the facts of the case indicate that the target company's actions are preclusive so as to render a successful proxy contest realistically unattainable, then such a measure may not be accepted. This is the underlying problem with combined defenses, such as the combination of the poison pill (defending against tender offers) and dual-class structure (defending against proxy contests).

162. *See* FLEISCHER & SUSSMAN, *supra* note 5, § 10.1 (discussing the frequency of combined tender offer/proxy contests and proxy contests, with a table showing success rates). For example, in 2013 there were 29 recorded proxy contests for control. *Id.* at tbl. Proxy Contest for Control.

163. If the target corporation has a staggered board, it will take two proxy contests to establish control of the board. These proxy contests must be conducted approximately one year apart, as staggered boards are made effective by the use of minimum terms for directors.

164. *See id.* § 10.1 (showing that between 2009 and 2013 approximately 25% of proxy contests for control have succeeded); *see also* Liz Hoffman, *Fending Off Hostile Bidders Hasn't Done Wonders for Stock Prices*, WALL ST. J. (Oct. 22, 2014, 1:01 PM), http://blogs.wsj.com/moneybeat/2014/10/22/fending-off-hostile-bids-hasnt-done-wonders-for-stock-prices/.

retaining the target's antitakeover measures.[165] In addition, staggered boards and other measures may complicate proxy contests, as noted above.

However, poison pills themselves are not the true problem when it comes to corporate control; it is the poison pill's *effect* that is so detrimental to shareholder rights. Despite this, shareholders may be coerced by bidders into tendering their shares without making an independent economic judgment. Indeed, the events of *Unocal* provide a compelling case for keeping directors as the primary decision makers in the face of a tender offer. However, *Unocal* presents a specific type of structurally coercive offer which is incomparable to the type of offer made in *Airgas*.[166] Where *Unocal* illustrates the opportunity for coercion by the bidder, *Airgas* demonstrates a board of directors refusing to allow their shareholders to make independent decisions.[167] Though directors are entrusted with making the business decisions in a corporation, the right of shareholders to freely dispose of their securities should not be abridged simply by invoking director power to make business decisions.

Unfortunately, in *Airgas*, shareholders did not enjoy the right to freely dispose of their shares. Instead, they were partially restricted in that they could not realistically tender to Air Products at any offered price. This restriction was not the result of some covenant entered into by each shareholder, but instead the result of measures taken unilaterally by the board of directors. Consequently, Air Products was barred from purchasing more than a certain number of Airgas securities.[168] In a broad sense, this restriction on alienability through restricting outside purchasers is the net effect of poison pills on shareholders. However, in a vacuum, shareholders may seek to remove a poison pill through the election of a new board during a proxy contest, assuming the bidder or another party initiates such a process.[169]

Ultimately, the lessons of *Unocal* and many other takeover battles demonstrate the utility of poison pills as an antitakeover measure. Indeed, in the face of a coercive offer, poison pills adopted without shareholder approval may be necessary to delay the process and provide shareholders with a method to resist coercion. The Delaware courts have noted that coercive offers represent a special case because the threat those offers pose is so great

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165. *See generally* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 70–2 (Del. Ch. 2011) (tracing the history of the takeover attempts, specifically the decision of the bidder's slate of directors voting against a takeover).

166. *See generally* Unocal Corp. v. Mesa Petrol. Co. 493 A.2d 946, 949 (Del. 1985); *Airgas*, 16 A.3d at 54;.

167. *See generally Unocal*, 493 A.2d at 949; *Airgas*, 16 A.3d at 54.

168. *See generally Airgas*, 16 A.3d at 54.

169. *See, e.g.*, *Unocal*, 493 A.2d at 957 (explaining that a shareholder, including a bidder, could initiate a proxy contest to replace the board and remove the poison pill).

that virtually any response may be proportionate. However, poison pills are not the only antitakeover measures that limit shareholder choice.

Capital structures may take many forms for a variety of reasons, as discussed above. However, some capital structures are designed to concentrate voting power in a small subset of shareholders. These dual-class structures, which assign greater voting rights to preferred stock, are a substantial antitakeover measure that significantly impairs the rights of shareholders. As an example, a dual-class capital structure can be imagined as having common stock and preferred stock, where the common stock is entitled to one vote per share and the preferred has ten votes per share. Beyond this voting disparity, the shares are essentially identical, particularly in terms of market value and equity stake. In order to maintain shared market value, preferred stock will typically be convertible to common stock at a one-to-one ratio, allowing preferred holders to sell their shares without transferring preferred voting rights.

