It's My Stock and I'll Vote If I Want to: Conflicted Voting by Shareholders in (Hostile) M&A Deals

MATTEO GATTI*

ABSTRACT

This article fills a vacuum in current takeover literature by organically analyzing instances in which shareholders' conflicts might lead to inefficient acquisition outcomes. While outside of the takeover field, Delaware courts have been wary of the perils for shareholder wealth maximization of misalignments in shareholder incentives, and while almost all jurisdictions that require a shareholder referendum as a precondition to conduct a hostile transaction have implemented disinterested shares regimes, Delaware takeover law has been silent. This article presents three possible approaches to address conflicted voting in acquisitions: a rule-based approach, a standard-based approach, and an unengaged approach. This article argues that none of these approaches can be expected to work better than the others under all circumstances—they each carry positives and negatives. A system of balanced bright-line rules (that is, applicable to both bidder and target incumbents) would contain conflicted voting in a series of circumstances, but its potential over-deterrence can put at risk a subset of deals in which the universe of disinterested shareholders might not get it right. Standards have the advantage that, if well adjudicated, only the prohibited, conflicted conduct will be detected and sanctioned, with no problems stemming from over- or under-deterrence. But the worrying aspect of a standard approach is judicial discretion and potential error: the policy would call for the judge to establish the inherent long-term value of the target as an independent entity. While the advantage of the unengaged approach is preserving the status quo, its clear problem is not offering protection when a conflicted vote distorts the voting and acquisition outcomes. This article suggests a combination of a rule-based approach and a standard-based one: the bidder and the incumbents would vote, but their shares would be presumed conflicted and thus not counted for determining the outcome of the vote/acquisition (rule-based element); however, each group could rebut the presumption by proving that its votes are not conflicted because they are directed to an outcome that maximizes shareholder value (standard-based element). This would constitute a less harsh version of a pure disinterested shares regime because a group initially labeled as interested could actually demonstrate the opposite: entrenchment-seeking directors and management will have to convince a judge they are casting their vote because rejecting the

bid is the best course of action, while bidders will have to prove their offer is not a "low baller."

I. INTRODUCTION

Takeovers have historically kept corporate lawyers very busy. Some have recently argued that "the allocation of authority between shareholders and the board of directors to determine whether a hostile takeover bid would go forward" is "the most intense corporate law debate of the last thirty years and perhaps the entire history of corporate law."[1] Yet, surprisingly, some stones have been left unturned: this article makes the first attempt to organically address the thorny issue of conflicted voting by shareholders in connection with a hostile acquisition, an issue that few scholars have dealt with (and tangentially at best).

To be sure, shareholder voting comes in many forms in the M&A context: mergers and sales of assets are the traditional transactional structures requiring a shareholders' vote.[2] Since the mid-1980s, it became apparent that hostile takeovers could also require a vote. How so? In the 1980s, back when classic Delaware takeover law was crafted, the policy dilemma rested on whom to select as the appropriate actor to determine the success or demise of a hostile acquisition attempt. Policymakers had three high-level approaches to choose from: shareholder choice, board centrality, or courts.[3] Albeit the initial impression was that board actions would be subject to some higher standard than routine

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1. Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation* 21 (Eur. Corp. Governance Inst., Law Working Paper No. 239/2014), http://ssrn.com/abstract=2359690.

2. *See infra* Section II.A.1.

3. *See* Ronald J. Gilson, *Unocal Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 494–95 (2001).

business judgment, directors eventually won and won big.[4] Soon enough, their supremacy and discretion became broader: directors could defend against virtually all hostile deals;[5] the idea being that they know better than shareholders about the inherent, hidden value of a target company.[6] However, this power was never absolute, as courts left a caveat: if shareholders do not like how directors are responding to the given offer, they have, and cannot be taken away, the ability to vote to oust the board and get rid of the defense[7] (the so-called ballot box route).[8] Pure hostile deals remained possible only through such ballot box route in the form of joint tender offers and proxy fights.[9]

This compromise left many dissatisfied. Some criticized it because of an unmotivated preference for elections as opposed to pure tender offers.[10] Others pointed out that "[s]hareholder ability to elect new directors emerges as an uneasy compromise between the logic of hidden value and the need to limit agency costs":[11] it is quite contradictory to give directors the power to defend because shareholders are prone to valuation mistakes, but then allowing shareholders to decide "in the related proxy battle presenting the

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4. In other words, the first impression was that Delaware courts gave themselves a policing role, which was ultimately de facto abdicated. *See* Gilson & Gordon, *supra* note 1, at 22–23.

5. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154–55 (Del. 1989) (endorsing a just say no response from directors).

6. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 522–23 (2002) (criticizing the policy).

7. This nowadays means redeeming a poison pill. *See infra* notes 33–34 and accompanying text.

8. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

9. *See infra* notes 38–40 and accompanying text.

10. Ronald J. Gilson & Alan Schwartz, *Sales and Elections as Methods for Transferring Corporate Control*, 2 THEORETICAL INQUIRIES L. 783, 788 (2001) ("[A]n outcome as significant as privileging elections over markets should at least come with an explanation. Providing a reason for an outcome at least imposes the discipline of logic on the range of alternatives available to the court."); Gilson, *supra* note 3, at 500–01 (criticizing the choice by Delaware judges to prefer elections over market dynamics).

11. Black & Kraakman, *supra* note 6, at 538 (2002).

same issue."[12] Others believe that shareholder choice in the ballot box compromise can at times be more apparent than real:[13] as I explained in earlier work, shareholders may lack the actual power to determine the outcome of a takeover bid because of corporate law rules, principles, and/or practices acting as barriers to the power to oust the board.[14] In this regard, scholars, practitioners, and market players have identified staggered boards as the main culprit.[15] But staggered boards are hardly alone in altering the odds of a bidder's prevailing via the ballot box route: other factors include shareholders' inability to call special meetings or to act by written consent, supermajority rules, proxy rules, and—the topic of this article—the conflict of interest regime.[16]

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12. Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet*, 19 CARDOZO L. REV. 511, 530 (1997).

13. *See, e.g.*, Randall S. Thomas, *Judicial Review of Defensive Tactics in Proxy Contests: When Is Using a Rights Plan Right?*, 46 VAND. L. REV. 503, 506–07 (1993).

14. Matteo Gatti, *The Power to Decide on Takeovers: Directors or Shareholders, What Difference Does It Make?*, 20 FORDHAM J. CORP. & FIN. L. 73, 109–21 (2014).

15. Staggered boards received a lot of attention in the aftermath of an influential study by Bebchuk, Coates, and Subramanian, in which they showed that the combined use of poison pills and staggered boards make unsolicited deals virtually impossible. When a target has a staggered board in place, because only one-third of its members are up for election every year, it takes two board elections, and hence at least twelve full months, to gain a majority of directors. At the first election, bidders would effectively give target shareholders a put option exercisable a year later: if between the two elections the stock has gone down, the bidder will have to close an acquisition where it is likely overpaying (the stock has gone down while the bidder cannot run the company because it only controls one third of the board); if, however, the target stock has gone up, shareholders would likely not vote for the bidder nominees unless the bidder increases the initial offer. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, & Policy*, 54 STAN. L. REV. 887, 890, 928 (2002) (finding that not a single hostile bid won a ballot box victory against an effective staggered board in the five-year period from 1996–2000).

16. *See* Gatti, *supra* note 14, at 109–24.

So, in the first place, the judges' idea that bidders and shareholders might find solace via a proxy fight safety valve[17] cannot apply squarely to a big chunk of companies in the market for corporate control, as some pre-planning on the target's end would impair, to varying degrees, the shareholders' ability to effectively use "the powers of corporate democracy."[18] Second, and moving to the main focus of this article, even in the absence of explicit anti-takeover devices, such as staggered boards, the mechanics of shareholder voting might present two additional types of distortions preventing the vote from representing a true expression of corporate democracy: on the one hand, proxy rules are notoriously tilted in favor of incumbents,[19] and on the other hand, the voting (and therefore the deal) outcome can be tainted by a conflict of interests carried by one or more shareholders.

This article focuses on the latter problem: how does, and how should, the law address conflicts of interest by shareholders when they vote in hostile deals? Basic questions that ought to be considered, but have yet to be explored in the literature, are, at a minimum, the following: Are we comfortable from a policy perspective that the bidder freely votes its shares? What about directors and management—can they vote their shares? In the tender offer structure, the bidder is the contractual counterpart to the target shareholders and is thus in *potential* conflict with them: put simply, buyers want to spend less, while sellers want to receive more. Additionally, because of the well-known desire to maintain their respective roles, the votes cast by directors and management of the target, together with persons affiliated with them, are *potentially* in conflict with the interests of the other shareholders.

As shareholder voting is a key factor in determining the success of an acquisition, it is of paramount importance that conflicted voting does not alter the collective decision of shareholders. In fact, as the Delaware Supreme Court pointed out in a relatively recent case on vote buying, a misalignment of interests puts at risk the very ability of such collective decision to determine an out-

17. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985).

18. *Id.* at 958–59.

19. Yair Listokin, *Corporate Voting vs. Market Price Setting*, 11 AM. L. ECON. REV. 608, 610–11 (2009).

come that is efficient for shareholders.[20] Such a concern was promptly echoed by the Chancery Court in a freeze-out case: "[e]conomic incentives matter, particularly for the effectiveness of a legitimizing mechanism like . . . a stockholder vote."[21]

This article takes the view that the negative influence of shareholders' conflicts of interest is circumstantial: the mere possibility of a conflict is not sufficient to taint the vote. The pathology, I argue, is pursuing a personal interest and casting a pivotal vote against the interests of the other shareholders: to make such determination, there is no way other than looking at facts and circumstances arising from the actual offer on the table. To simplify, if the offer is value maximizing, directors and managers voting against it (that is, voting to maintain the board and leave the pill in place) will be in conflict, but the bidder voting in favor will not. Conversely, if the offer is not value maximizing, the bidder voting in favor (that is, voting to replace the board and redeem the pill) will be in conflict, while directors and managers voting against will not. These conflicts are not exclusive to hostile acquisitions: all similar "final period" situations, for instance friendly deals, present similar risk (in such setting, the conflict is "shared" by the bidder and the target board who might collude to offer a lower price to shareholders).

Conflicted voting is no small issue even when compared to other well-known problems of the current regime, such as staggered boards: because the direction of whom the conflict is going to favor—whether the bidder or the incumbents—is not predictable ex ante when investing a given company (because the advantage can be determined only after the offer is presented and the vote takes place), conflicted voting can introduce a noisy element in the accuracy of pricing a given stock. This is not the same for most takeover defenses (staggered boards for instance), whose presence means there is less likelihood ex ante of a hostile deal: something

20. Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) ("[W]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization.") (citation omitted).

21. *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 416 (Del. Ch. 2010).

that market participants can anticipate and incorporate in the stock price accordingly.

After scoping how existing Delaware law addresses the issue,[22] this article investigates how to go about it from a normative perspective, and it does so through the angle of comparing the strengths and weaknesses of three strategies: a rule-based approach, a standard-based approach, and an unengaged approach. The first approach consists of bright-line rules that, because of the potential risk of a conflict, specifically disqualify ex ante certain shareholders by requiring that the resolution be approved by a majority of disinterested shares. The second standard-based approach would seek to invalidate ex post all votes that are actually cast in conflict and that are pivotal for the outcome of the election (I call this approach a "no-conflict standard"). Under the third unengaged approach, shareholders would have complete freedom to decide how to cast their votes.

This article argues that none of the approaches can be expected to work better than the others in all circumstances, and that they each carry positives and negatives. The advantage of the unengaged approach is leaving things as they (probably)[23] are now, meaning no additional litigation. The obvious problem is that it offers no protection when a conflicted vote distorts the voting and acquisition outcome. Not only is this dangerous because such an approach puts at risk the overall efficiency of the market for corporate control (in all deals that are determined by the pivoting vote of the conflicted party, efficiency would have called for the exact opposite outcome), but it also sends a sobering signal that the legal system, especially *this* legal system, whereby the ballot box route is considered the safety valve for the correct functioning of the market for corporate control, is structurally incapable of screening out inefficient outcomes for acquisitions (e.g., a bad acquisition not being defeated and a good acquisition not succeeding). Otherwise, if we surrender to the idea that legislating or enforcing conflicts would either be too cumbersome or create too much uncertainty, then we must once and for all accept that the ballot box route, which is considered a safety valve that supposedly keeps the effi-

22. *See infra* Part III.
23. *See infra* Section IV.A.4.

ciency of the market for corporate control in check, simply does not work or works in a potentially distorted way.

If the idea is to intervene, we have to choose between rules, standards, or, what this article suggests as the most promising option, a combination of the two. A system of balanced bright-line rules would contain conflicted voting in a series of circumstances, but its potential over-deterrence can put at risk a subset of deals in which the universe of disinterested shareholders might not get it right.[24] Standards have the advantage that, if well adjudicated, only the prohibited conflicted conduct will be detected and sanctioned, with no problems stemming from over- or under-deterrence. In a standard-based regime, target incumbents would be able to vote and only subsequently would takeover contenders have to litigate whether the vote was conflicted. But the complex element in a standard approach is judicial discretion and potential error: the policy would ultimately call for the judge to establish the inherent long-term value of the target as an independent entity.[25]

This article suggests to combine a rule-based approach with a standard-based one: the bidder and the incumbents would vote, but their shares would be presumed conflicted and thus not counted for determining the outcome of the proxy fight/acquisition (rule-based element); however, each group could rebut the presumption by proving that in fact its votes are not conflicted because they are directed to an outcome that maximizes shareholder value (standard-based element). This would constitute a less harsh version of a pure disinterested shares regime because a group initially labeled as interested could actually demonstrate the opposite: entrenchment-seeking directors and management will have to convince a judge they are casting their vote because rejecting the bid is the best course of action, while bidders will have to prove their offer is not a "low baller."

A couple of qualifications are in order. First, this article purposely moves within the boundaries of existing understandings of Delaware law on takeover defenses. It is beyond the scope of my work to endorse or criticize views as to whether it might make better economic sense to adopt other policies, such as a more shareholder-centric approach that is not based on hidden value or

24. *See infra* Section IV.A.1.
25. *See infra* Section IV.A.2.

substantive coercion (i.e., the underlying assumptions used by Delaware judges to justify the existing system),[26] or an opposite, more director-centric approach (for instance, validating a broader "just say no" defense to aggressively thwart proxy fights).[27]

Second, this article does not necessarily call for a policy reform. Rather, it illustrates what the implications are for the Delaware system of embracing any of the main policy avenues that are analyzed here, especially what are (a) the assumptions for each of the described solutions and (b) the implications of relaxing such assumptions. One of the main traits of this article is underscoring the partial nature of the current debate (which ignores the issue of conflicted voting) in the aim of fostering a new area of research.

This article is structured as follows. Part II surveys when (II.A) and why (II.B) shareholder voting is necessary in acquisitions, emphasizes the importance of voting sincerity from an efficiency standpoint (II.C), and describes how conflicted voting can

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26. This is the critical view on Delaware takeover law recently expressed by Gilson & Gordon, *supra* note 1, at 21–24, noting that the system emerged in the market environment of the 1960–80 period, which differs significantly from our current age of "agency capitalism" that is characterized by large institutional ownership and diversification.

27. Such harsher types of defenses are currently considered not available to Delaware targets. The outer limits of the legitimacy of defenses tampering with the proxy machinery are laid out in Blasius Indus. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (stating that if the board acts "for the primary purpose of preventing or impeding [the exercise of stockholder voting power], . . . the board bears the heavy burden of demonstrating a compelling justification for such action.") and Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388–89 (Del. 1995) (determining that takeover defenses are legitimate so long as the bidder's chances to win an election to replace the board are not "mathematically impossible or realistically unattainable."). Note, incidentally, that Delaware Courts have progressively eroded the boundaries in which *Blasius's* higher standard applies in favor of some other tests. *See* Keyser v. Curtis, C.A. No. 7109-VCN, 2012 WL 3115453, at *12–14 (Del. Ch. July 31, 2012) (applying the less onerous duty of loyalty standard rather than the *Blasius* standard where both were implicated when a corporation's sole director issued super voting shares of stock to himself at a bargain price to prevent his own removal from office); Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 806–07 (Del. Ch. 2007) (applying the *Blasius* standard to a board decision not to delay a merger vote by twenty-five days when it became clear there were not enough votes in favor of the merger on the original meeting date but holding that such standard must be consistent with the *Unocal* framework).

alter efficient outcomes in acquisitions (II.C.1 and 2). Part III contains the positive law analysis: it focuses on tools available to the interpreter to tackle conflicted voting in acquisitions, concludes there is no easy answer (III.C.1), and highlights the most complex key questions (III.C.2). In Part IV, the article analyzes some policy initiatives that could be contemplated to address conflicted voting. In Section IV.A, I lay out three potential policy options: a rule-based, a standard-based, and an unengaged approach. In Section IV.B, I then compare each such approach by testing it with hypotheticals of acquisition attempts. In Section IV.B.5, I describe the assumptions under which one approach can be expected to fare better than the others. In Section IV.C, I evaluate such assumptions and formulate policy remarks while taking into account some potential objections to a reform. Part V concludes.

II. FRAMING THE ISSUE: CONFLICTED VOTING IN ACQUISITIONS

A. Shareholder Voting in Acquisitions

1. Voting as a Statutory Requirement

Shareholder approval is often a requirement for the consummation of corporate acquisitions. In the context of statutory mergers, this is almost always true for shareholders of target companies;[28] sometimes shareholders of acquiring companies get to vote as well.[29] Shareholder approval is also a prerequisite of asset

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28. *See* Section 251(c) of the Delaware General Corporation Law ("DGCL"). DEL. CODE ANN. tit. 8, § 251(c) (2016). *But see* § 251(h) (stating that a shareholder vote is not necessary for a merger that follows a tender or exchange offer if, among other things, the acquirer owns at least the number of shares that would be sufficient to approve the merger); § 253(a) (stating that a shareholder vote is not necessary if the acquiring corporation already owns at least 90% of the shares of each class of stock of the target company).

29. Under Section 251(f) of the DGCL, a shareholder vote is not necessary if the certificate of incorporation of the surviving corporation is not changed and the number of shares does not increase more than twenty percent, meaning that cash mergers and medium-to-small mergers never trigger a shareholder vote in the acquirer. *See* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 140–41 (2009) (noting that, given the wide degree of freedom in structuring an M&A transaction, shareholder voting at the level of acquiring corporations is basically optional). For analysis, see also Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer*

deals involving a sale of all or substantially all the assets of a company.[30]

Target shareholders can also be called to vote in the context of tender offers—even if such a deal structure does per se not "naturally" require a shareholder resolution. Outside of Delaware, several states have enacted control share acquisition statutes,[31] which require a shareholder vote to authorize a tender offer or an acquirer to cross certain thresholds of stock ownership and therefore to obtain control of a corporation—such a vote, a prerequisite condition for the deal to go through, works as a referendum on the

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Overpayment Problem, 96 MINN. L. REV. 1018, 1044–49 (2012) (detailing the various ways to structure transactions in order to bypass voting of the acquirer shareholders of Delaware corporations); Marco Becht, Andrea Polo & Stefano Rossi, *Does Mandatory Shareholder Voting Prevent Bad Acquisitions?* 3 (Eur. Corp. Governance Inst., Finance Working Paper No. 422/2014), http://ssrn.com/abstract=2443792 (noting that shareholders of U.S. companies vote in limited circumstances and observing evidence supporting the proposition that value-reducing deals are more likely to be associated with acquisition structures designed to avoid shareholder approval).

30. Delaware courts have held different views with respect to determining what "substantially all the assets" means: one doctrine requires that certain quantitative thresholds are met, such as determining the percentage of total income the assets in question generate as well as their proportion to the company's overall size, while another doctrine focuses more on qualitative criteria by examining if the assets being sold represent a significant portion of the company's income or a deviation from its core business, even if the assets do not represent a large fraction of the company's total assets. *Compare* Gimbel v. Signal Cos., 316 A.2d 599, 606 (Del. Ch. 1974) (endorsing the quantitative approach, holding that a sale of 26% of assets generating 15% of income was insufficient to trigger a shareholder vote under DGCL § 271), *with* Katz v. Bregman, 431 A.2d 1274, 1276 (Del. Ch. 1981) (endorsing the qualitative approach, holding that a sale of assets triggered a shareholder vote under DGCL § 271 where the company would depart from its historically successful line of business by changing from steel drum to plastic drum manufacturing after the proposed sale). *See also* Hollinger, Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 377–78 (Del. Ch. 2004) (holding that the sale of an indirect subsidiary comprising approximately half of a company's total assets and revenues did not trigger DGCL § 271, reasoning that the company would still continue as a profitable entity in its historically successful line of business).