To illustrate the effects of this voting disparity, imagine a company with ten outstanding shares of preferred stock and ninety outstanding shares of common stock, as described above. This preferred stock is in the hands of a single individual, who owns a ten percent equity stake and is entitled to one hundred votes. The remaining ninety shares are freely traded on the market and entitle their holder to one vote per share. Even if a single person owns all ninety shares, that individual only has ninety votes. Thus, the investor holding a 10% equity claim in the corporation may exercise voting power over the remaining 90% of equity holders, even though that stake is concentrated in a single entity.

The disparate voting rights of dual-class capital structures give minority stakeholders the potential to exercise majority control even while ostensibly selling the majority of the equity in a corporation. In addition to altering fundamental corporate governance concerns which are beyond the scope of this Comment,[170] this represents a potentially insurmountable antitakeover measure. Assuming no other regulations or laws applied, even a corporation without this type of structure could implement it by issuing new preferred shares to insiders which would outweigh the combined voting power of outstanding shares. However, this problem is largely hypothetical, as stock exchange rules prohibit corporations with dual-class capital structures from listing unless the structure was in place at the time of the corporation's initial public offering.[171]

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170. *See generally* Wen, *supra* note 130 (discussing other concerns created by dual-class structures).

171. *See id.* at 1496–97.

Nevertheless, real world examples such as Zynga, LinkedIn, and Groupon are currently publicly traded and possess dual-class capital structures.[172] In these companies, the outstanding preferred stock is not sufficient to grant its holders a majority vote. However, these shares do offer very strong minority positions which account for around 30% of the total vote. These minority positions can be used to artificially empower directors, who often hold the preferred stock, during a proxy contest. Of course, without other defenses, the target would still be vulnerable to takeover through traditional means, such as a tender offer.

To illustrate the profound effects of dual-class capital structures on voting rights, consider a corporation where the Chairman of the Board owns 3% of the equity, all of its preferred stock. Assuming a voting rights multiplier of 10, the Chairman would exercise 30% of the voting rights in any proxy contest. As a result, the Board would only need to recruit an additional 20% of stockholders while an insurgent would need to muster 50% of the outstanding shares, assuming no one else on the board owned stock of any kind. As this model is adjusted so that more of the board and their family members own stock, regardless of whether or not that stock is preferred, a successful proxy contest becomes significantly less likely. Ultimately, the problems of dual-class structure mirror those of companies with a small public float. However, the dual-class structure allows owners and directors to use capital markets without giving investors representation proportionate to their equity share.

Given the potential problems poison pills and dual-class capital structures pose in isolation, the effects of combining these measures significantly increases their efficacy in the takeover context. Poison pills serve to effectively block a tender offer, especially when they may be reactivated repeatedly, and are generally removed after a successful proxy context. On the other hand, dual-class capital structures may either prevent or restrict the ability to wage a successful proxy contest. However, a dual-class capital structure can generally be overcome through a traditional tender offer. Thus, when implemented together, these measures augment one another to effectively prevent a takeover bid.

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172. *See, e.g.*, Groupon, Inc., Registration Statement 120 (Form S-1) (June 2, 2011); LinkedIn Corp., Registration Statement 116 (Form S-1/A) (Jan. 27, 2011); Zynga, Inc., Amended Registration Statement 137 (Form S-1) (Dec. 9, 2011).

III. PROPOSED SOLUTIONS

The problem of overly powerful antitakeover measures is not limited to dual-class capital structures combined with poison pills, but also extends to corporations that impose many different combinations of defenses, which can effectively prevent a takeover despite shareholder disapproval. As a final illustration, imagine a corporation which has experienced significant losses over the past several years and has modified its poison pill to a NOL threshold of 4.99%. Further, imagine that the corporation has a dual-class capital structure where preferred stock has ten times the voting rights as common stock, and the board holds a combined 4% of the equity stake in the corporation. This equity stake results in the board possessing about 29% of the total shareholder vote. Finally, imagine that the corporation has a staggered board, where one third of directors are elected each year and may only be removed during their election year.

In this scenario, the most an outside bidder could acquire is a 4.98% stake in the corporation prior to launching a proxy contest. As a result, the bidder must receive support from over 45% of the voting shares, while the board requires support of only 21% of shareholders. Additionally, the bidder would be required to win two proxy contests at this level to gain control of the board sufficient to remove the poison pill. While it is certainly possible for a bidder to accomplish this, it would be extremely difficult. In the market, this difficulty is illustrated by the fact that since 2009, only seven hostile takeover attempts went to a proxy vote and only one was successful.[173] Given this low probability of takeover success, the assumption of a thriving market for corporate control is questionable.