31. *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 115–16 (1987). For a list of states that adopted such legislation, along with statutory references, *see infra* Appendix I.

acquirer.[32] More importantly, as the immediately following subsection shows, voting is a frequent feature in connection with hostile deals for Delaware target companies.

2. Tender Offers and Proxy Fights: Voting as a Safety Valve for Hostile Deals

In the mid 1980s, the evolution of the law governing tender offers and hostile deals in Delaware led to a system in which, if a bidder does not want to or cannot come to terms with the target board, the only way to override a target's resistance through various defensive devices (most notably, a poison pill)[33] became launching a proxy fight in order to replace the incumbent board of

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32. *See* Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 985 (2002).

33. In short, a poison pill in its "flip-in" form gives subscription rights to purchase stock at a considerable discount if any person (alone or acting as a group) acquires a stake in the company in excess of a given threshold (normally, ranging from fifteen to twenty percent): such rights can be exercised by all shareholders with the exception of the person or group crossing the applicable threshold. Hence, a flip-in plan threatens a potential acquirer with significant economic and voting dilution unless the target's board redeems such subscription rights. *See* Jeffrey N. Gordon, *An American Perspective on Anti-takeover Laws in the EU: The German Example*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 541, 549 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004) ("[T]he flip-in pill operates through a discriminatory issuance of cheap shares that would massively dilute the hostile bidder's stake."). For the mechanics of the pill, see Wachtell, Lipton, Rosen & Katz, *The Share Purchase Rights Plan*, *in* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 741–42 (2d ed. 1995). The pill is effective for two reasons. First, no shareholder action is needed either for its adoption (so long as the charter, as it always does, authorizes, essentially without any substantial limits, directors to issue shares of blank-check preferred stock, as well as common stock) or for its redemption. Second, the pill really works as a deterrent: the threat of dilution for an unsolicited acquirer is so effective that the triggering of the pill is virtually never needed. The mere fact that the pill is in place compels an acquirer to either try to negotiate a friendly deal with the board or to replace the board through a proxy contest to get rid of the pill. *See* John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE, *supra*, at 677, 681 n.18; Jordan M. Barry & John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses*, 160 U. PA. L. REV. 633, 643–44 (2012).

directors with new directors nominated by the insurgent/bidder who would in turn repeal the defenses (hence, redeem the poison pill).[34] Such a parallel structure[35] is the result of a series of pro-target decisions throughout the 1980s and 1990s, which clarified on many occasions the wide array of discretion a board has in rejecting a takeover proposal.[36] It was the Delaware Supreme Court itself that, after granting targets the power to defend, suggested bidders could still use the proxy fight avenue: as the Delaware judges pointed out in *Unocal*, no defensive device implemented by

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34. Bear in mind that a board can always eliminate the effects of the pill ("redeem the pill") by canceling the rights plan to consent to a desirable acquisition by a friendly buyer. *Id*. at 643. However, the power to redeem gives hostile bidders a path to reversing a board's decision to resist precisely by ousting the incumbent board through a proxy fight and redeeming the pill.

35. One of the most important aspects of pills is that because they can be adopted very easily—in a matter of hours—by the board, all companies have a "shadow" poison pill plan to be approved quickly if and when circumstances so require. *See* John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV 271, 289 (2000) [hereinafter Coates, *Takeover Defenses*]. This means that *ex ante* a hostile bidder will—for any given target, whether it has a pill in place—*always* anticipate that if no agreement with the target management is realistically achievable, the only viable option to succeed in a hostile deal is to launch a proxy fight.

36. Delaware judges allow directors to adopt defensive measures so long as they can meet a two-prong test introduced in *Unocal Corp. v. Mesa Petroleum Co.* that requires that: (i) there are "reasonable grounds for believing that a danger [or a threat] to corporate policy . . . exist[s]" and (ii) the response taken by the company is "reasonable in relation to the threat posed" (the latter is often referred to as the *Unocal* proportionality test). Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). With the crucial decision in *Unocal*, the Delaware Supreme Court established an intermediate standard of review between the entire fairness test (the rigorous standard for duty of loyalty cases) and the business judgment rule, which, according to Delaware judges, cannot apply in its pure form in takeover cases "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders." *Id.* at 954 (footnote omitted). The most important practical implication of the *Unocal* decision was on poison pills: in a subsequent case, the Delaware Supreme Court used the *Unocal* test to validate the pill. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351, 1353 (Del. 1985) (adopting a rights plan by the board of directors of a target as a prospective takeover defense meets the *Unocal* proportionality test, but the use of the pill in an actual takeover may be subject to specific scrutiny); *see also infra* note 44.

a target can be considered definitive because, "[i]f the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out."[37] Ultimately, the judges put director elections at the center of attention, which, under existing law, work as a safety valve for the market for corporate control: in the words of the Delaware Supreme Court, "the emergence of the 'poison pill' as an effective takeover device has resulted in such a remarkable transformation in the market for corporate control that hostile bidders who proceed when such defenses are in place will usually 'have to couple proxy contests with tender offers.'"[38] Where tender offers

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37. *Unocal*, 493 A.2d at 959; s*ee also Moran*, 500 A.2d at 1357 (upholding the validity of the pill because, among other things, it does not "fundamentally restrict[] proxy contests."). The availability of the ballot-box route and director elections are often cited as the safety valve for hostile deals in the presence of a pill. *See, e.g.*, Michal Barzuza, *The State of State Antitakeover Law,* 95 VA. L. REV. 1973, 2005 (2009) (arguing that such safety valve is actually protected by the heightened standard of *Blasius*, which requires a "compelling justification" for directors who seek to thwart the shareholder franchise); Paul H. Edelman & Randall S. Thomas, *Corporate Voting and the Takeover Debate*, 58 VAND. L. REV. 453, 459–61 (2005); Barry & Hatfield, *supra* note 33, at 644; Bebchuk, Coates & Subramanian, *supra* note 15, at 907–09. *But see* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 58 (Del. Ch. 2011) (holding that *Unocal* is not breached if an effective staggered board refuses to redeem a pill after an incumbent slate lost the first election).

38. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1379 (Del. 1995) (citation omitted). *See generally* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L 859, 887 (2001) (noting that, particularly after Paramount Communications, Inc. v. Time, Inc. 571 A.2d 1140 (Del. 1989), "[r]eplacing the board became an essential part of a hostile offeror's strategy, because that was the only way to circumvent the otherwise preclusive effect of the poison pill that the target board would typically refuse to redeem.") (footnote omitted); Lucian Arye Bebchuk & Marcel Kahan, *A Framework For Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1073, 1082 (1990) (acknowledging, in the aftermath of the mid-1980s Delaware decisions, that "proxy contests have reemerged as an important tool for acquiring control."); Gordon, *supra* note 12, at 522–23; Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 858 (1993) ("Hostile bidders who proceed despite the[] heightened [legal and financial] barriers will likely have to couple proxy contests with tender offers. . . ."); Thomas, *supra* note 13, at 509, 524 ("[T]he target company board can force dissidents to rely completely on the pure proxy contest as a

alone do not allow going over directors' heads to remove inefficient management, a proxy fight would do.[39] Again, *if* a deal escalates to the level of a proxy fight to redeem a pill, the vote to replace directors becomes a de facto prerequisite for the deal to go through.[40] It is no coincidence that most of the action moved to the

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means of pressuring the incumbent board to negotiate a transaction or to push through a change of control."). *But see* Gilson, *supra* note 3, at 500–01 (criticizing the choice by Delaware judges to prefer elections over market dynamics); Gilson & Schwartz, *supra* note 10, at 788 ("[A]n outcome as significant as privileging elections over markets should at least come with an explanation. Providing a reason for an outcome at least imposes the discipline of logic on the range of alternatives available to the court.").

39. It is important to qualify the acquisition pattern I have described so far, that is, hostile deals that can (only) be completed by launching (and, if the incumbent board does not capitulate earlier, winning) a proxy fight. In practical terms, such a pattern cannot be pursued by a hostile bidder when certain factors are at work that constrain its ability to vote the target board out: as I explained elsewhere, shareholders may lack the power to determine the outcome of a takeover bid because of corporate law rules, principles, and/or practices acting as barriers to the power to oust the board (think of staggered boards, limits to director removability, shareholders' inability to call special meetings or to act by written consent, supermajority rules, proxy, and, what is the topic of this article, conflict of interest regimes). Gatti, *supra* note 14, at 109–21. Of all the above factors, the presence of an effective staggered board can be easily considered the most potent and the one that has gotten the most attention by commentators. When a target has a staggered board in place, because only one-third of its members are up for election every year, it takes two board elections, and, hence, at least twelve full months to gain a majority of directors. See Bebchuk, Coates & Subramanian, *supra* note 15, at 890, who first highlighted the powerful effect of combining poison pills with staggered boards. At the first election, bidders would effectively give target shareholders a put option exercisable a year later: if between the two elections the stock has gone down, the bidder will have to close an acquisition where it is likely overpaying (the stock has gone down while the bidder cannot run the company because it only controls one third of the board); if, however, the target stock has gone up, shareholders (M&A arbitrageurs) would likely not vote for the bidder nominees unless the bidder increases the initial offer.

40. In his discussion on this topic, Lucian Bebchuck states:

> Because directors usually can maintain a pill as long as they are in office, a hostile takeover would require that the bidder first replace the directors through a ballot box victory with directors that would redeem the pill. The voting, again, would not be formally on the offer but rather on the election of directors. But the vote would be practically a referendum on the

ballot box: Delaware case law on the legitimacy of takeover defenses has evolved, reflecting a tension between the idea that hostile bidders should be able, at least in theory, to resort to the weapon of the proxy fight[41] and the fact that "[m]anagers and their lawyers have sought . . . to neutralize the power of the shareholder vote."[42] In doing that, the Delaware judiciary has unsurprisingly been more responsive to management worries than bidders' aspirations:[43] today, a takeover defense would pass the *Unocal* standard so long as the target's response does not make "a bidder's ability to wage a successful proxy contest and gain control [of the board] . . . 'realistically unattainable[,]'"[44] which is arguably a pretty low bar.

> offer; the voting on directors would decide the fate of the offer, would be understood as such, and would be determined by shareholders' judgments concerning the offer.

Bebchuk, *supra* note 32, at 985.

41. See Gilson & Schwartz, *supra* note 10, at 787–88, for a critique ("Without confronting the issue directly, the Delaware Supreme Court appears to have assumed that the availability of a proxy fight renders the poison pill non-preclusive, thereby shifting attention to the circumstances under which the proxy fight could be conducted.").

42. Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 493 (1994); *see also* Gordon, *supra* note 12, at 531 ("[R]elying solely on shareholder suffrage gives the board incentives to take various measures to evade elections."); Thomas, *supra* note 13, at 505.

43. See Steven M. Davidoff, *A Case Study*: Air Products v. Airgas *and the Value of Strategic Judicial Decision-Making*, 2012 COLUM. BUS. L. REV. 502, 505–07 (2012), for an account of interest group pressures faced by Delaware judges in the takeover field.

44. Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 601 (Del. 2010) (citing Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1195 (Del. Ch. 1998)); *see also* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 113 (Del. Ch. 2011) (following the *Versata* instructions). In *Versata*, the Delaware Supreme Court confirmed how courts should interpret the *Unocal* proportionality requirement. *Versata*, 5 A.3d at 605. Such requirement had been initially clarified, in terms of preclusiveness, by *Unitrin*. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995). Under *Unitrin*, in order to fail the second prong under *Unocal*, that is, the proportionality test, the board's actions must be "draconian, by being either preclusive or coercive[,]" and, "[i]f the . . . response [is] not draconian, the Court must then determine whether it [falls] 'within a range of reasonable responses to the threat' posed." *Airgas*, 16 A.3d at 92–93 (quoting *Unitrin*, 651 A.2d at 1367). The *Versata* Court explained that there is no impermissible preclusion if a successful proxy fight is still realistically attainable. *Versata*, 5

B. The Rationales for Voting in Acquisitions

All in all, shareholders of Delaware companies often get to vote in the context of corporate acquisitions: as some commentators put it, "shareholder voting's most important contribution in the corporate governance area is in the takeover arena."[45] This is in countertrend with the otherwise scarce instances of matters on which they generally vote under the DGCL.[46] The reasons behind the right to vote vary depending on whether the transaction is sell-side (where they generally have such a right)[47] or buy-side (where they rarely get it)[48] and, of course, depending on the actual structure of the transaction (merger, asset sale or tender offer).

From an historical and structural perspective, shareholder voting in mergers derives from the old rules channeling the principle of "inviolability of contract[,]" which required a unanimous approval to alter the initial terms of the investment made by the shareholders.[49] Over the 1800s, unanimity went out of favor because it promoted strategic hold-outs at the expense of consolidations that were considered necessary for technological innovation:[50] it first turned into supermajority and subsequently into ma-

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A.3d at 604. It was the *Unitrin* decision itself that first introduced the concept that takeover defenses are legitimate so long as the bidder's chances to win an election to replace the board are not "mathematically impossible or realistically unattainable." *Unitrin,* 651 A.2d at 1388–89.

45. Edelman & Thomas, *supra* note 37, at 460 (citing FRANK H EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 70 (1991)).

46. *See generally* Thompson & Edelman, *supra* note 29, at 130 ("Voting plays a limited role in corporate decisionmaking, much more limited than in the public sphere. Shareholders have binding votes on only two things: the election of directors and ratifying fundamental corporate changes such as mergers."). *See also* Oesterle & Palmiter, *supra* note 42, at 501 ("[S]hareholder suffrage in American public corporations is limited and largely perfunctory.").

47. *See supra* note 28.

48. *See supra* note 29.

49. William Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 79–92 (describing the evolution of rules governing fundamental changes and noting that the more liberal approach towards asset sales was progressively extended to consolidations).

50. *Id.* at 79 (citing, in particular, technological change to develop the long-line railroad).

jority of the shares outstanding.[51] Note, however, that one cannot read too much into the decisional powers by shareholders in a merger for the simple fact that the entire process depends for the largest part on directors' initiative.[52] In fact, the whole gatekeeper power rests on the board: "[i]f [the board] does not wish for a merger to happen, it is not obligated to put the matter before the shareholders, hardly an indication of shareholder primacy."[53] In any event, as Black and Kraakman point out, the "law supports bilateral decision-making by shareholders and the board on decisions that are fundamental to the corporation's identity and existence, especially decisions that place managers and directors in a final period problem, where agency costs are likely to be high."[54]

Voting in tender offers, when it happens, simply flows from the governance structure of a corporation in which shareholders have extremely limited decisional power, which nonetheless includes the right to remove and elect directors[55]—a power that

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51. As stated by Gilson and Black:

> Prior to the 1960s, the great majority of states required a two-thirds vote. This pattern was broken in 1962 when the Model Business Corporation Act reduced the required percentage approval to a majority. . . . Delaware reduc[ed] the vote requirement in its statute from two-thirds to a majority in 1967.

GILSON & BLACK, *supra* note 33, at 642–43 (footnotes omitted). *See* Carney, *supra* note 49, at 95. The ease for approving mergers was counterbalanced with the added protection of appraisal rights. *Id.* at 70–71, 94–95. *See also* Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 3–4 (1995).

52. Thompson & Edelman, *supra* note 29, at 139.

53. *Id.*

54. Black & Kraakman, *supra* note 6, at 559 (noting that "[a] mandatory shareholder vote on mergers and sales of all or substantially all assets, and the appraisal remedy for mergers, belie the assumption that the law should always presume that the board knows best."); *see* WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 462 (2012) (mentioning special agency problems when incumbents potentially face a final period).

55. Delaware law requires a shareholder vote only for certain types of acquisitions, namely mergers (subject to some exceptions), *see* DEL. CODE ANN. tit. 8, § 215(c) (West 2010), and sales of all or substantially all of the assets, *see* DEL. CODE ANN. tit. 8, § 271 (West 2010). As mentioned earlier, a shareholder vote *can* be triggered in the tender offer context, but not as an automatic requirement; rather it would naturally flow from basic corporate law rules on di-

Delaware judges exalted to show the non-definitive nature of takeover defenses and ultimately justify them.[56] So, when we answer the question as to why the lawmaker conferred voting power to shareholders in the context of acquisitions, we have all but a unitary explanation.

Still, if we look at shareholder voting in the context of acquisitions from a functional perspective, we observe something different and quite interesting. When shareholders vote in an acquisition, especially when they vote from a sell-side standpoint, the aggregation of their preferences works, either de jure[57] or de facto,[58] as a requisite approval for the transaction to go through. Such an approval is value-based: each shareholder has to determine whether he or she would be better off with or without the transaction. To that end, they compare the per-share consideration under the transaction with their own reservation price based on what they think the long-term value of the target will be if the transaction does not get approved.[59]

In the context of hostile deals, some scholars believe that shareholder voting is an effective way to solve the so-called pressure-to-tender problem affecting tender offers: the concern that shareholders might decide whether to tender their shares not on the basis of the merits of the offer but rather because they want to

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rector removability and election, *see* DEL. CODE ANN. tit. 8, §§ 141(k), 211(b), 216, which, to be sure, are subject to a whole host of bells and whistles, depending whether directors may be removed without cause, an effective staggered board is in place, shareholders can call special meetings or act by written consent, and so forth. *See* Gatti, *supra* note 14, at 109–21. Bear in mind that the inverse can also be true: there are tender offers that do not entail any vote, yet they share the same functional result of the transactions that do entail one. Just like many other major business and financial decisions, tender offers can happen without getting any shareholders' approval.

56. *See supra* notes 37–40 and accompanying text.

57. That is the case for mergers and asset sales. *See supra* notes 28 and 30 and accompanying text.

58. In hostile deals, sometimes winning the proxy fight to replace the board and redeem the poison pill is the only strategy a bidder can pursue. *See supra* notes 38–44 and accompanying text.

59. *See, e.g.*, Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1700–01 (1985) [hereinafter Bebchuk, *Undistorted Choice*]; Barry & Hatfield, *supra* note 33, at 661–62.

avoid failing to tender to an offer that is ultimately successful, in which case they would get stuck with minority shares that would trade at a much lower price.[60] By way of voting, the argument goes, shareholders are able to decide cohesively, as if they were a "sole owner."[61] The decision reached by shareholders is considered the best tool to obtain a statistical approximation[62] of what a

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60. Lucian Bebchuk is the most prominent advocate of shareholder voting in connection with tender offers. *See* Lucian Arye Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL STUD. 197, 198 (1988) [hereinafter Bebchuk, *Sole Owner*]; Bebchuk, *Undistorted Choice*, *supra* note 59, at 1747–54.

61. Lucian Arye Bebchuk, *A Model of the Outcome of Takeover Bids* 16, 22 (Harvard Law Sch., John M. Olin Ctr. Law, Econ. & Bus., Discussion Paper No. 11, 1985) (on file with author); *see also* Zohar Goshen, *Voting (Insincerely) in Corporate Law*, 2 THEORETICAL INQUIRIES IN L. 815, 835 (2001) [hereinafter Goshen, *Voting (Insincerely)*] ("These restrictions [including shareholder voting] allow security holders to arrive at the group preference by forcing people who wish to transact with the group to acquire its consent.").

62. *See* Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 399 (2003) [hereinafter Goshen, *Controlling Corporate Self-Dealing*]. On majority voting as the best approximation to determine a group preference, with particular regards to corporate law, Goshen states that "[t]he voting mechanism is based on the assumption that the majority opinion expresses the 'group preference,' that is, the optimal choice for the group as a whole. *Id.* Goshen also states:

> Voting is most commonly accepted as the best method for extracting the group preference from among the disparate and diverging subjective opinions of the group of security holders. The majority view of the security holders reflects the optimal choice for the group as a whole, providing the best approximation of the choice that would be implemented if a single individual, rather than a group, were making the decision. The presumed correlation between the group preference and the majority view rests on a statistical proposition: assuming each security holder is more likely to be correct than mistaken, the choice made by the largest number of voters will most probably be the "correct" one. Hence, it is certainly in the minority's interest, *ex ante*, that the majority view prevail.

Goshen, *Voting (Insincerely)*, *supra* note 61, at 817–18 (citations omitted); *see also* GILSON & BLACK, *supra* note 33, at 643 ("[T]he majority requirement . . . [is] based on the simple assumption that if more shareholders favor a transaction than oppose it, the gains to those favoring it will exceed the losses to those opposing it and, therefore, the transaction will result in a net gain."). Clearly, majority voting in the corporate context has a pretty different meaning than the sole owner would have done in a two-person, buyer and seller negotiation.[63] In the absence of a vote, shareholders would fail to coordinate and might likely decide to tender because of pressure to do so. Since shareholders are able to tender their shares even if they voted against the bid, through a vote they can express their genuine opinion of the bid based on how they view the offer price versus the expected value of the target if it were to stay independent. Notably, the U.S. Supreme Court endorsed this rationale in the *CTS Corp. v. Dynamics Corp. of America* decision when it upheld the constitutionality of the Indiana anti-takeover statute, a control share acquisition statute.[64]

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numerical majority we are accustomed to in regular political elections. Here, "majority" means majority of shares cast in favor or against a given resolution: as each share generally carries one vote, larger shareholdings can carry more votes than shareholders that only won a few shares. But the validity of a majority proposition is assured by the fact that those who own more shares are deemed to have better incentives to make the right decision since they can reap the benefits (or alternatively bear the bad consequences) of their choice. *See* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 408–09 (1983); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 612–13 (2006).

63. *See* Lucian Arye Bebchuk, *Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 915–17 (1987) (discussing the actions of a sole owner in the sale of his or her assets and why the shareholder vote is the best mechanism to ensure undistorted choice and efficient allocation of assets in a tender offer); Goshen, *Controlling Corporate Self-Dealing*, *supra* note 62, at 399–400.

64. The United States Supreme Court in *CTS Corp. v. Dynamics Corp. of America* stated:

> The Indiana Act operates on the assumption, implicit in the Williams Act, that independent shareholders faced with tender offers often are at a disadvantage. By allowing such shareholders to vote as a group, the Act protects them from the coercive aspects of some tender offers. If, for example, shareholders believe that a successful tender offer will be followed by a purchase of nontendering shares at a depressed price, individual shareholders may tender their shares—even if they doubt the tender offer is in the corporation's best interest—to protect themselves from being forced to sell their shares at a depressed price. As the SEC explains: "The alternative of not accepting the tender offer is virtual assurance that, if the offer is successful, the shares will have to be sold in the lower priced, second step." Two-Tier Tender Offer Pricing and Non-

A system of shareholder referendums for takeovers is not without its critics, who come from opposite sides of the takeover debate. On the one hand, takeover champions like Gilson and Schwartz believe that tender offers combined with director elections (i.e., the byproduct of *Unocal*, *Unitrin*, and their progeny) perform worse than pure buyer/seller market transactions like stand-alone tender offers. One reason is because tender offers are cheaper to run and quicker, while "target managers have an incentive and the opportunity to pervert an election process."[65] Similarly, Gordon questions the overall logic of giving directors ample powers to say no to a deal in the aim of helping shareholders not make valuation mistakes[66] but then offer shareholders the ballot box route: "[i]f shareholders are prone to mistakes in evaluating a hostile bid, why are they suddenly wiser in deciding how to vote in the related proxy battle presenting the same issue?"[67] On the other hand, management advocates and takeover critics like Stephen Bainbridge and Martin Lipton believe that shareholders' final say on a takeover is a dangerous policy because, among other things, it would foster short termism and give arbitrageurs pivoting power

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> Tender Offer Purchase Programs, SEC Exchange Act Rel. No. 21079 (June 21, 1984), [1984 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 83,637, p. 86,916 (footnote omitted) . . . . *See* Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 307–309 (1983). In such a situation under the Indiana Act, the shareholders as a group, acting in the corporation's best interest, could reject the offer, although individual shareholders might be inclined to accept it. The desire of the Indiana Legislature to protect shareholders of Indiana corporations from this type of coercive offer does not conflict with the Williams Act. Rather, it furthers the federal policy of investor protection.

CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 82–83 (1987).

65. Gilson & Schwartz, *supra* note 10, at 791 (conceding that the issue is ultimately an empirical matter, yet in their theoretical model "transfer by vote appears . . . to be a less efficient mode than transfer by sale.").

66. This, in short, is the concern the court in *Unitrin* raised to justify the use of defensive measures. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1385 (Del. 1995) (discussing how substantive coercion, that is, the showing that shareholders could accept an inadequate offer because of "ignorance or mistaken belief[,]" is sufficient for directors to show the existence of a threat under *Unocal*).

67. Gordon, *supra* note 12, at 530.

over acquisitions.[68] For purposes of this article, there is no need to take a position on this issue: I treat shareholder voting in hostile deals as a given.

In sum, albeit shareholder voting generally has a limited role in corporate governance, its gating importance in acquisitions cannot be understated. Put simply, without a shareholder vote, mergers and sales of all the assets cannot happen.[69] Even hostile takeovers require a vote, whether actual or operating in the shadow—that is, simply feared by the target because it is either threatened or launched and withdrawn following a target's decision to capitulate.[70]

C. *"Sincerity" as a Basic Element of Majority Voting*

Whether or not the right policy choice,[71] shareholders are entrusted with the power to determine the fate of an M&A deal, either by statute or the way the law of the market for corporate control has evolved.[72] To support shareholder choice, both state and federal law provide safeguards and protections of a various nature. These include mandatory disclosure, procedural rules for the meeting (including the applicable quorum and approval requirements),[73] as well as subjecting directors to extensive fiduciary

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68. Short-term oriented investing as represented by event-driven, merger arbitrageurs is central to understanding pro-target advocates' support for anti-takeover measures like poison pills, staggered boards, and delayed shareholder elections. Since the inception of the 1980s takeover boom, Martin Lipton, the most prominent voice in management advocacy, has been citing investors' short-termism as a primary justification for empowering directors with veto power in the context of hostile acquisitions. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW 101, 104–05 (1979) (insulating boards of directors from shareholder pressure best serves the long-term interests of the corporation and its long-term shareholders); *see also* Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1744–51 (2006).

69. Unless it is a short-form merger or a tender offer combined with a merger under Section 251(h) of the DGCL. *See supra* notes 28 and 30 and accompanying text.

70. *See* Gatti, *supra* note 14, at 85 n.26.; *infra* note 242 and accompanying text (providing accounts where proxy fights operated "in the shadows").

71. *See supra* notes 65 and 68 and accompanying text.

72. *See supra* Section II.A.

73. *Cf.* DEL. CODE ANN. tit. 8, § 141(k) (West 2016) (detailing procedures for removing directors or an entire board); DEL. CODE ANN. tit. 8, § 251(c)

duties in order to bolster the disclosure apparatus and the effectiveness of the franchise.

My focus is to establish whether in the context of M&A deals the majority rule is effective in aggregating shareholders preferences: in particular, I analyze whether the majority vote should be sincere, that is, not tainted by conflicts of interests by some shareholders. Sincerity is indeed considered a precondition for the efficiency of a majority vote, [74] and efficiency is a proxy

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(West 2016) (laying out the notice requirements as well as the procedure for signing a merger agreement); DEL. CODE ANN. tit. 8, § 271(a) (West 2010) (noting that stockholders or members with the right to vote must approve a sale, lease, or exchange of assets at a meeting); DEL. CODE ANN. tit. 8, § 211(b) (West 2009); DEL. CODE ANN. tit. 8, § 216(3) (West 2007) (noting that directors must be elected by a plurality of those present at a board meeting); *see also* Janet Fischer & Mary Alcock, *Voting at Annual Meetings*, *in* CLEARLY GOTTLIEB MERGERS & ACQUISITIONS REPORT CORPORATE GOVERNANCE REPORT 14, 16–17 (June/September 2007), http://web.archive.org/web/20151203063914/http:/www.cgsh.com/files/Publication/589d153f-cf1b-4ee0-ba93-d653470caa99/Presentation/PublicationAttachment/052f619c-f3dc-4af3-b36e-d7423556e6e0/CG%20M%26A%20and%20Corporate%20Governance%20Report.pdf (discussing "whether the quorum requirement is met and whether the proposal received enough 'for' votes to pass"); Richard W. Barrett, Note, *Elephant in the Boardroom?: Counting the Vote in Corporate Elections*, 44 VAL. U. L. REV. 125, 158–64 (2009) (for the account that understanding vote tabulating rules can be tricky and ministerial mistakes are not that rare).

74. Several works by Zohar Goshen study the interplay between majority voting and conflicts of interests under U.S. corporate law:

> [I]f the shareholders of a target company have a common interest—increasing share value—but differ on the question of whether or not they will benefit from a proposed reorganization, the proposed solution will allow us to ascertain the group preference. The majority opinion will be the best measure because majority choice is the most efficient alternative. On the other hand, the proposed solution will not be appropriate in cases where the parties have conflicting interests and differ not only regarding their judgment about the preferred alternative but also regarding the desired result . . . . When such a conflict of interest exists between voters, the majority's opinion is not necessarily the most efficient choice for the group.

Zohar Goshen, *Controlling Strategic Voting: Property Rule or Liability Rule?*, 70 S. CAL. L. REV. 741, 797 (1997) [hereinafter Goshen, *Controlling Strategic Voting*]; *see also* Goshen, *Controlling Corporate Self-Dealing*, *supra* note 62, at 399–400; Goshen, *Voting (Insincerely), supra* note 61, at 815. *Cf.* Iman Anabthat corporate scholars, by looking at any marginal improvement of aggregate shareholder wealth, have used to assess a voting system's effectiveness.[75] My work looks into whether shareholder voting in M&A deals can be considered to effectively and efficiently aggregate shareholder preferences. Does the system care if the vote is sincere? By sincerity, I mean that the vote be cast by an interested shareholder with the purpose of satisfying his or her own private preference[76] against the common preference of fostering

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tawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 575 (2006) ("Shareholders with private interests . . . might prefer the firm to pursue those interests at the expense of the interests they have in common with other shareholders."); Michael C. Schouten, *The Mechanisms of Voting Efficiency*, 2010 COLUM. BUS. L. REV. 763, 773, 802–03 ("When shareholders have heterogeneous preferences and some vote with a view to maximizing their private interests rather than their pro-rata share of the firm's future cash flows, the probability that a majority of the shares is voted for the correct option decreases dramatically.") (discussing conflicted insincere voting); Thompson & Edelman, *supra* note 29, at 174 (relying on votes to determine the decision of the group requires that voters' interest be aligned with the collective interest).

75. *See, e.g.*, Bebchuk, *Sole Owner*, *supra* note 60, at 203; Goshen, *Voting (Insincerely)*, *supra* note 61, at 816–17; Schouten, *supra* note 74, at 774–75. Although I am well aware that, as a principle to guide director actions, shareholder wealth maximization is far from being a settled concept, see *infra* Section III.C.2.b, using it for purposes of testing the effectiveness of a voting system is the correct methodological approach. When the corporate law system entrusts the very group of shareholder-principals with the power to make certain decisions and essentially allows the aggregated preferences of the majority to bind the dissenters and select the course of action for the corporation and/or the outcome of the deal (as in the case of a joint takeover and proxy fight), it only appears normal to expect (i) shareholders to pursue an improvement in their wealth and (ii) that the underlying voting procedure to serve as instrument for such quest and to thus reflect adequately and with fidelity such aggregated preferences. Now, few can dispute that shareholders invest in corporations to make money and increase their wealth, hence the choice to use shareholder value as a metric—what can be and is disputed with respect to shareholder preferences is that they may very well not be homogeneous because of diverse attitudes towards risk, liquidity constraints, investment strategy, investment horizon, and so forth. But as a starting point, it is safe and useful to establish that certain procedural preconditions need to be in place to ensure that through the vote shareholders can improve their wealth.

76. *See* GILSON & BLACK, *supra* note 33, at 649 ("[T]he term 'interested' is a shorthand for the fact that the shareholder is disproportionately affected by the proposed action."); *see also* Anabtawi, *supra* note 74, at 564 n.9 ("By 'pri-

the corporation's interests;[77] this is something that makes economic sense for the given shareholder whenever the private benefit is greater than the pro-rata loss *qua* shareholder.[78] Imagine, for instance, a given transaction with a negative net effect for a corporation (say a sale of assets at less than fair market value), in which the potential pro-rata loss that a shareholder might suffer is offset by the gain such shareholder would otherwise make because of her conflicting interest in the transaction (assume she is the acquirer of the asset at the below market price) and the vote cast by such shareholder is *pivotal* to approve the transaction.[79]

Delaware case law has shown sensitivity over the issue of misalignments of shareholder interests in general: not long ago, in 2010, quoting Professors Thompson and Edelman, in a vote-buying case the Delaware Supreme Court cautioned that a disconnect between voting rights and the economic interests of shares "'compromises the ability of voting to perform its assigned role'" as "a decisionmaking system that relies on votes to determine the decision of the group necessarily requires that *the voters' interest be aligned with the collective interest*."[80] However, as the subsec-

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vate' interests, I mean those interests of a shareholder that are not shared by shareholders generally.").

77. *See* Goshen, *Voting (Insincerely)*, *supra* note 61, at 815. Goshen believes that "the proper functioning of the voting mechanism is often endangered due to *insincere voting*" and that "[t]he mechanism cannot operate properly unless every security holder votes sincerely, that is, in accordance with his or her personal belief regarding the value of the transaction to the corporation as a whole." *Id.* Note that, in Goshen's view, insincere voting means two things: strategic voting and conflict of interest voting. The former occurs "[w]henever voters take into account how other members of the group will vote," while the latter, the topic of this article, is when shareholders "vote according to their assessment of the transaction's value to them personally outside of the group." *Id*. at 818. *See also* Goshen, *Controlling Corporate Self-Dealing*, *supra* note 62, at 400; Schouten, *supra* note 74, at 802.

78. *See* Anabtawi, *supra* note 74, at 575.

79. If it is not pivotal, the lack of sincerity would not alter the outcome and would thus be irrelevant. With respect to vote-buying, see Crown Emak Partners, LLC v. Kurz, 992 A.2d 377, 387 (2010) ("[V]ote buying merits judicial review if it is disenfranchising, *i.e.*, if it actually affects the outcome of the vote.") (citation omitted).

80. *Id*. at 388 (quoting Thompson & Edelman, *supra* note 29, at 153, 174) (emphasis added); *see* Goshen, *Voting (Insincerely)*, *supra* note 61, at 818 ("[C]onflict of interests voting undermines the voting system's ability to ascer-

tions that immediately follow can tell, while M&A law has addressed the issue in certain situations such as freeze-out transactions, it has been silent on others such as proxy fights in connection with tender offers.

1. Sincerity of Shareholder Votes in Freeze-Out Transactions

Lack of sincerity due to a shareholder conflict can therefore trigger deviations from what would have otherwise been the optimal outcome of the vote for the corporation. The most discernible scenario is of course a parent/subsidiary freeze-out merger, in which the parent company, with sufficient votes to approve the merger at the shareholder meeting of the subsidiary, has a clear interest in saving costs in the buy-out transaction and not paying a sizeable price to shareholders.[81] The fact that a parent has enough votes to push the transaction arguably makes the voting exercise potentially futile; that is why the law does not seek to simply curb the conflicted vote but goes on to expand the breadth of fiduciary duties both directors of the subsidiary and the controlling shareholder are subject to. Indeed, under Delaware law this situation triggers an enhanced level of scrutiny of the underlying transaction, which goes under the name of entire fairness and requires the defendant directors and controlling shareholder to show both "fair dealing" and "fair price."[82] Subsequent case law clarified that the

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tain the group preference by shifting the focus away from the transaction's value to the group as a whole towards the voters' personal stakes in the deal.").

81. *See generally* Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 8–9 (2005) (noting that the levels of freeze-outs activity increased in the 1960s and 1970s when stock markets were not performing well and controlling shareholders took advantage of fire-sale prices for the subsidiary stock). S*ee also* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 796 (2003) (A "method by which a controlling shareholder can extract private benefits of control is through freezing out minority shareholders at a market price that reflects a discount equivalent to the private benefits of control available from operating the controlled corporation.").

82. In *Weinberger v. UOP, Inc.*, the Delaware Supreme Court stated:

> [Fair dealing] embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. . . . [Fair price] relates to the economic and financial considerations of the proposed merger,

burden of proving that the transaction meets such criteria, which the entire fairness standard initially puts on the defendants because of the conflicted nature of the transaction, can be shifted back to the plaintiff if certain procedural safeguards are followed: namely, that the transaction is either negotiated by an independent committee with broad negotiating powers (inclusive of the power to appoint separate counsel and financial advisor, as well as to say no to the transaction)[83] or that the transaction is approved by the majority of the minority of the subsidiary shareholders.[84]

Note again that the entire fairness scrutiny does not necessarily entail a limitation on the parent's voting rights at the shareholders' meeting of the subsidiary: *Rosenblatt* specified that approval by a majority of the minority is not "a legal prerequisite"[85]

> including all relevant factors . . . . However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.

Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (footnotes omitted.).

83. The independent committee was actually a suggestion by the *Weinberger* court:

> Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length. Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued. Particularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.

Id. at 709 n.7 (citations omitted).

84. *Compare* Kahn v. Lynch Commc'ns Sys., 638 A.2d 1110, 1117 (Del. 1994) (clarifying that an effective independent committee would only shift the burden of proof, which in the specific case did not happen because the independent committee faced a retributive threat by parent—to launch a tender offer at a lower price if the committee kept rejecting it terms—, thus impairing its judgment and negotiating abilities), *with* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) ("[A]pproval of a merger . . . by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").

85. *Rosenblatt*, 493 A.2d at 937.

and so parent companies can get away with not subjecting the deal to a majority of the minority provision if they entrusted a well-functioning independent committee with broad negotiating powers.[86] Also, even if a voting limitation is put in place on a voluntary basis by way of subjecting the deal to a majority-of-the-minority condition, under some circumstances such a safeguard might not be enough to escape liability in the presence of procedural or disclosure flaws:[87] all the minority vote does is shift the burden of proof, but entire fairness remains the standard, [88] unless the transaction meets the recent and more onerous procedural requirements of the *MFW* safe harbor (in a nutshell, approval of the transaction by *both* an independent committee of directors and a majority of the minority of shareholders), in which case the transaction will be subject to simple business judgment review.[89]

All in all, the conflict in a parent/subsidiary freeze-merger is a well-known and amply explored issue in case law and legal literature—while this article does not purport to investigate it further, I note that, first, the law acknowledges the issue by regulating the transaction through, among other things, limiting the voting

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86. *See* Subramanian, *supra* note 81, at 16 (showing evidence that transactions planners prefer independent committees to majority-of-the-minority approvals).

87. This is what happened in *Weinberger* when the Court held that the minority vote was insufficient because "[m]aterial information, necessary to acquaint those shareholders with the bargaining positions of Signal and UOP, was withheld under circumstances amounting to a breach of fiduciary duty." *Weinberger*, 457 A.2d, at 703–08 (using proprietary information of the subsidiary, two of its directors—who were also directors of the parent—conducted a study to determine the fair price to offer in acquiring the remaining stock, but they only shared the results with inside directors, and shareholders were never informed).

88. *See supra* note 84.

89. Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645–55 (Del. 2014) (explaining that the business judgment standard of review applies if the controlling stockholder subjects the merger to the necessary approval of: (i) a special committee of independent directors with separate financial and legal advisors, fully empowered to reject the transaction and negotiating a fair price with due care and (ii) a majority of the unaffiliated stockholders, fully informed and not coerced).

rights of the controlling shareholder and, second, one of the devices the law uses is the majority-of-the-minority condition.[90]

2. Sincerity of Shareholder Votes in Deals for Contestable Companies

A less obvious, yet equally critical scenario occurs in connection with transactions for companies with control contestable in the market, especially in hostile deals. As mentioned earlier, if a bidder cannot come to terms with target management over an acquisition proposal, the only way to override anti-takeover devices is to mount a proxy fight and repeal them.[91] In other words, buyers in pure hostile deals (that is, deals that start and finish with the two sides antagonizing) must make use of a shareholder vote to replace directors, with the vote being a de facto prerequisite for the deal success.[92]

Now, similar to the parent in a freeze-out transaction, the bidder does sit opposite to the target shareholders and thus is in *potential* conflict with them. Still, it is not expected that a bidder will refrain from voting in the proxy fight since replacing the board of directors is ultimately the last resort a bidder has in order to succeed in a hostile deal.[93] And of course that is not the only conflict

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90. Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1232 (2008) ("Delaware case law, while not requiring shareholder approval of self-dealing transactions . . . provides a variety of inducements for it."). See Goshen, *Controlling Corporate Self-Dealing*, *supra* note 62, at 402, for a discussion on the majority-of-the-minority vote as a device to solve self-dealing problems.

91. *See supra* note 34 and accompanying text.

92. As noted *infra* note 242 and accompanying text, I reckon that not *all* hostile deals end up in an actual vote because many times the target or, as the case may be, the bidder will capitulate before even continuing with the vote: that happens whenever management or bidder believe they have little chance to prevail.

93. That bidders may and actually have to vote to win a proxy fight to redeem a pill is considered as a given in the literature, and it clearly happens in practice. For example:

> For a dissident shareholder group to win a proxy contest for corporate control, the shareholder group must either purchase enough voting shares to vote itself into office, or persuade enough other shareholders to vote for the dissident slate so that it obtains a majority of the votes cast in the election.

that might alter the voting outcome: because of the desire to maintain their respective roles, the votes cast by directors and management of the target, together with persons affiliated with them, are also *potentially* in conflict with the interests of the other shareholders.[94]

To be sure, as I explain further in Part IV,[95] shareholders' conflicts of interest are circumstantial: the mere possibility of a conflict (that is, the simple, positional conflict of bidders sitting on the other side of the transaction or the desire to stay in power for target directors and managers) is not per se sufficient to taint the

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Thomas, *supra* note 13, at 512.