There are many potential ways to overcome these problems with antitakeover measures, from altering judicial oversight doctrine to adopting the approach of the European Union. Indeed, those who fully embrace shareholder primacy might suggest disallowing antitakeover measures entirely, absent shareholder approval on a case-by-case basis. To begin, this Comment suggests that the *Unocal* standard is appropriate as it relates to structurally coercive offers. As in *Unocal*, an offer may be structured to force shareholders to tender, or risk receiving little compensation during a back-end merger. In the face of such threats, it is reasonable to presume that shareholders may not be able to act as decisively as the board. Coercive offers have a tendency to bias shareholders and force potentially sub-optimal decisions, and therefore require a higher level response than one-tiered, non-coercive offers.

173. Hoffman, *supra* note 164.

In the case of an offer like the one in *Airgas*, there does not seem to be any coercion or any reason to prohibit shareholders from tendering at will. In *Airgas*, Air Products made a tender offer at $60 per share for up to 100% of the outstanding shares of the corporation.[174] The board of Airgas believed that the price was substantially lower than it should have been and sought to prevent the tender offer through a variety of antitakeover measures.[175] However, the board apparently refused to recognize that shareholders should be able to make that decision independently, particularly after the extensive litigation surrounding the tender offer. Instead, the board continued in its attempts to prevent shareholders from being able to dispose of their shares as they saw fit. This was only possible because the board was capable of imposing a multi-layered defense which effectively prevented a tender offer.

One option that would allow shareholders to make decisions about their shares, even in the takeover context, would be to deem any multi-layered defense preclusive under *Unocal*, unless approved by the shareholders in response to a specific bid. Under this model, a corporation could benefit from a staggered board, dual-class capital structure, or other antitakeover measures that have both takeover and non-takeover benefits. However, a hostile bidder could use litigation to force redemption of a poison pill, if the pill were combined with any other method. While this solution would increase the efficacy of tender offers and diminish the utility of poison pills, it would also likely result in costly and time consuming litigation. Thus, this method is not ideal.

Another option is to adopt the European Takeover Directive; however, the directive has substantial flaws. First, many of its provisions are not mandatory, which raises the question of which provisions to adopt. More importantly, the directive is predicated on a mandatory bid rule which significantly restricts bidder freedom and imposes significant government control on the market. The European Takeover Directive's mandatory bid rule presents substantial problems in the context of American law and principles. For example, creating a mandatory bid rule would grossly restrict freedom of contract, an underpinning of American commercial law. Therefore, this is also not an ideal solution.

Instead, a hybrid approach may be ideal in resolving the problems of antitakeover measures in the United States. Under this approach, dual-class structures, staggered boards, and even poison pills could be maintained without inviting a substantial increase in litigation. In the context of a takeover, shareholders would be able to cast one vote per share in any proxy

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174. *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 69 (Del. Ch. 2011). Air Products made a subsequent tender offer of $65.50. *Id.* at 76.

175. *Id.* at 70.

contest related to the takeover. However, antitakeover measures would still be allowed in the general sense. Thus, in order to launch a successful hostile takeover, a bidder would need to launch a successful proxy contest and then use a follow-on tender offer. To prevent staggered boards from interfering with this process, the board would be required to redeem any poison pill after a successful proxy contest. This approach has the benefit of allowing shareholders to tender their shares while preventing coercive bids and requiring substantial effort from a potential bidder. However, this solution would restrict current corporate practices substantially, by decreasing the utility of staggered boards. Moreover, this approach may not stand the test of time, as novel ways of resisting takeover attempts may be created if this approach were adopted. Ultimately, this solution is not perfect but it does provide increased shareholder rights and forces corporate boards to either engage with shareholders or seek new methods to resist shareholder supported takeovers.

CONCLUSION

The possible solutions provided in Section III, *supra*, are not intended to serve as a comprehensive listing, but to illustrate alternatives to a system that has rapidly evolved into the status quo. The cases which led to the development of the poison pill and the subsequent innovations in takeover mechanisms, as well as antitakeover measures, have dramatically changed the takeover landscape since *Unocal* and *Unitrin*. Moreover, the dynamic nature of the global economy causes the very reasons for a proposed takeover, or consensual merger, to shift continuously. Perhaps most importantly, takeovers, like all mergers, represent business transactions which must be accomplished with consideration of speed and certainty that litigation cannot provide. As such, judicial solutions to the potential entrenchment of directors and management under the current regime is not well addressed through ad hoc judicial determinations. Instead, in the interest of all equity holders of a corporation, the Delaware takeover environment should be redefined to allow shareholders free alienability of their securities without regard to director intervention. Section III's solutions provide several mechanisms through which this could be accomplished, but regardless, shareholders must be liberated from the confines of their ever shrinking rights as property owners.