94. With particular regard to director elections in the context of an acquisition, see Gilson & Schwartz*, supra* note 10, at 792, for an argument that "a minority composed of target management and its associates may have sufficient intensity of preference to defeat an efficient takeover because the manager group will have a large, private stake in the outcome." *See also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (mentioning "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ."). The literature on directors' conflicts in tender offers is vast, to say the least. *See, e.g.*, ROBERT C. CLARK, CORPORATE LAW 588 (1986) ("*[I]n no other context is the conflict of interest as serious as in the takeover situation*.") (emphasis in original); Allen, Jacobs & Strine, *supra* note 38, at 862 ("[T]he directors have no direct pecuniary interest in the transaction but have an 'entrenchment' interest, i.e., an interest in protecting their existing control of the corporation."); Black & Kraakman, *supra* note 6, at 557–58 ("If the possibility that a controlling shareholder might cash out minority shareholders without sharing hidden value with them disqualifies the hidden value model in change-of-control transactions, why does the risk that a target's board will be either disloyal or simply wrong in its claim of hidden value not have the same effect?"). Additionally, it is argued that:

> The lower stock price . . . is not . . . a moderate deterrent to board misbehavior in control contests. To entrenched managers, it is better to have a job with a capital-poor company than no job at all. The proxy fight changes their calculus, forcing managers to factor in the prospect of unemployment, even if they can mount successful tender offer defenses. Courts crafted the standards for tender offer defenses assuming the backstop of a proxy contest. To now absorb the proxy contest defenses into the forgiving judicial regime for tender offer defenses is conceptually and practically mistaken."

Oesterle & Palmiter, *supra* note 42, at 580.

95. For particular examples, see *infra* Sections IV.B.1, IV.B.2, and IV.B.4.a.

vote. It is in fact pursuing a personal interest and voting in the given resolution against the interests of the other shareholders that amounts to a pathology; determining what the interests of the other shareholders are depends on facts and circumstances arising from the actual offer on the table. In other words, assuming conflicts need to be analyzed under a shareholder wealth maximization norm,[96] if the offer is value maximizing, directors and managers voting against it (that is, voting to maintain the board and leave the pill in place) will be in conflict, but the bidder voting in favor will not. Conversely, if the offer is not value maximizing, the bidder voting in favor (that is, voting to replace the board and redeem the pill) will be in conflict, while directors and managers voting against will not. Interestingly, outside of Delaware, jurisdictions that have adopted a control share acquisition statute, and have therefore made hostile deals subject to a shareholder referendum,[97] have actually acknowledged and addressed the issue of conflicted voting through specific rules, which I come back to in Part III.[98]

All such potential conflicts are not peculiar to hostile acquisitions but appear in all similar "final period" situations. They can in fact be exacerbated in negotiated deals whereby acquirer and target management—in its aim to be "employed" by the former as future controlling shareholder or to otherwise get other favors[99]—might collude by agreeing to a subpar premium for the shareholders and have the merger approved thanks to their con-

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96. *See supra* Section II.C and *infra* Section III.C.2.b.

97. *See supra* note 32 and accompanying text.

98. *See infra* notes 111–115 and accompanying text.

99. The Chancery Court in *Paramount Communications, Inc. v. Time, Inc.* noted:

> There may be at work [in a friendly deal] a force more subtle than a desire to maintain a title or office in order to assure continued salary or prerequisites. Many people commit a huge portion of their lives to a single large-scale business organization. They derive their identity in part from that organization and feel that they contribute to the identity of the firm. The mission of the firm is not seen by those involved with it as wholly economic, nor the continued existence of its distinctive identity as a matter of indifference.

Paramount Commc'ns, Inc. v. Time, Inc., Nos. 10866, 10670, 10935, 1989 WL 79880, at *7 (Del. Ch. July 14,1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

flicted votes.[100] While in a hostile deal the position of target management and bidder is adversarial (and therefore, depending on whether the bid on the table is value maximizing or not, only one of the two sides can be in actual conflict with its fellow shareholders),[101] in a friendly deal, whenever the merger consideration is not value maximizing, *both* target management and the acquirer will be conflicted.[102] Moreover, in a friendly deal, if the merger requires a shareholders vote at the acquiring company as well,[103] conflicts of interests may also influence that vote.[104] In Part III, I

100. For an account of the many conflicts that may arise in friendly deals, see John C. Coates, IV, *Mergers, Acquisitions and Restructuring: Types, Regulation, and Patterns of Practice* 11 (European Corp. Governance Inst., Law Working Paper No. 260/2014), http://ssrn.com/abstract_id=2463251 (mentioning, among other things, that "[f]iduciaries may favor one bidder over another, not in return for an explicit quid pro quo (e.g., in the form of a payment) but to curry good will in the hope of obtaining post-deal employment, or perhaps out of malice towards a bidder or gratitude for some past favor."). Coates adds that "[f]iduciaries may seek to sell their company 'too early' or 'too cheaply' to trigger 'golden parachutes' or vesting under option plans or retirement plans, or in return for benefits from the buyer." *Id.*; *see also* STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 58–59 (3d ed. 2012):

> Although the tension between shareholders and managers is perhaps most obvious in hostile takeovers, . . . similar conflicts of interest arise in negotiated acquisitions . . . . To purchase the board's cooperation the bidder may offer side payments to management, such as an equity stake in the surviving entity, employment or non-competition contracts, substantial severance payments, continuation of existing fringe benefits or other compensation arrangements. Although it is undoubtedly rare for side payments to be so large as to materially affect the price the bidder would otherwise be able to pay target shareholders, side payments may affect management's decision making by causing them to agree to an acquisition price lower than that which could be obtained from hard bargaining or open bidding.

Id. (footnotes omitted).

101. See *supra* note 95 and accompanying text.

102. For a discussion of how conflicts are ultimately circumstantial, see *infra* Section IV.A.2.

103. *See supra* note 29.

104. A case in point is the failed acquisition of King Pharmaceuticals by Mylan Pharmaceuticals, which was subject to shareholder approval of both companies. Ianthe Jeanne Dugan, *Hedge Funds Draw Scrutiny Over Merger Play*, WALL ST. J. (Jan. 11, 2006), http://www.wsj.com/articles/

SB113695140652343511. With its sizeable premium, the transaction would have benefited the hedge fund Perry Corp., owner of about 4.3 million King shares. *Id.* However, the market view of the deal was that Mylan was overpaying and vocal investors like Carl Icahn campaigned against the deal to hinder Mylan shareholder approval. *Id.* To ensure that the deal would not fall through, Perry accumulated 9.9% of Mylan shares to vote in favor of the merger. *Id.* But it did so, via a hedging transaction: while buying all the stock, a brokerage firm working for Perry was shorting the same amount of stock and Perry had a right to sell its shares back to the brokerage firm, which in turn had a right to call the stock back to Perry thus generating a wash (the end result of this strategy is what Hu and Black call "empty voting," that is, holding greater voting power than the underlying economic ownership). *Id.*; Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 626 (2008) [hereinafter Hu & Black, *Equity and Debt Decoupling*]. So the practical effect of this transaction was for Perry to obtain voting rights at Mylan, without bearing any economic interest or risk associated with a decrease in the price of such shares. *See* Dugan, *supra*. The ensuing lawsuit to challenge Perry's voting strategy was eventually dropped after the Mylan/King merger agreement was terminated—however, the SEC subsequently sanctioned Perry for failure to make disclosures under Section 13(d) of the Exchange Act and Rule 13d-1 thereunder. *In the Matter of Perry Corp. Respondent*, Exchange Act Release No. 60351 (July 21, 2009).

Another case to consider in this regard is the merger between Hewlett-Packard and Compaq, which was approved by the Hewlett-Packard shareholders with a mere 51.4% of the votes and with allegations of vote-buying by Hewlett-Packard: four days before the Hewlett-Packard shareholder meeting, Deutsche Bank submitted its proxy, voting its shares against the merger. Kahan & Rock, *supra* note 90, at 1229. On that same date, Hewlett-Packard closed a credit facility to which Deutsche Bank was added as a co-arranger. *Id.* Allegedly, on the morning of the shareholder meeting, at the demand of Hewlett-Packard management, a telephone conference was held between Deutsche Bank and Hewlett-Packard, after which the bank changed most of its votes in support of the proposed merger. In the ensuing litigation, during the motion to dismiss phase, the court emphasized that it will maintain its focus on the "possible deleterious effects of a challenged vote-buying agreement on shareholders[,]" especially whether a vote-buying agreement was "sufficient to change the result of a vote," and shareholders were "defrauded or disenfranchised." Hewlett v. Hewlett–Packard Co., No. CIV.A. 19513–NC, 2002 WL 549137, at *5 (Del. Ch. Apr. 8, 2002). The case was eventually dismissed on the merits for the plaintiff's failure to prove that management improperly enticed or coerced Deutsche Bank into voting in its favor. Hewlett v. Hewlett-Packard Co., No. CIV.A. 19513–NC, 2002 WL 818091 (Del. Ch. Apr. 30, 2002).

briefly mention some recent developments in Delaware case law that have in fact addressed conflicted voting in friendly deals.[105]

Given the importance of voting sincerity, which is regarded as a prerequisite to the effectiveness and efficiency of shareholder voting overall, leaving the issue unaddressed can, in the long run, generate market failures in how corporate control ultimately gets allocated in all those instances in which the acquisition outcome is decided through a shareholder vote that is tainted by a conflict.[106] Additionally, if shareholders' conflicts having a determinant impact on the outcome of a vote were left undetected, using shareholder approval as a proxy to reflect what is best for the company (irrespective of whether we want to frame the issue in profitability, efficiency, fairness, or any other terms) would simply cease to work because a tainted vote cannot clearly operate as a device to reflect an aggregation of preferences.[107] True, as Part III will show, in parent/subsidiary mergers, conflicts are well recognized and receive a detailed and multifaceted legal treatment. However, Part III will also indicate how shareholder conflicts in deals concerning companies with control contestable in the market have in fact largely lacked attention from policymakers and legal commentators.

III. POLICING SHAREHOLDER CONFLICTS IN ACQUISITIONS: THE LAW OF THE LAND, IF ANY

A. Introduction

Part III focuses on the tools available to the interpreter to tackle conflicted voting in acquisitions. While the main focus of this article lies in how conflicted votes can affect proxy fights in connection with hostile acquisitions, this Part also broadens the

105. *See infra* notes 122 –124 and accompanying text.

106. On the importance that corporate control is allocated efficiently, see, for example, Bebchuk, *Sole Owner*, *supra* note 60, at 198, noting that "secur[ing] the efficient outcome of acquisition attempts . . . would provide appropriate incentives to investment in . . . companies."

107. For the long-term effects of conflicted voting on shareholder value, see Anabtawi, *supra* note 74, at 575, noting a "diminution in shareholder value that results whenever the rent seeker succeeds in persuading the firm's managers to make a decision that is privately beneficial to the rent seeker but detrimental to the common interests of shareholders."

spectrum to assess, on the one hand, instances of shareholder conflicts in connection with acquisitions that are not necessarily hostile and, on the other hand, situations in which the judiciary has intervened (or calls for a judicial intervention or statutory reform have been made) to address situations tainted by a shareholder conflict, such as vote buying and empty voting. Section B shows how, in Delaware, no specific regime for hostile deals exists but mentions specific "disinterested shares" regimes in some related fields, especially in the context of control share acquisition statutes in other states. Section C tackles the main question starting with the few indications we can grasp from existing scholarship (C.1) and then tentatively surveys all the complex interpretative questions a judge would likely face (C.2).

A preliminary qualification is in order. This article does not purport to identify the correct interpretative solution to existing law in Delaware: the many variables and contours that can emerge in a specific case would make such a task very hard, possibly naïve, and ultimately not useful given the wide discretion entrusted in equity courts like the Delaware Chancery Court and the Delaware Supreme Court.[108] However, this article will still seek to shed light on certain critical areas of the positive law of corporate voting not only to help facilitate any future interpretational effort but also to elucidate the possible policy approaches a system can adopt.

B. Lack of a Specific Regime (But Some Regimes in Related Areas Deal with the Issue Somehow)

The DGCL does not address the issue of shareholder conflicts in general terms: similar to the rest of corporate law codes in America, there is no regime to sanction conflicted voting in shareholder resolutions.[109] Also, with the exception of a portion of its

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108. *See generally* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?,* 44 UCLA L. REV. 1009, 1016–17, 1101–02 (1997) (analyzing the inner mechanics of how Delaware cases are adjudicated). Rock states that "the process that leads to reasonably precise standards proceeds through the elaboration of the concepts of independence, good faith, and due care through richly detailed narratives of good and bad behavior, of positive and negative examples, that are not reducible to rules or algorithms." *Id.* at 1017.

109. Some jurisdictions around the world actually do provide for regimes to generally address conflicted voting: for example, the Italian corporate law system provides that any resolution adopted with the pivotal vote of a share-

business combination statute,[110] Delaware statutory law does not provide for any ad hoc regime for conflicted voting in acquisitions. This does not mean that domestic corporate laws completely refrain from dealing with the issue.

On the one hand, specific regimes for certain type of acquisitions do tackle conflicted voting. As far as hostile deals are concerned, all states that have adopted control share acquisition statutes ("CSAS"), which essentially require unsolicited acquirers of significant stakes to obtain a prior authorization before crossing certain ownership thresholds, contemplate bright-line rules restricting voting by certain shareholders. Such authorizations must be passed by a majority (sometimes a supermajority) of disinterested shareholders.[111] In the absence of such authorization, shareholders crossing the applicable threshold cannot generally exercise the voting rights attached to their shares exceeding the applicable threshold.[112] All existing CSAS disqualify the acquirer from voting in such referendums.[113] Almost all the statutes also disqualify officers and employees,[114] and a few disqualify directors who are nei-

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holder carrying an interest (on his or her behalf, or as instructed by a third party) in conflict with the corporation's interest can be annulled if the resolution may potentially damage the corporation. *See* CODE CIVIL [C.c.] [CIVIL CODE], art. 2373 (It.).

110. Compare section 203(a) of the DGCL, which prohibits a public company from entering into certain business combinations with a stockholder owning 15% or more of the corporation's voting stock (or with any of its affiliates or associates) for a three-year period following the crossing of the 15% threshold, unless, among other exceptions, the business combination is "approved by the board of directors and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock *which is not owned by the interested stockholder*." DEL. CODE ANN. tit. 8, § 203(a) (2007) (emphasis added).

111. For references to statutory provisions, see *infra* Chart, Appendix I.

112. Each state has its own peculiar remedies regime. *See infra* Appendix I. For instance, while Hawaii denies the voting rights of an acquirer for one year should the acquisition not be approved by a majority of disinterested shares, other states disallow an acquirer to vote in shareholder matters if the acquirer has more than 20 percent of the voting rights. *Id.* Wisconsin restricts the voting power of an acquirer which holds over 20 percent of the voting power to one-tenth of the acquirer's shares. *Id.*

113. *See infra* Appendix I.

114. The only jurisdictions that have adopted a CSAS not limiting votes by officers and employees are Hawaii, Nebraska, and Pennsylvania. HAW. REV.

ther officers nor employees.[115] I will refer to these bright-line rules as "disinterested shares" regimes.

Similarly, as noted earlier,[116] analogous disqualifying provisions are present in the context of freeze-out mergers, whereby subjecting on a voluntary basis the shareholder vote to a majority-of-the-minority condition would either: (i) generally switch the burden of proof on the entire fairness of the transaction back to the plaintiff;[117] or (ii) together with the additional safeguard of the approval by a fully empowered independent committee, switch the standard of review to the much more lenient business judgment review as laid out by the Delaware Supreme Court in the recent *MFW* case.[118]

On the other hand, under Delaware case law there can be restrictions for votes cast as a result of a vote-buying transaction; a relatively recent Delaware Supreme Court decision actually puts conflict of interests at the center of the analysis on the validity of vote-buying: while generally not illegal, vote-buying is not permitted when the economic interests and the voting interests of the shares do not remain aligned.[119] In that decision, the Delaware

STAT. § 414E-2 (2008); NEB. REV. STAT. § 21-2441 (2012); 15 PA. STAT. AND CONS. STAT. ANN. § 2562 (West 2012).

115. *See* ARIZ. REV. STAT. ANN. § 10-2725(B) (2013); IDAHO CODE § 30-1601(11) (2013); NEV. REV. STAT. ANN. § 78.3787 (LexisNexis 2010).

116. *See supra* Section II.C.1.

117. *See supra* notes 82–88 and accompanying text.

118. *See supra* note 89.

119. Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 387–90 (Del. 2010). Vote-buying at one time was per se illegal. Joe Pavelich, Note, *The Shareholder Judgment Rule: Delaware's Permissive Response to Corporate Vote-Buying*, 31 IOWA J. CORP. L. 247, 248 (2005). Many courts adopted the principle that reciprocal obligations among shareholders required each to use their independent judgment in determining how to vote their shares: as a consequence, it was held that the receipt by a shareholder of some personal consideration in return for the exercise of his or her powers as a shareholder operated as a fraud on other shareholders or otherwise violated public policy. *See id.* at 251−55 In 1982, the Delaware Chancery Court altered this line of thought in *Schreiber v. Carney* by generally permitting vote-buying, subject to certain exceptions on a case-by-case basis: the court determined that vote-buying agreements are to be invalidated on an individual basis if the purpose of the act is to defraud or disenfranchise other stockholders or if the agreement is against public policy. 447 A.2d 17, 25 (Del. Ch. 1982); Pavelich, *supra* note 119, at 251. This approach did not dissipate the debate on vote-buying, specifically on how vote-

Supreme Court echoed the concerns of then Vice–Chancellor Steele that "a shareholder who divorces property interest from voting interest[ ] fails to serve the 'community of interest' among all shareholders, since the 'bought' shareholder votes may not reflect rational, economic self-interest arguably common to all shareholders."[120] In the closely related field of empty voting (that is, holding greater voting power than the underlying economic ownership), some of the literature has suggested that certain vote decoupling transactions be scrutinized through the misalignment lens and screened out if the underlying motives of the empty voter are in conflict with the interests of the other shareholders.[121]

Moreover, a recent line of cases in M&A litigation originated by the Delaware Supreme Court decision in *Corwin v. KKR Financial Holdings LLC*[122] has established that under Delaware

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buying might potentially disenfranchise shareholders. *See* Thompson & Edelman, *supra* note 29, at 153 (noting that a disconnect between voting rights and the economic interests of shares "compromises the ability of voting to perform its assigned role"). In *Crown EMAK Partners*, while on the one hand the Delaware Supreme Court conceded that vote-buying needs close judicial scrutiny when the votes bought will swing the vote in the buyer's favor, potentially disenfranchising other shareholders, on the other hand, it held that there was no improper vote-buying in the specific case because the economic interest and the voting interest remained aligned (more precisely, no improper vote buying was found in obtaining votes from another shareholder to remove certain directors, because even though the acquiring shareholder did not obtain title to the shares, both the voting and economic interests were transferred from one shareholder to another under a purchase agreement). *Crown EMAK Partners*, 992 A.2d at 390.

120. *Crown Emak Partners*, 992 A.2d at 388 (quoting IXC Commc'ns, Inc. S'holders Litig. v. Cincinnati Bell, No. C.A. 17324, 1999 WL 1009174, at *8 (Del. Ch. Oct. 27, 1999)).

121. For more detail, see *infra* note 155 and accompanying text.

122. 125 A.3d 304 (Del. 2015). In Chief Justice Strine's words:

> When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them.

Id. at 313. Subsequent pronouncements by Delaware courts have expanded the boundaries of the *Corwin* decision. *Compare* Singh v. Attenborough, 137 A.3d 151 (Del. 2016) (finding when the business judgment rule applies, the only instance in which directors might be liable for damages is under the waste doctrine), *with In re* Volcano Corp. S'holder Litig., 143 A.3d 727, 747 (Del. Ch.

law the fully informed, uncoerced vote of a majority of the *disinterested* stockholders of a corporation approving an M&A transaction that is not subject to entire fairness restores the presumption of the business judgment rule in lieu of any other enhanced type of scrutiny.[123] While the absence of a conflict of interest in the majority approving the transaction is a necessary element in order to qualify for an easy dismissal of the litigation under the benevolent business judgment rule, none of the decisions rendered by the Delaware judiciary thus far has analyzed how a scrutiny over whether shareholders are conflicted or not will work in practice;[124] in particular, it is not clear whether plaintiffs can actually prove that certain shareholders (say directors, managers, or the acquirer) voting in favor in the specific resolution are in fact conflicted and as a result their vote must be disregarded.

All in all, conflicted voting does receive *some* legal treatment for *some* types of acquisitions: it is disregarded under unsolicited deals in jurisdictions adopting a CSAS, and it is discouraged in both freeze-out transactions and, more recently, in friendly deals in which directors seek an early dismissal of litigation under the business judgment rule. In addition, Delaware law distinguishes vote-buying cases on the basis of conflict of interests: so long as there is such a conflict in the specific case, the vote-buying transaction is illegal and sanctioned, otherwise vote-buying is generally permissible.

However, for a large chunk of M&A transactions, conflicted voting receives no statutory treatment; absent a vote-buying arrangement or the aim to qualify for the *Corwin* safe harbor to

2016) (extending the ruling of *Corwin* to two-step mergers under Section 251(h) of the DGCL: the acceptance of a first-step tender offer by a majority fully informed, disinterested, uncoerced shareholders has the same cleansing effect of a fully informed, uncoerced vote by disinterested shareholders in connection with a merger). Note that the emphasis on the absence of conflicts by the voting majority for the resolution to be effective is not a novelty. *See* Lewis v. Vogelstein, 699 A.2d 327, 335 (Del. Ch. 1997) (discussing ratification law in the context of director conflict transactions and mentioning that ratification may at times be "ineffectual . . . because a majority of those affirming the transaction had a conflicting interest with respect to it").

123. *Corwin v. KKR*, 125 A.3d at 308–11.

124. The presence of a conflict of interest of shareholders was not in dispute under any of the cases mentioned, see *supra* note 122.

have a deal scrutinized under the more lenient business judgment rule, there should be little expectation that the vote will be second guessed. Hence, there is a risk that deals can get approved or rejected not because the underlying decision is in the best interests of the corporation, but because of the votes cast by shareholders whose interest are in conflict with the corporation's. Traditionally, two main categories of transactions come to mind: (i) friendly deals for companies whose control is contestable in the market (which to be sure are now subject to the tenets of *Corwin* and its progeny); and (ii) hostile deals in which the target board refuses to redeem a poison pill and that escalate to a proxy fight to replace the sitting board and redeem the pill.[125]

This article mainly deals with the latter category. The reason for paying greater attention to hostile deals is that their analysis reveals more. Not only do bidders sit opposite to target shareholders at the acquisition table, but in hostile deals, bidders are also in an adversarial position with target management: hostile deals structurally come with two different layers of conflicts and thus provide a unique viewpoint to understand how shareholder conflicts inherently work (and, as I investigate in Part IV, how they can be impacted by bright-line rules, such as disinterested shares regimes, and by no-conflict standards). In the end, much of the analysis will nevertheless be useful to show how conflicts can appear in any type of deal, including negotiated ones where conflicts can in fact be exacerbated by the collusion of target management with its (presumably) new future boss, that is, the bidder.[126]

C. Elements for a Positive Law Analysis

The positive law question is pretty straightforward: absent vote-buying, in which a conflict is admittedly problematic, are shareholders completely free to cast their votes in M&A transactions even when they pursue interests that are not aligned with those of the corporation and of their fellow shareholders? In other words, can they vote given the risk that their "votes may not reflect rational, economic self-interest arguably common to all sharehold-

125. *See supra* Section II.A.2.
126. *See supra* notes 99–104 and accompanying text.

ers?"[127] The answer is not straightforward. The core tension is between the principle that shareholders can vote in whichever way they like (*especially* in the context of director elections)[128] and the idea that sincerity is a prerequisite for majority voting to work: if an electoral outcome is tainted by a pivotal vote of a shareholder pursuing his or her conflicting interest, shareholder voting would not reflect a genuine aggregation of preferences and the underlying result would lead to an inefficient outcome.

1. No Case Law, Very Little Scholarship

Not only is case law lacking, meaning no contested election that I am aware of resulted in a losing party legally challenging on grounds of an alleged conflict of interests the legitimacy of the votes cast by the winning proxy contender (whether insurgent or incumbent), but the issue has also drawn very little interest from scholars, none of whom, as far as I know, have expressly dealt with shareholder conflicts in the context of proxy fights to replace a target board and redeem a pill.

Further, the legal literature on shareholders conflicts in M&A deals is pretty limited. Among the few exceptions, there is a contribution by Lucian Bebchuk some thirty years ago: in advocating a policy to promote undistorted choice in corporate takeovers pursuant to which shareholders would hold a separate referendum on whether the offer should succeed,[129] Bebchuk warned that,

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127. Crown Emak Partners LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010); *In re* IXC Commc'ns, Inc. S'holders Litig. v. Cincinnati Bell, No. C.A. 17324, 1999 WL 1009174, at *8 (Del. Ch. Oct. 27, 1999); *cf. supra* notes 119 and 120 and accompanying text.

128. *See, e.g.*, BAINBRIDGE, *supra* note 100, at 118 ("As a general matter, it remains the law that shareholders qua shareholders are allowed to act selfishly in deciding how to vote their shares."); Roberta S. Karmel, *Should a Duty to the Corporation Be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 13 (2004) ("[S]hareholders do not represent anyone but themselves and do not have any duties to either the corporation or other shareholders.").

129. Bebchuk proposed a referendum system whereby each shareholder would be allowed to tender either approvingly or disapprovingly; in case the latter tenders were more than the former, the acquisition would not be approved and would not take place. This way, pressure to tender would not play a role in takeovers because shareholders would not have to think in second-best terms

for such a referendum to truly reflect the aggregate of each shareholder's preference on the bid, only disinterested votes should be counted, i.e., votes that are cast "solely by the effect that a takeover would have on the value of his shareholdings."[130] In fact, he acknowledges that some shareholders, including of course the bidder, can become interested whenever their preference is shaped by considerations other than the price on the table—the bidder's interest, for instance, would of course not be paying too much, which in some instances can lead to a subpar acquisition getting approved.[131]

More recently, Zohar Goshen addressed in general terms the issue of conflicted voting by shareholders, noting that while "the voting system is an acceptable mechanism for determining the group preference, it only functions as an indicator of transaction efficiency when every individual in the group 'votes sincerely.'"[132] Because it "distorts the voting mechanism by shifting the focus away from what is best for the group as a whole to what is best for each individual member[,]" conflicted voting "undermines the voting mechanism's ability to determine the group preference."[133] However, Goshen mostly focused on typical conflict situations, such as freeze-out mergers, dual-class recapitalizations, and interested directors.[134] He touched upon takeovers rather briefly without clarifying if his attention was on shareholder or director voting, but just admonished the complexity of a policy that would have to deal with a positional[135] conflict of interest where "it is hard to

when considering whether or not to tender. Bebchuk, *Undistorted Choice*, *supra* note 59, at 1754–57.

130. *Id.* at 1760.

131. *Id.* at 1761 (characterizing target managers as a group of inevitably interested shareholders who, in order to maintain their private benefits of control in place, would resist acquisitions even when they are in the best interests of the other shareholders).

132. Goshen, *Voting (Insincerely)*, *supra* note 61, at 818.

133. *Id.* at 828.

134. *Id.* at 828–30.

135. A positional conflict of interest occurs "when a director acts to preserve her own position in the company, while her self-serving action could be construed as promoting a different legitimate motive." *Id.* at 830.

ascertain which motive is the true one standing behind the action."[136]

Note incidentally that in the Seventh Circuit decision that ruled on the unconstitutionality of the Indiana control share acquisition statute,[137] a decision subsequently reversed by the U.S. Supreme Court in the famous *CTS* case,[138] Judge Posner criticized the disinterested shares referendum mechanism contemplated by the Indiana legislature,[139] although it is not clear on the face of his dicta whether it was the "disinterested shares" portion of the regime that Posner disliked or the referendum itself.

Aside from these contributions, there is nothing of particular relevance in the American literature. Even the formal literature on tender offers combined with a proxy fight, which includes economic models that aim at anticipating shareholders' strategies and pay-offs in such deals, does not address the possibility that some of the actors might be conflicted: those models stipulate that management and dissidents always cast their votes freely.[140]

To be sure, the situation does not improve significantly if one looks at shareholder conflicts that do not necessarily involve M&A cases.[141] Aside from considering those conflicts when ana-

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136. *Id.* ("[W]hen resisting a takeover, directors could be guarding their own positions or protecting the corporation against exploitation or looting.").

137. IND. CODE §§ 23-1-42-1 to 23-1-42-11 (1986).

138. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

139. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 262–63 (7th Cir. 1986) ("[T]he Indiana statute . . . puts the acquirer at the tenderer mercies of the 'disinterested' shareholders . . . . The Indiana statute is a lethal dose. . . .").

140. *See, e.g.*, Barry & Hatfield, *supra* note 33, at 646–55; Edelman & Thomas, *supra* note 37, at 465, 474; Lucian Bebchuk & Oliver Hart, *Takeover Bids vs. Proxy Fights in Contests for Corporate Control* 22–26 (European Corp. Governance Inst., Working Paper No. 04/2002, 2001), http://ssrn.com/abstract=290584. *But see* Gilson & Schwartz*, supra* note 10, at 792–99.

141. In fact, this should not surprise much if one considers the very few instances in which shareholders are called to vote under Delaware law. *See, e.g.*, D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 128, 186–88 (2011) (noting that under the current system, shareholders participate only on the margins and recommending changes to broaden shareholders' ability to participate in monitoring the corporation); Robert B. Thompson, *Defining the Shareholder's Role, Defining A Role for State Law: Folk at 40*, 33 DEL. J. CORP. L. 771, 778 (2008) ("Delaware's statute mandates that shareholders vote on only two sub-

lyzing such issues as cleansing statutes for interested directors,[142] vote-buying,[143] and, more recently, empty voting,[144] the academic literature has remained silent on the very issue.

2. Some Key Questions

All in all, without any specifics from a case, it is extremely difficult to predict in a vacuum how a Delaware court would approach the issue, that is, under what circumstances an acquirer or, as the case may be, target management and directors can be considered conflicted and should be restricted from, or somehow limited in, voting their shares in a proxy fight in connection with a hostile deal. As mentioned earlier, the issue is essentially unexplored. Therefore, rather than seeking to predict an interpretative outcome, I address some of the core questions and conceptual hurdles a judge would likely have to face under current law.

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jects: election of directors and fundamental corporate changes such as mergers.") (footnotes omitted); Paul H. Edelman, Randall S. Thomas, & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1365–69 (2014) (noting that under current law shareholders play a subordinate governance role and state corporate law reflects this by limiting the areas shareholders can vote to electing directors, sometimes amending the bylaws, and approving certain fundamental changes, but only after directors have consented to the action.); *cf.* Edelman & Thomas, *supra* note 37, at 458 (noting that, before the surge in hostile deals in the 1980s and with the exception of the wave of proxy fights in the 1950s and 1960s, "[h]istorically, shareholder voting rarely attracted much attention.").

142. *See generally* FRANKLIN A. GEVURTZ, CORPORATION LAW 361–66 (2000) (discussing whether Delaware requires that shareholders approving a transaction whereby one or more directors have a conflicting interest be disinterested or not); *see also* Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 910–14 (2011) (describing different ways by which interested transactions could survive a legal challenge as well as the procedure and scrutiny applicable to such transactions); Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part II)*, 42 VILL. L. REV. 1043, 1098–1106 (1997) (detailing the level of judicial scrutiny given to interested transactions and how the burden on interested directors can be reduced or shifted to the party challenging he transaction).

143. *See supra* notes 119 and 120 and accompanying text.

144. *See infra* note 155 and accompanying text.

a. On What Basis Could Judges Limit the Freedom to Cast Votes?

Absent any express statutory provisions, on what grounds could Delaware judges intervene, either at a preliminary injunction phase or subsequently, to prevent or invalidate resolutions passed because of votes cast by shareholders that are in conflict? Delaware judges are not a priori reluctant to intervene on a voting outcome if not doing so would lead to an inequitable setting for the franchise: an indication in this direction can be drawn by judicial decisions on situations where the shareholder franchise is endangered, including vote-buying cases.[145] Judges have done so since the foundational *Schnell v. Chris-Craft*[146] to the more recent *Hewlett-Packard*[147] via *Blasius*,[148] which still is the leading case

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145. *See supra* notes 119 and 120 and accompanying text.

146. Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971) (invalidating a director action, on its face permitted by the DGCL, which anticipated the date of the annual meeting and moved its location in order to dampen turnout and fend-off an insurgent campaign). The Delaware Supreme Court stressed that "inequitable action does not become permissible simply because it is legally possible." *Id.* at 439. Effectively, *Schnell* treated tampering with the voting process by incumbents as inequitable and presumably a violation of fiduciary duties. *See generally* Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable To Take That Action: The Implicit Corollary to the Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877, 881 (2005) (noting that "the Delaware Supreme Court emphatically rejected the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders"). However, the Delaware judiciary has, over the years, interpreted the boundaries of the *Schnell* heightened review quite narrowly. For a critical analysis, see Oesterle & Palmiter, *supra* note 42, at 494–95.

147. Hewlett v. Hewlett-Packard Co., No. CIV.A. 19513–NC, 2002 WL 549137 (Del. Ch. Apr. 8, 2002). The Delaware Chancery Court stated:

> Shareholders are free to do whatever they want with their votes, including selling them to the highest bidder. Management, on the other hand, may not use corporate assets to buy votes in a hotly contested proxy contest about an extraordinary transaction that would significantly transform the corporation, unless it can be demonstrated, as it was in *Schreiber*, that *management's vote-buying activity does not have a deleterious effect on the corporate franchise*.

Id. at *4 (emphasis added) (footnotes omitted).

148. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (stating if the board acts "for the primary purpose of impeding the exercise of

for protecting shareholder voting power in connection with acquisitions.

Now, there is one conceptual issue that judges would need to overcome in legal challenges to director elections that run parallel to a hostile deal: unlike in *Schnell* and in the *Blasius* lines of cases in which judges have resorted to fiduciary duties to sanction any directorial attempt to hamper the franchise,[149] there can be circumstances in which fiduciary duties would probably not seem viable, at least prima facie. Consider cases in which the allegedly conflicted voter is the bidder:[150] by definition, someone who is not (yet) a controlling shareholder, let alone a director or an officer, is, according to the leading view, not subject to fiduciary duties towards other shareholders.[151] In such cases, the judiciary would have to find, within its array of equitable powers, some devices to provide protection to shareholders.

This, however, should not pose an insurmountable task. On the one hand, there are sufficient indications under case law that fiduciary duties are not the only devices a judge can adopt to constrain the actions of corporate players for purposes of shareholder protection. Consider, for instance, that judges have been policing

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stockholder voting power . . . the board bears the heavy burden of demonstrating a compelling justification for such action"). But see Allen, Jacobs & Strine, *supra* note 38, at 884–90 for a reductionist read of *Blasius* on grounds that the *Unocal*/*Unitrin* standards are sufficient to protect the franchise.

149. *Cf.* MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1127 (Del. 2003). *MM Companies* seems to suggest that in the eyes of the court that judicial protection of the franchise only runs one-way, which is to punish attempts perpetrated by management: "This Court and the Court of Chancery have remained assiduous in carefully reviewing any board actions designed to interfere with or impede the effective exercise of corporate democracy by shareholders, especially in an election of directors." *Id.* (footnote omitted).

150. Compare, for example, the hypotheticals laid out in Sections IV.B.1 and IV.B.4.a.

151. *See, e.g.*, Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 507–08 (Del. 2005) (noting that while non-controlling shareholders may vote as they please, controlling shareholders are subjected to fiduciary duties). *But see* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1269–72 (2008) (criticizing conventional shareholder fiduciary duties that are only applied to a shareholder with stable control and proposing an extension to minority shareholders who carry swing votes in specific resolutions).

vote-buying via disenfranchisement and public policy theories, not fiduciary duties.[152] On the other hand, judges have enough equity powers to extend fiduciary duties in certain circumstances.[153] This is something scholars have proposed to address challenges coming from abuses in shareholder activism and empty voting: to contain potential abuses by activist investors, Iman Anabtawi and Lynn Stout have suggested extending fiduciary duties to *any* shareholder whenever he or she can influence the outcome of a particular decision because of a personal conflict of interest;[154] similarly, accord-

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152. *See* Schreiber v. Carney, 447 A.2d 17, 24 (Del. Ch. 1982) ("[V]ote-buying is illegal *per se* if its object or purpose is to defraud or disenfranchise the other stockholders."). Because the agreement in *Schreiber* benefited the public shareholders, the court decided there was no fraud or disenfranchisement. *Id.* at 25–26. *See also* Hewlett v. Hewlett-Packard Co., Civ. A. No. 19513-NC, 2002 WL 818091, at *15 (Del. Ch. Apr. 30, 2002) (failing to find vote buying where management convinced an institutional shareholder to vote for a proposed merger on a promise of future business.); Weinberger v. Bankston, Civ. A. No. 6336, 1987 WL 20182, at *2–4 (Del. Ch. Nov. 19, 1987) (failing to find impermissible vote buying where an out of court settlement to calm an insurgent where the corporation agreed to pay the insurgent's proxy expenses in exchange for the insurgent granting an irrevocable proxy to management because the purpose was to benefit the public shareholders); Kass v. E. Airlines, Inc., Civ. A. Nos. 8700, 8701, 8711, 1986 WL 13008, at *4 (Del. Ch. Nov. 14, 1986) (finding that an agreement to vote was not contrary to public policy where an agreement was made to an entire class and was fully disclosed); *cf.* Flaa v. Montano, Civ. A. No. 9146-VCG, 2014 WL 2212019, at *8–9 (Del. Ch. May 29, 2014) (discussing vote buying but not deciding if the agreement disenfranchised other shareholders, thereby making it impermissible. Instead, the court sidestepped the question and struck down the agreement for failing to make proper disclosure on proxy materials).

153. One might also wonder to what extent the equity powers of the judiciary are (or should be) ultimately constrained by the boundaries of a fiduciary relationship. In other words, why should fiduciary duty theories represent the only options to protect stakeholders? Otherwise, if such theories are all we have to fight corporate abuses, in situations like conflicted voting in acquisitions fiduciary duties would show their inadequacy as a protective device: indeed, it does not take a controlling position (whether de jure or de facto) for a shareholder to harm other shareholders. *See* Anabtawi & Stout, *supra* note151, at 1269–72.

154. *See id.* at 1295–96; *see also* Anabtawi, *supra* note 74, at 593–97; Andrea Zanoni, *Hedge Funds' Empty Voting in Mergers and Acquisitions: A Fiduciary Duties Perspective* 3–4 (2009), http://ssrn.com/abstract=1285589 (arguing that M&A deals approved through empty voting devices should carry

ing to Hu and Black, existing equitable powers entrusted to courts could be used to tackle the most egregious empty voting practices, such as voting with negative economic ownership, that is, when the decoupling of voting and economic rights is done in a way that creates economic incentives for voting against the interests of other shareholders:[155] "even without a legislative amendment, one can imagine courts using their equitable powers to disallow voting by shareholders with negative economic ownership."[156]

All in all, whilst not straightforward conceptually, the scope of equity powers of the Delaware judiciary appears to be wide enough to contain, one way or another, conflicted voting in acquisitions.[157]

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the approval by a majority of disinterested shareholders and be subject to fiduciary duty review).

155. Hu & Black, *Equity and Debt Decoupling*, *supra* note 104, at 703. More specifically, negative economic ownership occurs whenever a shareholder creates a net short position (i) through equity derivatives, (ii) by "soft parking" (where one party holds shares that are fully hedged but agrees to vote those shares according to instructions received from another party with a negative economic interest in the company), or (iii) by acquiring shares before the record date and subsequently selling them after the record date but before the shareholder meeting. *See id.* at 637–38. In all such cases, economic ownership goes in "the opposite direction from the return on shares." *Id.* at 637. To be sure, disallowing votes by empty voters is not the only solution proposed address the issue. Some authors call for an outright ban on the practice. *See* Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 787–804 (2005). Some others call for "enhanced disclosure." *See* Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 819 (2006) [hereinafter Hu & Black, *New Vote Buying*]; Kahan & Rock, *supra* note 90, at 1277–78.

156. Hu & Black, *Equity and Debt Decoupling*, supra note 104, at 703.

157. The formal distinction that the shareholders vote on a director election and not on the outcome of the acquisition should not be overstated. True, one might in theory argue that the conflict really relates to the actual redemption or non-redemption of the pill and not the director election in itself. However, this overly formalistic approach would short-circuit the *Unitrin* line of cases that does not engage in any substantive review of the director refusal to redeem a pill so long as (and precisely because) the ballot box route remains "realistically attainable." Indeed, if judges refuse to look not only at the lack of redemption by the board but also at how the ballot box route works (especially when it is in no position to work properly as a result of a conflict), we would be left with no effective legal safeguards against corporate actors trying to exploit the system. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1381, 1388–89 (Del. 1995)

b. What Are We Talking about When We Talk about Interests?

To understand what one means with expressions such as conflict of interests and misalignment of interests, it is crucial to have a clear sense of what interests are being put at risk by the conflicted shareholder. Generally, Delaware courts refer somewhat loosely to the concept of the "interests of the corporation and its stockholders" as the primary goals directors need to pursue and protect,[158] and mainstream law and economics literature in the cor-

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(holding that the board's refusal to redeem a poison pill is not preclusive under *Unocal* unless a proxy fight is "mathematically impossible or realistically unattainable"); *see also* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 601–04 (Del. 2010) (noting that although a combination of defensive measures makes it more difficult for an acquirer to obtain control of a board, it does not make such measures "realistically unattainable" because there is still the availability of a shareholder vote); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 111–13 (Del. Ch. 2011) (holding that a poison pill with a 15% trigger, a staggered board, continued protection of Delaware's anti-takeover statute, and supermajority merger approval provisions was permitted under *Unocal* because a successful proxy contest was still "realistically attainable").

158. In the seminal case of Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 181–82 (Del. 1986), the Delaware Supreme Court established an enhanced standard of conduct that compels directors to maximize value for the benefit of shareholders in the sale of the company above the protection of interests of other stakeholders, including maintaining the independence of the corporate entity. Specifically, under *Revlon* the role of directors was transformed "from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company." *Id.* at 182. *Revlon* duties are triggered in certain limited circumstances (e.g., if a company is put on sale [either in a stock or in an asset deal] or if a break-up is inevitable). *Id.* In the words of Justice Moore, "[a]lthough such considerations [those of other constituencies] may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders." *Id.* (citation omitted); *cf.* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) ("[The board of directors duty of loyalty] embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage."); *In re* Fort Howard Corp. S'holders Litig., CIV.A. No. 9991, 1988 WL 83147, at *14 (Del. Ch. Aug. 8, 1988) (noting that courts must review the board's adherence to its fiduciary duties with an eye toward promoting shareholder interests, the court then turned to the scope of these duties and stated that

porate field embrace the shareholder primacy norm,[159] even though some scholars disagree.[160] Delaware courts themselves, in the *Unocal* line of hostile takeover cases (but outside of *Revlon*),[161] took the view that directors may pursue interests of corporate constituencies other than shareholders when resisting an unsolicited deal.[162]

"the validity of the agreement itself cannot be made to turn upon how accurately the board did foresee the future").

159. Shareholder primacy dictates that corporate management's decision making should focus on the advancement of shareholder interests, even if those interests are in conflict with the interests of non-shareholder constituencies and represents an idea of corporate governance which allows for significant shareholder influence. D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 282 (1998). *Compare* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1913, 1921 (1996) (arguing that the principal goal of corporations should be to provide governance rules that maximize value for investors), *with* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423–25 (1993) (arguing that corporations should be committed to the shareholder wealth maximization norm).

160. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 253 (1999) (observing that boards should not only serve shareholders but also the enterprise-specific investments such as managers, rank and file employees, creditors, and the local communities); *see also* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 745 (2005) (stating that managers should have some "discretion to temper" their duty to make profits "to comply with social and moral norms").

161. Delaware law mandates that when a sale, break-up, or change of control of the company is imminent, the board of directors has a duty to maximize shareholder value. Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 38–39, 48 (Del. 1994). The Court in *Revlon* states, "concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder." *Revlon*, 506 A.2d at 182

162. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1369 (Del. 1995) (accepting that the effect on constituencies other than shareholders is an acceptable factor in considering defensive measures); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (stating that while reviewing the reasonableness of a target's defensive measures against a hostile bidder, the courts may consider such concerns as the "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)"). *But see* Roberta Romano, *The States as a Laboratory:*

Of course, one thing is what (and whose) corporate interests directors must pursue and protect and another thing is how the common interests of shareholders might limit one or more shareholders' free exercise of the right to vote. The two issues are and must be kept distinct. Because only the second one is relevant for the purposes of this article, and because it is safe to assume that in the context of shareholders resolutions shareholders cannot be expected to pursue interests other than theirs, I will not consider interests of other constituencies.[163]

Legal Innovation and State Competition for Corporate Charters, 23 YALE J. ON REG. 209, 235 (2006) (arguing that other stakeholders' interests can never trump those of the shareholders: "Delaware . . . has rejected the broad discretion accorded directors under other constituency statutes, by requiring any consideration of non-shareholder interests to provide a benefit to the shareholders, and by rejecting the propriety of such considerations in a takeover auction."). *See generally* Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 702 (2004) (discussing constituency statutes and noting that more than half of all states have statutes that permit directors and officers to consider the interests of other constituencies); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26 (1992) (observing that some states have statutes allowing directors of public corporations to consider other interests and constituencies when making decisions.); Barzuza, *supra* note 37, at 1989, stating:

> Thirty-five states have adopted directors' duties statutes, also known as "other constituency" statutes. Typically, these statutes allow directors to take into account the interests of constituencies other than shareholders and/or the long-term value of the firm. Sometimes, in addition, they apply weaker fiduciary duties on managers' use of defensive tactics.

Id.

163. I do not consider the interests of other constituencies: neither for current purposes nor where I address normative aspects of conflicted voting *infra* in Part IV. Note incidentally that it is quite common in the takeover literature to consider only the interests of shareholders. *See, e.g.*, Luca Enriques, Ronald J. Gilson & Alessio M. Pacces, *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, 4 HARV. BUS. L. REV. 85, 91 (2014):

> [T]akeovers are merely one way in which corporations respond to changes in economic conditions . . . . [T]he scope and the features of the safety net protecting individuals and communities against the effects of economic and regulatory change are only relevant to the takeover debate if takeover regulation is the best (or the only) protection tool available.

Now, even if focusing *just* on shareholder interests, the interpreter would still have to deal with complex conceptual issues: Are the interests of the corporation and those of its shareholders distinct or the same?[164] If they are the same, do they coincide with the maximization of shareholder value? But if they are distinct, can *they* be in conflict with each other? How do we interpret when we relate such interests to the interests of the conflicted shareholder? But most importantly, shareholders' interests qua shareholders are not necessarily homogeneous: different investment strategies and different investment horizon can hardly be reconciled into one all-encompassing interest that suits the entirety of the shareholder population.[165] In particular, the takeover arena intensifies the heterogeneity of shareholder interests because of the evident opportunity to cash in the takeover premium, whether or not such a premium truly reflects the potential value of the target. Such a short-term opportunity is the basis for investment strategies carried out by merger arbitrageurs who, after the announcement of a transaction, proceed to buy a huge portion of the shares of the target betting on the fact that the deal will eventually close so they will be able to tender the shares and profit from the difference between the tender offer price and the price they paid on the market right after the deal was announced. In such a scenario, holding out in the hope of capturing an even higher price resulting from the long term value of the target is too volatile and makes no sense for such type of investors.[166] Unsurprisingly, merger arbitrageurs normally constitute a significant chunk of the shareholder base once a transac-

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> Because we have not seen that position carefully presented in the takeover debate, our discussion of takeover regulation in the following does not further consider it.

Id. (footnote omitted.)

164. *Cf.* Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?*, 2015 U. ILL. L. REV. 1069, 1098–99 (2015).

165. *See, e.g.*, Edelman & Thomas, *supra* note 37, at 463 ("Different shareholders may hold different views about . . . how to cast their votes on different issues.").

166. As the Delaware Chancery Court put it in the *Airgas* case, short-term arbitrageurs are "happy to tender their shares at [the offer] price regardless of the potential long-term value of the company." Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 111 (Del. Ch. 2011).

tion is announced[167]—a judge would face the tough job of factoring in the arbitrageurs' interests and reconciling them with the interests of those who pursue a long-term investment proposition.

c. Do Specific Regimes in Similar Areas Have Any Bearing?

Specific regimes to police conflicted voting already exist. On the one hand, in deals subject to entire fairness, majority-of-the-minority clauses can either help defendants shift the burden of proof on entire fairness back to the plaintiff (in the *Weinberger* and *Kahn v. Lynch* line of cases)[168] or make the whole transaction subject to the more lenient business judgment review if other precon-

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167. A notable case can be traced in the *Airgas* transaction. Following the announcement of the takeover by Air Products, arbitrageurs and other event-driven investors started to purchase significant stakes in the target stock that ultimately allowed them to own approximately 46% of the company. *Id.* at 118. Such dramatic change in the shareholder base had an impact in the actions undertaken by management and was an important factor in the ultimate decision:

> Airgas's board members testified that the concepts of coercion, threat, and the decision whether or not to redeem the pill were nonetheless "implicit" in the board's discussions due to their knowledge that a large percentage of Airgas's stock is held by merger arbitrageurs who have short-term interests and would be willing to tender into an inadequate offer.

Id. at 105; *see also* Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 990 (2013) (detailing then-Chancellor Chandler's analysis regarding the role of short-termism and deal arbitrageurs in *Airgas*). Note incidentally that the decision by the Airgas board to resist the Air Products offer (which the Chancery Court permitted) eventually proved to be a correct one from a long-term value perspective, according to Martin Lipton who states:

> [I]n vindication of the Airgas board's judgment and confirmation of the wisdom of the Delaware case law (particularly the Delaware Chancery Court's 2011 *Airgas* opinion validating the use of the poison pill), Airgas agreed to be sold to Air Liquide at a price of $143 per share, in cash, nearly 2.4x Air Products' original $60 offer and more than double the final $70 offer, in each case *before* considering the more than $9 per share of dividends received by Airgas shareholders in the intervening years.

Martin Lipton, *The Long Term Value of the Poison Pill*, HARV. L. SCH. F. ON GOVERNANCE & FIN. REG. (Dec. 18, 2015), https://corpgov.law.harvard.edu/2015/12/18/the-long-term-value-of-the-poison-pill/#more-72224.

168. *See supra* notes 82–88 and accompanying text.

ditions to the *MFW* safe harbor are met.[169] Similarly, an informed, uncoerced vote by *disinterested* shareholders is a precondition to apply the business judgment rule under the *Corwin* line of cases.[170] On the other hand, CSAS have all implemented rules requiring approval from a majority of disinterested shares, excluding from the count the votes of bidders, officers, and employees (and sometimes outside directors).[171] Delaware itself has implemented a "disinterested shares" regime in the context of its business combination statute.[172]

Make no mistake: these regimes are not likely to be applied by mere extension anytime soon. For starters, the most relevant regime for our purposes, disinterested shares in the context of a CSAS, is clearly not applicable in Delaware: it is the law in other states. Moreover, Delaware judges are generally reluctant in M&A cases to extend statutory regimes to promote substance-over-form justice. In fact, in several instances, including cases with plaintiffs challenging transactions on the basis of de facto mergers theories (in the context of asset deals structured as to avoid appraisal rights),[173] cases in which plaintiffs allege de facto liquidation theories (in the context of cash-out mergers whereby preferred stock is retired at a price below the liquidating preference)[174] or de facto amendments to the charter (in the context of mergers denying a class vote to the preferred stockholders),[175]

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169. *See supra* note 84.

170. *See supra* notes 122–25 and accompanying text.

171. *See supra* notes 111–15 and accompanying text.

172. *See supra* note 110; *infra* text accompanying note 197.

173. *See generally* Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963) (noting that although an asset sale has achieved the same result as a merger, the asset sale rules have equal dignity under the DGCL as the merger rules and the former should apply).

174. *See generally* Rothschild Int'l Corp. v. Liggett Grp., Inc., 474 A.2d 133, 1236–37 (Del. 1984) (explaining that the right to be paid the liquidating preference is triggered only in the event specified under the preferred stock terms and a merger does not constitute a liquidation).

175. Warner Commc'ns, Inc. v. Chris-Craft Indus., Inc., 583 A.2d 962, 970 (Del. Ch. 1989) (explaining that because under independent legal significance, "satisfaction of the requirements of Section 251 is all that is required legally to effectuate a merger[,] . . . the language of Section 242(b)(2)" of the DGCL alone, which in the specific case was paralleled by the charter of the corporation, "does not entitle the holders of a class of preferred stock to a class

judges have embraced the exact opposite doctrine of independent legal significance, according to which "action taken under one section of the [DGCL] is legally independent, and its validity is not dependent upon, nor to be tested by the requirements of other unrelated sections under which the same final result might be attained by different means."[176] According to independent legal significance, which a Delaware court once labeled as a "bedrock doctrine" in the state,[177] each statutory acquisition method has equal dignity and a court cannot "gainsay the legislative decisions to provide different acquisition forms carrying different levels of shareholder protection."[178] Similarly, the tortured evolution of freeze-out law also shows that Delaware courts for quite some time had used a formalistic approach that applied different standards of review to going private transactions depending on how a freeze-out is structured: before the *CNX* and *MFW* decisions introduced a unified standard,[179] a negotiated merger between a controlling stockholder and its subsidiary was reviewed for entire fairness,[180] while under *In re Siliconix Inc. Shareholders Litigation*,[181] a parent/subsidiary unilateral tender offer followed by a short-form

vote in a merger, even if . . . the interests of the class will be adversely affected by the merger").

176. Orzeck v. Englehart, 195 A.2d 375, 378 (Del. 1963).

177. *Warner*, 583 A.2d at 970.

178. BAINBRIDGE, *supra* note 100, at 112; *see also* Strine, *supra* note 146, at 879 n.10 ("The courts have long respected th[e] ability to choose among the various methods for accomplishing a business transaction through judicial recognition of the doctrine of independent legal significance."). *But see* D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 WILLAMETTE L. REV. 825 (2004) (criticizing the doctrine).

179. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645–54 (Del. 2014) (explaining that the business judgment standard of review applies if the controlling stockholder subjects the merger to the necessary approval of: (i) a special committee of independent directors with separate financial and legal advisors, fully empowered to reject the transaction and negotiating a fair price with due care and (ii) a majority of the unaffiliated stockholders, fully informed and not coerced); *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 400 (Del. Ch. 2010).

180. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994).

181. *In re* Siliconix Inc. S'holder Litig., No. CIV.A. 18700, 2001 WL 716787 (Del. Ch. June 19, 2001).

merger was reviewed under a standard less demanding than entire fairness.

Still, even without formally applying any disinterested shares or majority of the minority regime by extension, such regimes contain indicators of the perils raised by conflicted voting and offer a judge, especially when using his or her equity powers, some substantive support to justify an intervention on the basis of a conflict. Moreover, aside from such regimes, the principles stemming from the *Corwin* line of cases,[182] from case law on vote buying (most notably, *Crown Emak Partners*),[183] as well as indications from the empty voting literature, could make a judge eager to use some of their implications in a challenge to alleged conflicted votes in the context of a takeover deal. In the context of conflicted voting, this has in fact already occurred for challenges to freeze-out transactions: in the *CNX* case, a pivotal shareholder had stock ownership in both the bidder-parent and the target-subsidiary and Vice-Chancellor Laster, quoting a passage from the vote buying decision *Crown Emak Partners* on the importance of economic incentives when casting votes, questioned the effectiveness of the majority-of-the-minority clause.[184] Similarly, in the context of the

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182. *See supra* notes 122–25 and accompanying text.

183. *Cf. supra* notes 119– 20 and accompanying text.

184. As Vice-Chancellor Laster stated:

> [T]he plaintiffs have raised sufficient questions about the role of T. Rowe Price to undercut the effectiveness of the majority-of-the-minority tender condition. Economic incentives matter, particularly for the effectiveness of a legitimizing mechanism like a majority-of-the-minority tender condition or a stockholder vote. *See Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 388 (Del.2010) ("[W]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization.") (citation and internal quotation omitted). In *Pure Resources*, the holders of shares subject to put agreements were excluded from the majority-of-the-minority calculation because "it is clear that the Put Agreements can create materially different incentives for the holders than if they were simply holders of Pure common stock." 808 A.2d at 426. . . . T. Rowe Price's has materially different incentives than a holder

Zale merger litigation, the Chancery Court discussed, yet based on facts dismissed, whether a shareholder, which stood to earn an additional $3.2 million in prepayment fees on a loan they had previously made to the target Zale, was conflicted in casting its 23.3% stake (amounting to approximately $225 million in value at the merger consideration) in favor of the merger.[185]

IV. ASSESSING POLICY APPROACHES AND THEIR POSSIBLE OBJECTIONS

While Part III suggests that current law is all but easy to grasp, in this Part IV, I analyze some policy initiatives to address conflicted voting. In Section IV.A, I lay out three approaches: a rule-based, a standard-based, and an unengaged approach. In Section IV.B, I compare each such approach by testing it with hypotheticals of acquisition attempts. I then describe the assumptions under which one approach can be expected to fare better than the others (Section IV.B.5). In Section IV.C, I evaluate such assumptions and formulate policy remarks while taking into account some potential objections to reform.

A. Possible Policy Approaches

In this Section IV.A, I analyze three approaches that can be conceived to address conflicted voting in the context of hostile

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> of CNX Gas common stock, thereby calling into question the effectiveness of the majority-of-the-minority condition. . . .
> This case is not about "holdings in competitor corporations" or "directional sector bets." It is about a direct economic conflict that at best renders T. Rowe Price indifferent to the allocation of value between [the parent] CONSOL and [the subsidiary] CNX Gas and at worst gives T. Rowe Price reason to favor CONSOL.

In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 400, 416−17 (Del. Ch. 2010).

185. *In re* Zale Corporation Stockholders Litigation, C.A. No. 9388-VCP, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015). The alleged conflict was based on the fact that the merger triggered the $3.2 million payment, which the Court ultimately did not consider material because it only amounted to less than 1.5% of the payment the shareholder was expecting from its consideration under the merger. *Id.* at *9 (noting that under Delaware law "there are cases in which a plaintiff's allegations of a large stockholder's need for liquidity have been sufficient to defeat a motion to dismiss").

acquisitions: first, a rule-based reform, similar to the disinterested shares regimes applicable in the context of control share acquisition statutes consisting of bright-line rules that, because of the abstract risk of a conflict, *ex ante* specifically disqualify certain shareholders—say the bidder and target directors and management—by requiring that the resolution be approved by a majority of disinterested shares (IV.A.1); second, a standard-based reform that would seek to invalidate *ex post* all votes that are actually cast in conflict and that are pivotal for the outcome of the election—I label this approach the "no-conflict standard" (IV.A.2); [186] third, an unengaged approach, in which the system, expressly or by inertia, whether deliberate or not,[187] does not intervene in any way—I label this as "unengaged approach" (IV.A.3). In Section IV.A.4, I mention briefly how each of these approaches fit, or would fit, within Delaware law.

1. Bright-Line Rules: Approval by a Majority of "Disinterested Shares"

A familiar bright-line rule approach to address shareholder conflicts consists of requiring the relevant resolution to be approved by a majority of disinterested shares. Such a rule would explicitly exclude from the count votes by certain categories of shareholders who are presumptively considered conflicted: the bidder, or directors and managers of the target (hereinafter target incumbents), or both categories.[188] This represents an ex ante ap-

186. Note that these first two approaches are not too different from those suggested by Zohar Goshen in his works on conflicts of interest, see *supra* notes 61 and 74 and accompanying text, which analyze solutions based on the well-known property versus liability distinction. *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). Similar to his methodology is the ex ante versus ex post lens that obviously also comes with a rule versus standard analysis. *See infra* note 189. However, instead of relying on the more remedy-focused property/liability dichotomy, I prefer to frame the policy discussion in terms of trade-offs between certainty and under-inclusiveness, which is typical of a rules/standards comparison.

187. That could occur deliberately or as a consequence of insufficient enforcement of general standards, because the judiciary may be reluctant to second-guess the resolution, especially in less than clear-cut situations.

188. For more detail, see *infra* Section IV.B.1.a.

proach that has the advantage of clarity and thus of limiting litigation costs and uncertainty.[189] However, like any other rule-based approach, it would come with two main problems. First, it would likely be over- or under-inclusive depending on the circumstances:[190] sometimes a shareholder that is not conflicted may be prevented from voting (e.g., a bidder wishing to vote in favor of a value-increasing transaction or target incumbents wishing to vote against a value-decreasing transaction), and, other times, a conflicted shareholder may cast its vote (e.g., any person who is not picked by the rule but is an ally of one of the excluded catego-

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189. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 562–63 (1992) ("Rules are more costly to promulgate than standards because rules involve advance determinations of the law's content, whereas standards are more costly for legal advisors to predict or enforcement authorities to apply because they require later determinations of the law's content."); *see also* Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation,* 104 COLUM. L. REV. 496, 515 (2004) ("[R]ules and procedures are more formalistic, and thus provide more certainty and protection at lower cost, than those that would be applied by generalist courts . . . ."); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1690 (1976) ("[A] regime of general rules should reduce to a minimum the occasions of judicial lawmaking."); Prasad Krishnamurthy, *Rules, Standards, and Complexity in Capital Regulation*, 43 J. LEGAL STUD. S273, S276 (2014) ("The presence of aggregate risks, regulatory uncertainty, and agency costs each imply the superiority of rules over standards . . . ."). For a recent account that uses a rules versus standards taxonomy for framing a general corporate law reform, see Ronald J. Gilson, *A Model Company Act and a Model Company Court* 6-11 (Stan. L. Sch., Working Paper No. 489, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2750256.

190. On over- and under-inclusiveness of rules, see generally Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Rulemaking*, 3 J. LEGAL STUD. 257, 268 (1974); Frederick Schauer*, Rules and the Rule of Law,* 14 HARV. J.L. & PUB. POL'Y 645, 647–51 (1991); *see also* Gilson, *supra* note189, at 7 ("A single rule applying to all companies regardless of industry or circumstances will lack context and flexibility. Nor is there an easy way to make the *ex ante* rule more context-related. Precisely because drafters cannot predict a company's future circumstances, rough categorization . . . is about the best that can be done *ex ante*."). *But see* Kaplow, *supra* note189, at 565 (noting that "the suggestion is misleading because typically it implicitly compares a complex standard and a relatively simple rule, whereas both rules and standards can in fact be quite simple or highly detailed in their operation.").

ries).[191] Second, this rule-based approach would create the potential for circumvention—smart lawyers would quickly grasp the rule and know how to avoid it, which would, of course, exacerbate the risk of under-inclusiveness.[192]

Such rules might also generate disincentives to blockholding: if shares owned by the bidder and/or target directors and management were never to be counted in the outcome of a vote to determine the fate of a heated battle for corporate control, accumulating significant levels of ownership in a target company would matter less than it does currently—at the very least, the contending

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191. To be effective, a rule-based regime has to avoid easy evasion: it must have some ability to capture votes cast by shareholders who are not formally disqualified yet act on behalf of a disqualified one. One well-known way to extend the reach of a prohibition that would otherwise apply solely to one person is to use expansive definitional tools; for example, the group definition under the Williams Act, see Rule 13(d)-3 of the Securities Exchange Act of 1934, § 16(b) (codified at 15 U.S.C. § 78p(b) (2012) [hereinafter the Securities Exchange Act], or the acting in concert concept under the EU Directive on Takeover Bids, see Article 1(d) Directive 2004/25/EC, of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142) 19:

> '[P]ersons acting in concert' shall mean natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid . . . .

Id. For a description of how, in the current market environment, the group definition under the Securities Exchange Act has become incapable of aggregating purchases by hedge funds acting via wolf packs, see John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* 28–39 (Colum. L. and Econ., Working Paper No. 521, 2015), http://ssrn.com/abstract=2656325, which suggests that companies might consider adopting a poison pill that "could broadly define its coverage so as to apply to any persons 'acting in concert' or 'in conscious parallelism' with the leader of the 'wolf pack'"; such a pill would require "defin[ing] 'group' for purpose of the poison pill much more broadly than the case law under the Williams Act." *Id.* at 97.

192. *Cf.* Luca Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?*, 1 EUR. CO. & FIN. L. REV. 440, 445–46, 452 (2004) (noting how, in order to avoid onerous bright-line rules, like the mandatory bid rule in the European Union, corporate lawyers are often prompted to figure out alternative acquisition structures that do not fall squarely under the legal command).

parties would presumably not make extra purchases of stock right before a record date if such stock were not to be counted for voting purposes.[193]

As noted earlier, bright-line rules to contain conflicted voting in connections with acquisitions already exist in the corporate laws of several states.[194] The most salient cases are in the context of CSAS, which require a shareholder vote to authorize a tender offer or an acquirer to cross certain thresholds of stock ownership and therefore to obtain control of a corporation.[195] All existing statutes disqualify the acquirer from voting in such referendum, almost all the statutes also disqualify officers and employees who are directors of the target corporation and some disqualify outside directors as well.[196] Even Delaware, which of course has never enacted a control share acquisition statute, is no stranger to similar disqualifying rules in its anti-takeover statute: if we look at the exemptions under Section 203 of the DGCL, the three-year moratorium for entering into a business combination with an interested stockholder does not apply if, among other things, such combination is authorized by "at least 66 2/3% of the outstanding voting stock *which is not owned by the interested stockholder*" (emphasis added).[197]

2. No-Conflict Standard

A no-conflict standard is an ex post command in which "efforts to give content to the law are undertaken . . . after individuals

193. However, holding a significant stake would still matter for purposes other than casting the vote: for instance, having a significant stake would be relevant for purposes of (i) both the bidder and the target directors and managers, tendering to the winning bidder and making a substantial return; (ii) the bidder, reaching the minimum thresholds for the tender offer to be effective; and (iii) the target directors and managers, to accumulate a large enough level of shares for holdout purposes.

194. *See supra* notes 111–15 and accompanying text.

195. *See* Bebchuk, *supra* note 32, at 985 (labeling such shareholder vote "a referendum on the offer"). For a description of such statutes, see generally GILSON & BLACK, *supra* note 33, at 1333–58.

196. *See supra* notes 111–15 and accompanying text.

197. DEL. CODE ANN. tit. 8, § 203(a)(3) (2007).

act."[198] Consider a standard that would (i) generally prohibit any shareholder to cast a vote if, given all the circumstances, his or her vote happens to be in conflict with the common interests of the other shareholders and (ii) provide for sanctions if such conflicted vote is pivotal for determining the outcome of the resolution. In this example, the actual legal command can only be formulated ex post after a judge considers all the specifics of the resolution. In other words, the standard nature of the command stems from the open-endedness of the factual and legal determinations of when, in the specific case, a vote by a shareholder is in actual conflict with the other shareholders' interests: the details of the conflict can only be analyzed after the vote is cast and in light of several circumstances, such as whether or not the pivotal vote by the given shareholder was directed toward pursuing the common interests of shareholders, which also requires determination in light of all the circumstances. For example, a standard in the context of a resolution deciding the outcome of an acquisition can (be either formulated or interpreted to) reflect that, if the offer is in the best interests of the shareholders (imagine an offer of $100 per share when the expected value of the target under current management is in the $70 to $80 range), *potentially* conflicted shareholders such as directors and managers voting against the acquisition (i.e., voting to maintain the board and the pill in place) will be in *actual* conflict, but other potentially conflicted shareholders such as a bidder voting in favor will not. Conversely, if the offer is not beneficial (imagine an offer of $60 per share when the expected value of the target under current management is in the $70 to $80 range), a bidder voting in favor of the acquisition (i.e., voting to replace the board and redeem the pill) will be in actual conflict, while directors and managers voting against will not.[199]

Standards have the advantage that only the prohibited, conflicted conduct will be detected and sanctioned, with no problems stemming from over- or under-deterrence. That however assumes that standards are well enforced and adjudicated. In other words,

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198. Kaplow, *supra* note189, at 560*; see* also Gilson, *supra* note 189, at 7 ("[E]*x post* review of the terms of a particular . . . transaction by reference to a standard has the obvious advantage of being contextual.") (footnote omitted).

199. This of course assumes conflicts need to be analyzed under a shareholder wealth maximization norm. S*ee supra* Section III.C.2.b.

standards get it right . . . but only when they get it right. The approach has two main drawbacks: on the one hand, uncertainty and the ensuing costs of obtaining legal advice, especially when the standard is a complex one,[200] because who may or may not vote is not specified ex ante, and, on the other hand, possibly insufficient or misguided enforcement because the judiciary may be reluctant to second-guess the resolution, especially in less than clear-cut situations, and because judicial error is easier when courts' discretion is wide.[201]

As mentioned earlier, based on today's Delaware case law, absent any statutory hint, precise adjudication would be quite difficult (and extremely difficult to predict). The hardest issue would be establishing when a shareholder is actually in conflict with the other shareholders. In that regard, policymakers and/or judges would have several issues to clarify: (i) whether shareholders are required to pursue any specific corporate interest when voting (put differently, whether there are limits to their freedom to cast their vote in director elections); (ii) what level of misalignment is necessary to trigger a response from the judiciary (after all, shareholders pursue different investment strategies); (iii) whether there is anything peculiar in director elections aimed at removing a takeover defense to help an acquisition go through;[202] (iv) on remedies, if an injunction is not granted, whether the resolution is voidable or damages are the only route. But of all these complexities, the big-

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200. Kaplow, *supra* note 189, at 566, 569.

201. *See, e.g.*, Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23, 38–39 (2000) ("[B]ecause of unsystematic imperfection or rational concern with the cost of adjudication, adjudicators might fail to apply a standard precisely in particular cases. Consequently, standards can be over- or under inclusive as applied."); Gilson, *supra* note 189, at 8 ("[T]he standard cannot be more effective than the courts that enforce it and the underlying procedural rules through which enforcement takes place."); Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 WM. & MARY L. REV. 1055, 1133 (2004) ("[B]right-line rules generally are more straightforward and clearer than standards and are therefore more predictable.").

202. In a vacuum, electing a given director instead of another can hardly be considered in conflict (the election per se is a preparatory event to future managerial decisions), so a judge would have to consider the election, the imminent pill redemption, and the underlying price offered in the acquisition as a unitary action. *See supra* note 157.

gest hurdle is probably the following:[203] to establish an actual misalignment of interests between the bidder or the target directors or managers, on the one hand, and the best interests of all their fellow shareholders, on the other hand, a judge would ultimately need to perform a *valuation exercise* to ascertain whether the inherent value of the target company is higher or lower than the price of the bid on the table.[204]

All in all, who is and who is not conflicted depends on the specifics of the case, which in turn calls for establishing the underlying value of the target company; case law and scholarship on appraisal rights remind us that ascribing a precise value to a company is far from being an easy task: some would in fact consider it impossible, if not even pointless,[205] and a recent trend of the Chan-

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203. In this suggested policy approach, going through a valuation exercise represents the most sensible way to ascertain when a shareholder is in conflict with the others' interests: first, it is in line with commonly accepted shareholder primacy principles, see *supra* note 159; second, although admittedly not easy, it is the only quantitatively verifiable way to make a no-conflict standard work (absent an independent value reference, it is not clear how a judge can ascribe a conflict of interest to a shareholder).

204. In other words, if the inherent per share value of the company is lower than the bid price, managers voting to perpetuate the current board would be conflicted (whereas a bidder trying to unseat them would not). If vice-versa, the inherent value were higher than the bid price, a bidder would be in conflict when trying to replace the board and get rid of the pill; in such a case, the incumbents vote to maintain the board in power would be aligned to the other shareholders' best interests.

205. Indeed, some of the most skeptical views on the judicial valuation exercises come from Delaware judges. Here are Vice-Chancellor Strine's views on the task, as he put it in *Andaloro v. PFPC Worldwide, Inc*.,:

> The real world nitty-gritty use of [corporate finance] principles brings to the fore problems of measurement and theory that academics, and frankly, even real world business people, have no rational reason to solve because they seek to use [such] principles to reach a reliable approximation of a range of values from which rational investment decisions can be made. The process of appraisal calling for the court to derive a single best estimate of value based on the "expert input" of finance professionals paid to achieve diametrically opposite objectives tends, regrettably, to surface minor, granular issues of this kind, which are not well addressed in the academic literature. The trial record in this case has more than its share of these minute disputes and the literature cited to me has done

cery Court has been to solely rely on the actual merger price under certain circumstances.[206] I address this and a few additional objections to a non-conflict standard in Section IV.C.

3. Unengaged Approach

Finally, given the complexity of the issue and the potentially unsatisfying solutions discussed above, a jurisdiction might simply decide to not intervene. This can happen explicitly, by clarifying that no limits are posed to a shareholder right to vote in replacing directors or, more likely, by simply not enforcing a plausibly dormant no-conflict standard—for example, judges may be uncomfortable to enter the unchartered territory of second-

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> little to convince me that there are clear-cut answers to most of them.

No. CIV.A. 20336, 2005 WL 2045640, at *2 (Del. Ch. Aug. 19, 2005); *see also* Chancellor Chandler's view in *Cede & Co. v. Technicolor, Inc.*:

> Experience in the adversarial, battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity. For a judge who is not an expert in corporate finance, one can do little more than try to detect gross distortions in the experts' opinions. This effort should, therefore, not be understood, as a matter of intellectual honesty, as resulting in *the* fair value of a corporation on a given date. The value of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all of the relevant evidence and based on considerations of fairness.

No. Civ.A. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003).

206. *See* Jason M. Halper, *Fair Price and Process in Delaware Appraisals*, HARV. L. SCH. F. ON GOVERNANCE & FIN. REG. (Nov. 6, 2015), http://corpgov.law.harvard.edu/2015/11/06/fair-price-and-process-in-delaware-appraisals/ (commenting on Merion Capital LP v. BMC Software, Inc., No. 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015) and mentioning that the case is one of many decisions by the Chancery Court in 2015 "finding that merger price (following an arm's length, thorough and informed sales process) represented the most reliable indicator of fair value in the context of an appraisal proceeding.").

guessing an election and/or entertaining a valuation exercise, especially in less than clear-cut situations. This unengaged approach has the advantage of leaving unaltered the current understanding of the legal landscape by M&A players and therefore of not creating additional lawsuits in the already litigation-clogged takeover field—but the advantages end here. In fact, the risk of an unengaged approach is that a lack of protections for non-conflicted shareholders might lead, depending on the circumstances, to inefficient acquisitions or to the unfair demise of efficient ones.

4. Fitting the Three Approaches within Existing Delaware Law

Given the lack of ad hoc statutory provisions, even in the absence of actual case law on conflicted voting in proxy fights to repeal poison pills, it is safe to guess that today's Delaware law is positioned somewhere in between the second approach of a no-conflict standard (potentially looming but yet to apply to a specific case) and the third, an unengaged approach.

B. Testing the Approaches

I now test each of the three approaches with some hypothetical scenarios. First, I address some scenarios in which the misalignment of interests is sharp: a clearly bad acquisition and a clearly good acquisition, each adopted with the pivotal vote of a conflicted party (the bidder and the incumbents, respectively). I then assess less apparent cases, therefore not as "easy" for an adjudicator to rule on, which I label somewhat bad acquisitions and somewhat good acquisitions.

By bad acquisition, I mean an acquisition whereby the offer price is lower than the per-share price of the target if it stayed independent.[207] As Lucian Bebchuk illustrated, rejecting such an

207. *See* Bebchuk, *Undistorted Choice*, *supra* note 59, at 1701 ("When the shareholders judge the offered acquisition price to be lower than the independent target's value . . . then the acquisition offer should be rejected; in such a case, efficiency would likely be served by having the target remain independent.").

I am well aware of some influential views in the literature according to which, for purposes of assessing the efficiency of an acquisition, one should not look solely at the value of the target, but at the value of both bidder and target post-acquisition: if they are worth more combined rather than separate, the acquisition is efficient, regardless of the fact that sometimes some acquisition gains are redistributive in nature as they come at the expense of target shareholders. The underlying intuition is that shareholders hold or at least can hold diversified portfolios and do not care losing some pennies from one position (their stake in the target) if they can make more pennies with the other position (their stake in the bidder). *See generally* Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1, 7–9 (1982) (stating that because shareholders can diversify their securities portfolios, they are expected to own both bidder and target stock: as a result, shareholders should prefer a policy that maximizes the combined gains, with no regard as to how those gains are being shared between bidder and target). But see Lucian Arye Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 29–30 (1982), noting that (i) "many shareholders do not own portfolios, or at least not portfolios sufficiently diversified for the argument to hold" and (ii):

> Shareholders who hold only the shares of a company that is more likely to be a target than an acquirer do value an increase in expected takeover premiums. That these shareholders could have diversified and that their view would then have changed is of little relevance when one considers which rule is desirable from their perspective.

Id.; John C. Coffee Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1217–21 (1984) [hereinafter Coffee, *Regulating the Market*] (noting that Easterbrook and Fischel's argument proves too much, as they "come dangerously close to claiming that directors cannot pursue a gain whenever its realization would also impose greater costs on society . . . . Their rule means that a potential gain should be foregone when it would come simply from [the bidder's] shareholders.").

Even though the diversification argument has some bite, I prefer testing the desirability of an acquisition just by looking at the target value. From a positive law angle, there are no indications that current Delaware law would protect anything other than the best interests of the target: the *Unocal* line of cases steers away from considering the bidder's interest or the interest of greater society generally. While this reasoning might be doctrinal, it in fact represents a sensible way to approach the issue from a system-coherence standpoint, if only we consider that, through the proxy fight safety valve, it is solely the target shareholders who get a say on the ultimate outcome of the deal. Therefore, the desirability of the deal will have to be looked at from the perspective of the group who gets to vote. Otherwise, we would have an inconsistent system that, on the one hand, empowers directors to resist takeovers in the name of the best interests of the corporation (whatever that means—but clearly *not* the interests of the bidder or of efficiency generally) and, on the other hand, gives shareholders a say where their counterpart's influence could swing the outcome in their favor if conflicted votes remained undetected. More importantly, even from a wider normative perspective, the value of the target alone represents the optimal acquisition is a desirable outcome from an allocational-efficiency standpoint because a lower-valuing user would otherwise acquire the firm.[208] However, if a bidder is left free to vote, it could force an inefficient acquisition to go through if it has enough shares to cast a pivotal vote, replace the board, and redeem the poison pill. Conversely, by good acquisition, I mean an acquisition whereby the offer price is greater than the per share price of the target as an independent company. The desirable outcome of such a value-creating transaction is that it succeeds; any obstacle to it, such as a conflicted (and pivotal) vote by the target incumbents to maintain the pill in place would therefore be detrimental. In each of these scenarios, I will thus hypothesize that passing the resolution leads to an inefficient outcome, which would not have otherwise occurred but for the pivotal vote by a shareholder whose interest is contrary to the other shareholders' common interest (that is, the replacement of the board in the bad acquisition and the defeat of the insurgent slate in the good acquisition).

While this is hardly the first contribution in the M&A literature that analyzes the law and suggests exploring new policy avenues by looking at how the law can, to quote Professor Coffee, "encourage efficient transactions while chilling inefficient

benchmark. First, as Bebchuk pointed out, there are few elements to believe that investors are in general sufficiently diversified for the opposite argument to hold: in some circumstances, there is just no way for them to diversify. Bebchuk, *supra*, at 29–30. Consider for instance when the acquirer is a private equity firm, a hedge fund or a closely held competitor—all plausible scenarios. Moreover, market participants take long positions on stocks they think are more likely to become subject to an acquisition: their expectation is to grab a large premium and their market activity is propaedeutic to capturing such premium; introducing the interests of the bidder and its shareholders into the equation, would penalize such expectations and propaedeutic activity. Further, the diversification argument might just prove too much: absent a workable proxy to establish if the offer is value-increasing or not, exploitative low ball offers could get a pass in the name of diversification even when the combined entity is worth less. *See* Coffee, *Regulating the Market, supra*, at 1218–19.

208. Bebchuk, *Undistorted Choice*, *supra* note 59, at 1765 ("While the acquisition of some companies might produce efficiency gains, there are many other companies whose assets are employed most efficiently under their existing, independent mode of operation.").

ones,"[209] nobody to my knowledge has applied this lens when analyzing conflicted voting by shareholders in hostile deals.

1. Clearly Bad Acquisition Going Through with the Pivotal Vote of the Bidder

Assume an $80 offer with a small premium (say 10–15%) that target management is resisting on the grounds that it significantly undervalues the target. Assume the market consensus is that the target will have a long term $110 to $130 trading range. Assume further that the bidder has accumulated a significant stake that would allow it to win a vote to replace the incumbent board of directors and redeem the poison pill, in which case the offer is expected to succeed. However, without counting the bidder shares, the incumbent board would not be unseated, the pill would not be redeemed, and the offer would not go through. Just to make an admittedly simplistic numerical example, the bidder wins 53% vs. 47% after voting 9.99%[210] of the shares; without such conflicted votes, incumbents would prevail 52.2% vs. 47.7%. In the former case, an inefficient deal goes through, while in the latter it does not.

In this hypothetical, the defeat of the offer is a socially desirable outcome, which would not be achieved if the bidder were left free to cast its conflicted votes to support a low premium acquisition. Below, I assess how each of the three approaches would address the issue.

a. Bright-Line Rules and Clearly Bad Acquisitions

What would happen if a regime expressly limited certain shareholders in casting their votes in the context of acquisitions, including of course in proxy contexts aimed at redeeming a poison

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209. John C. Coffee Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions while Chilling Inefficient Ones?*, 21 DEL. J. CORP. L. 359, 395 (1996) [hereinafter Coffee, *Transfers of Control*]; *see also* Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q.J. ECON. 957 (1994; Bebchuk, *Undistorted Choice*, *supra* note 59, at 1701); Einer Elhauge, *The Triggering Function of Sale of Control Doctrine*, 59 U. CHI. L. REV. 1465 (1992).

210. *See infra* note 221 and accompanying text.

pill? Such rules could be shaped in different ways, which for sake of clarity I will just condense into three main types: (i) rules limiting[211] a bidder's right to vote its shares ("bidder-disqualifying rules"),[212] (ii) rules limiting the right to vote of the shares held by directors and managers of the target ("target-disqualifying rules"), and (iii) rules limiting voting rights in shares held by the bidder and in shares held by the target directors and managers ("balanced rules").[213]

Bidder-disqualifying rules would help fend off low-value offers that would otherwise go through with the pivotal vote of the bidder. In dealing with these types of acquisitions, target-disqualifying rules would instead be irrelevant unless the voting limitation itself would help the bidder win the vote in the first place, in which case they would actually represent bad policy.[214] If bright-line rules were balanced, both the votes of both bidder *and* target incumbents would be disregarded.

Whether such balanced rules could help in our hypothetical would depend on the actual ownership structure of the given target:[215] what happens after we *also* disregard the shares voted by target incumbents so that the remaining, disinterested shareholders ultimately make the decision? One would guess that, given the wide gap between the offer price and the potential value of the tar-

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211. By limiting a shareholder's right to vote, I mean a system whereby such shareholder's vote is either not counted (because, for instance, the law calls for an approval by a majority of disinterested shares) or, if counted, the resolution may be subsequently voided.

212. Hawaii, Nebraska and Pennsylvania are examples of control share acquisition statutes where only an acquirer is disqualified from voting. *See supra* note 114.

213. In CSAS, that is the most common rule, but see the exceptions mentioned *supra* note 212.

214. Imagine a situation in which, if *all* shareholders voted, a low-ball offer would be rejected, but because only the votes of the target incumbents are disqualified, a bidder actually prevails with its inefficient acquisition.

215. Of course, M&A activity itself (including its planning and execution) is shaped by the uniqueness of each company's stock ownership; some scholars consider the actual ownership pattern of the company as one of the most important variables in the field. *See generally* John C. Coates IV, *The Powerful and Pervasive Effects of Ownership on M&A* (Harv. L & Econ., Discussion Paper No. 669, 2010), http://ssrn.com/abstract=1544500. *See also* Edelman & Thomas, *supra* note 37, at 464.

get, a majority of such shareholders should be able to identify that their value-maximizing course of action is a vote to confirm the incumbent board in office and therefore reject the acquisition.[216] However, there can be no assurance that this type of inefficient acquisition—passed because of the conflicted and pivotal vote of the bidder—would be screened out through balanced bright-line rules because there might be circumstances in which the (non-conflicted)[217] votes of the incumbents are necessary to determine the efficient outcome. To use the initial numerical example (a 53% vs. 47% vote in favor of bidder, which becomes a 52.22% vs. 47.8% vote in favor of target after disregarding the bidder's 10% stake), if the stake held by incumbents were greater than 2.22%, a bidder would manage to win even if its offer was not value maximizing. So the question thus turns to the determinants of a "correct" voting outcome by the disinterested shareholders, which is something that depends on the underlying ownership structure and on how easy it is for disinterested shareholders to understand what is the right course of action: all else being equal, the greater the pool of disinterested shareholders[218] and the wider the gap between the offer price and the value of the target as an independent company, the more likely that a disinterested shares regime consisting of balanced rules will result in the correct outcome.

In sum, a clearly bad acquisition would call for either bidder-disqualifying rules or balanced rules (assuming in this latter case that rejecting the offer does not depend on the votes by target incumbents) but never for target-disqualifying rules. However, because we are about to see that bidder-disqualifying rules would not work in the context of good acquisitions (for reasons that mirror why target-disqualifying rules do not work here) and because it

216. This largely depends on management's ability to convince enough shareholders that the offer undervalues the company. If management fails in delivering such message, the outcome of the deal will be an inefficient one, irrespective of the rules to contain conflicted voting: the remaining shareholders would just get the decision wrong, which is something no policy solution on conflicted voting, whether rule- or standard-based, can help fixing.

217. Because of the circumstantial nature of conflicts, see *supra* Section IV.A.2, the votes of the incumbents are not conflicted in the specific case because they seek to fend-off an acquisition that is not value-maximizing.

218. *See infra* note 234.

is obviously not realistic to anticipate that only bad acquisitions will emerge,[219] we are left with balanced rules.

Note incidentally that a disinterested shares regime would contribute to level the playing field between bidders and target directors and management—something that is arguably not happening at the moment because bidders are constrained by poison pill thresholds (normally ranging from 10 to 20 percent), the 15 percent threshold contained in Section 203 of the DGCL,[220] and the 10 percent limit to toehold accumulation of Section 16(b) of the Securities and Exchange Act.[221]

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219. *See, e.g.*, Sandra Betton, B. Espen Eckbo & Karin S. Thorburn, *Corporate Takeovers, in* HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 291, 356–72 (B. Espen Eckbo ed., 2d ed. 2008) (finding that the combined returns of target and acquiring companies are positive on average); Michael Bradley, Anand Desai & E. Han Kim, *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 39 (1988) (arguing that premiums paid in takeovers reflect real efficiency gains); *see also* Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 599–601 (1989) (confirming that generally target shareholders gain value from takeovers and noting that many takeovers lead to efficiency gains while exploring the reasons behind such gains). *Cf.* Afsharipour, *supra* note 29, 1027–34 (2012) (discussing the development of empirical literature in merger returns and noting the ongoing debate stemming from numerous studies on whether acquiring companies generally benefit from mergers); Ulrike Malmendier, Enrico Moretti & Florian Peters, *Winning by Losing: Evidence on the Long-Run Effects of Mergers* 1–2 (April 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1787409 (discussing the difficulties in measuring if a merger has led to value creation or destruction). *But see* Klaus Gugler, Dennis C. Mueller, Michael Weichselbaumer & B. Burcin Yurtoglu, *Market Optimism and Merger Waves,* 33 MANAGERIAL & DECISION ECON. 159 (2012) (providing evidence that the long-term effects of takeovers are negative on average).

220. *See supra* note 110.

221. Under Section 16(b) of the Securities Exchange Act any shareholder may sue to recover "short swing" profits for the corporation that are based, among other things, on a purchase and sale of the stock of a reporting company within a 6-month period. Securities Exchange Act of 1934, § 16(b) (codified at 15 U.S.C. § 78p(b) (2012)). For the view that 10% is generally a threshold large investors do not want to cross to avoid being subject to short-swing profits limitations, see Coffee & Palia, *supra* note 191, at 30, noting that the "typical activist will not cross the 10% threshold, probably because at that point it will become subject to Section 16(b) of the Securities Exchange Act, which may force

b. No-Conflict Standards and Clearly Bad Acquisitions

A no-conflict standard is more malleable in dealing with the peculiarities of the case, such as the economics of the deal (how the offer price compares with the expected value of the target as an independent entity that determines who is in conflict and who is not), and the actual ownership structure of the target (a standard that would only disallow votes if they are *both* conflicted *and* pivotal).

If well adjudicated, such an approach has the advantage that a judge can determine the legal command after the voting conduct has taken place and in light of all the circumstances:[222] in the hypothetical scenario of a clearly bad acquisition, a judge should detect the misalignment between the interest of the bidder to pay a low premium with its $80 offer and the interests of the other shareholders to reject the offer and capture the long-term value of the target (in the example, ranging from $110 to $130).

However, this is obviously based on important assumptions relating to adjudication. For starters, a judge is more likely to get to the right result if, as is stipulated in the hypothetical, the discrepancy between offer price and long-term value of the target as an independent company is significant: in other words, less clear-cut cases might be trickier. Second, adjudication costs have to be manageable: a standard would likely result in more litigation in the field, which might well mean more uncertainty; also, judges themselves might not be too eager to entertain valuation exercises to establish what would be the value of the target as an independent entity.[223] Third, standards work well in the presence of several cases generating decisions that over time get fine-tuned to an identifiable, easy to grasp command: confusion and uncertainty might otherwise ensue "when there are too few cases from which to triangulate the norm . . . ."[224] Available data on shareholder voting in

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it to surrender any 'short swing' profits to the corporation on shares acquired in excess of 10%."

222. *See supra* Section IV.A.2.

223. *See supra* note 205.

224. Rock, *supra* note 108, at 1063. *Cf. also* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 85 (1991) ("As few suits produce a legal rule (only two in this sample), this [public

hostile acquisitions, which derives from a FactSet SharkRepellent database listing the universe of attempted hostile deals with a Delaware target from 2003 to July 2015,[225] suggests that, currently, there are probably not enough cases to establish a solid norm (but this would not necessarily be the case for voting in friendly deals).[226]

c. Unengaged Approach and Clearly Bad Acquisitions

The analysis so far suggests that adopting any of the two main approaches to a clearly bad acquisition that is about to succeed because of the conflicted vote of the bidder—a hypothetical that, because of the staggering difference between the offer price and the much higher long term value of the target on a stand-alone basis, one may well consider an "easy case"—raises several practical questions. In this type of acquisition, rules are over-inclusive when they prohibit target incumbents from voting and may well be under-inclusive if they do not extend the prohibition to somebody voting on behalf of the bidder, thus a standard looks somewhat hard to administer. The complexity of the policy choices could lead a jurisdiction to decide to not intervene after all. As mentioned earlier, such a decision can be either silent (i.e., prior to any litigation, a refusal to intervene), or express. In the latter case, it can be embedded in the legislation or, more realistically, stem from case law.[227]

However, an unengaged approach might turn out to be ill-fated when dealing with a clearly bad acquisition because an undetected conflicted vote would end up determining the success of a

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goods] explanation of lawsuit efficacy turns on the need for a large number of lawsuits in order to obtain a ruling.").

225. *Fact Set*, SHARKREPELLENT.NET (July 29, 2015) (on file with author).

226. In such a period there were a total of 60 attempted hostile takeovers targeting Delaware companies. While twenty-eight of these attempts went through the ballot box route, in that the bidder formally launched a proxy fight, only seven deals resulted in an actual vote: in all other cases the proxy fight was abandoned because either the bidder or the target determined to cease the fight before going to the vote count. *Id. But see infra* note 242 and accompanying text.

227. *See supra* Section IV.A.4.

suboptimal acquisition, which would go through even if it is not beneficial to other shareholders. In the long run, this could mean an undue presence of suboptimal acquisitions.

2. Clearly Good Acquisition Rejected with the Pivotal Vote of the Target Directors and Management

I now assume an opposite scenario: a $120 offer with a sizeable premium (say 25–35%) that target management resists by incorrectly alleging that it undervalues the company significantly. Assume here that the market consensus is that with current management the target will have a long term trading range not to exceed $100. Assume, further, that the level of ownership of target directors and managers is such that they are in a position to reject a vote to replace the incumbent board of directors: with the veto power of the pill unaffected, the offer is then expected to fail. Assume finally that without counting the vote from directors and managers of the target, the incumbent board would be unseated, the pill would be redeemed and the offer would go through. In this hypothetical, the success of the offer is a socially desirable outcome, which cannot be achieved because of the incumbents' voting to reject the acquisition.[228] Again, I assess below how each of the three approaches would address the departure from the socially desirable outcome. Unsurprisingly, the results mirror the remarks made for clearly bad acquisitions that go through with the pivotal vote of the bidder.

a. Bright-Line Rules and Clearly Good Acquisitions

I apply to this hypothetical the three types of voting prohibitions I analyzed earlier, namely bidder-disqualifying rules, target-disqualifying rules and balanced rules. Bidder-disqualifying rules either would not matter or have a negative impact, in that they may help the target directors and managers win the vote. Target-disqualifying rules would be beneficial here because they would preclude incumbents from determining the defeat of a good acquisition. Whether balanced rules would work in this hypothet-

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228. *See* Thomas, *supra* note 13, at 526 ("Who controls the corporation is important both to its shareholders and to society because the value of its assets depends significantly on the skill with which they are managed.").

ical would again depend on the voting outcome after disregarding the votes from both the target directors and managers and from the bidder. Still, because in the market for corporate control there can be both good and bad acquisitions, unilateral approaches are too rigid and likely to over-deter (consider bidder-limiting rules in good acquisitions) or under-deter (consider target-limiting rules in bad acquisitions), balanced rules would be the only sensible option if the policymaker opted for a rule-based approach.

b. No-Conflict Standards and Clearly Good Acquisitions

Similar to clearly bad acquisitions, in the hypothetical scenario of a clearly good acquisition, a judge should not find it too hard to detect the misalignment between the interest of the directors and managers to fend-off a high premium offer ($120 versus $100 of long term value of the target if it stays independent) and the interests of the other shareholders to capture such value by replacing the incumbent directors with appointed new ones who would redeem the poison pill. Again, a standard would work well if it can rely on the same critical assumptions I laid out earlier in Section IV.B.1.b, namely that (i) the discrepancy between offer price and long-term value of the target as an independent company is sizeable and (ii) because of a potential increase of litigation in the field and therefore more uncertainty, the adjudication costs are manageable (including a judiciary not reluctant to second guess a resolution by entertaining a valuation exercise).

c. Unengaged Approach and Clearly Good Acquisitions

If a jurisdiction decided to pull away from tackling conflicted voting, an undetected conflicted vote would end up determining the defeat of an acquisition that would have been clearly beneficial to other shareholders. In the long run, this could stifle an efficient market for corporate control.

3. Preliminary Remarks

Thus far, a few insights can be drawn from the opposite hypotheticals I have described. First, as far as bright-line rules are concerned, they work only if balanced, that is, if they neutralize votes from both the bidder and the target's directors and managers:

without any proof that attempted hostile bids tend to systematically be only clearly bad or clearly good, it would be a mistake to inhibit voting from one side only.[229] However, even when balanced, rules carry the flaws of one-size-fits-all inflexibility (that is, over- and under-deterrence, depending on the specifics of the case), which also creates potential for circumvention as those whose votes are not counted will try to find ways to put shares in the hands of allies to whom the voting limitation is not directed.[230] Not to mention that, from a public choice angle, limiting the right of shareholders to vote can be considered a hard sell for policymakers: especially because the suggested rules would equally inhibit the voting prerogatives of both insurgents and incumbents, the legislative measure cannot be expected to receive support from either side (given that ex ante, each side is equally likely to win or lose because of the limitation). Finally, a rule-based approach assumes that unaffiliated shareholders are not only capable of understanding what they should vote for, but that they are also of a sample size that would lead to an outcome adequately reflecting the aggregation of the underlying preferences by shareholders.

Second, a no-conflict standard can be quite an effective response assuming good enforcement and low adjudication costs, which for "easy cases" like a clearly bad acquisition or a clearly good acquisition may well be negligible: this approach would have the advantage of getting it right without being over- or under-inclusive. But since there is no assurance that judges will hear only "easy cases" (quite the contrary actually), one needs to reassess the soundness of the approach after considering less clear-cut cases.

Third, the decision to not engage in regulating conflicted voting (either by the legislative or the judiciary branch) in cases with a wide discrepancy (in one direction or the other) between the offer price and the value of the target as an independent entity is unsound because it would encourage unfair voting practices and leave market failures potentially undetected. This could result in negative ripple effects in the long term, especially in a system that

229. That would represent a big advantage for the side who is not prohibited from voting, which may well from time to time exploit the remaining shareholders by forcing the outcome of the deal in its favor.

230. *See supra* note 191.

elevates shareholder voting to a safety valve for the overall functioning of the market for corporate control.[231]

In any event, the preliminary insight stemming from these hypotheticals, which I labeled as "easy cases," should be taken with a grain of salt. On the one hand, these cases are conceivably not too worrisome from a practical standpoint, especially clearly bad acquisitions, which might have been common in the era of two-tier tender offers of the 1970s and early 1980s, but not so much today because of all the regulatory and private law constraints bidders have become subject to over the years: consider the Williams Act and related SEC regulations, Section 203 of the DGCL and of course *Unocal* and its progeny, which made the poison pill possible.[232] On the other hand, unless the stake held by the conflicted shareholder is truly substantial, which, of course, depends on the very ownership structure of the target, it is less likely that a conflicted vote will be pivotal because the remaining shareholders can be expected to identify the correct voting strategy.

4. Less Clear-Cut Hypotheticals: Somewhat Bad Acquisitions and Somewhat Good Acquisitions

Moving from these relatively "easy cases," I now focus on other, not so clear-cut hypotheticals, such as what I call a somewhat bad acquisition and a somewhat good acquisition.

As to the former, I assume a \$100 offer with a mid-size premium (say 15–20%) that target management is resisting on grounds that it undervalues the target and further assume the market consensus for long-term value is somewhere around \$110 to \$115. A vote by the bidder can again determine the outcome in its

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231. *See supra* note 37; *see also* Marilyn B. Cane, *The Revised SEC Shareholder Proxy Proposal System: Attitudes, Results and Perspectives*, 11 J. CORP. L. 57, 79 (1985) (discussing the role of shareholders in corporate governance, the centralized management system that authorizes board influence necessitates shareholder voting that acts as a "safety valve"); Thomas, *supra* note 13, at 526–32 (discussing the wide recognition by corporate law theorists of the importance of shareholder voting in change-of-control situations).

232. *See generally* Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1177–80 (1999).

favor.[233] For a somewhat good acquisition, I assume a $120 offer with a 15–20% mid-size premium that target management is resisting because it allegedly undervalues the company. I assume here that the market consensus is that with current management the target will have a long term trading range not to exceed $110 to $115 and that, with their ownership level, directors and managers can reject a vote to replace the incumbent board and therefore can make the offer fail.

a. Bright-line Rules

The prior analysis on the impact of bright-line rules on "easy cases" (clearly good and clearly bad acquisitions) remains essentially valid for more ambiguous cases as well. Again, bidder-disqualifying rules would help fend-off a suboptimal acquisition,

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233. A fact pattern similar to this hypothetical has emerged under case law in *Stahl v. Apple Bancorp Inc.*, 579 A.2d 1115 (Del. Ch. 1990). Stahl, a 30% stockholder of Apple Bancorp, launched a joint tender offer and proxy fight with a mere 17% premium, which the target board considered, based on an opinion by its financial advisor, unfair to the stockholders from a financial point of view. *Id.* at 1118–19. After being advised that adequate exploration of alternatives would require more time than was available before the scheduled meeting, the board determined to withdraw the record date in order to pursue alternatives to the offer (no date for the actual meeting had been set). *Id.* at 1119–20. Litigation ensued based on an alleged violation of the *Blasius* standard whereby the board is required to present a compelling justification for withdrawing a record date, see *supra* note 37, to which the company replied that its rescission of the record date was not a response to a proxy contest by Stahl, but rather as a response to Stahl's tender offer (and as such its actions fell under the *Unocal* proportional standard of review, compare *supra* note 36). *Id.* at 1120. Ultimately, Chancellor Allen dismissed the lawsuit on grounds that the directors' action did not constitute a breach of the standards of review of either *Blasius* (which did not apply because the directors' primary purpose was not to hamper the franchise) or *Unocal* (postponing the meeting was a mild, proportional response to the threat that target shareholders would not be sufficiently informed with respect to the pending transaction). *Id.* at 1124. The interesting takeaway is that with a system that leaves open the ballot box route for joint tender offers and proxy fights *and* apparently leaves all shareholders free to cast their vote in the proxy fight (including a 30% stockholder who launches a low-ball bid), targets face the risk of succumbing to value-decreasing transactions and hence need to resort to disruptive defenses in the aim of avoiding the shareholder vote in the first place.

yet they would either be irrelevant or dangerous (if screening out the bidder votes help the target incumbents win) in the context of the somewhat good offer. Similarly, target-disqualifying rules would, with respect to somewhat bad offers, either be irrelevant for changing the outcome or, if such voting restriction itself helps the bidder win the vote in the first place, represent bad policy. Because target incumbents and the bidder may or may not be conflicted depending on the very circumstances surrounding the actual offer, namely its price as compared to the expected long-term value of the target if it stays independent, a viable route to mitigate the risk that bright-line rules are either an over- or under-deterrent is again to introduce balanced rules. In other words, voting limitations applying to *both* bidders, on the one hand, and target management and directors, on the other hand, seem the only sensible way to introduce an ex ante, one-size-fits-all body of rules. Such parallel limitations would quite probably determine, with respect to a somewhat bad acquisition, a vote that confirms the incumbent board in office and fends-off the acquisition, and, with respect to a somewhat good acquisition, a vote that elects the insurgent slate, which in turn redeems the pill for the acquisition to go through.

However, this obviously does not imply that balanced rules will *always* help reach the efficient outcome; that would in fact depend on how the remaining, non-affiliated shareholders will actually vote. Indeed, the end result is contingent on some additional factors, including, most notably, on the one hand, the actual ownership structure of the target company, the sample size of the remaining, unaffiliated shareholders,[234] and whether there are allies

234. *Cf.* Goshen, *Controlling Corporate Self-Dealing*, *supra* note 62, at 402 (noting that "when the minority is composed of a small group, the threat of strategic voting increases."). On the risks of non-consummation because of strategic voting by arbitrageurs and hedge funds in deals that are subject to majority-of-the-minority provisions, see Sunjeela Jain, Ethan Klingsberg & Neil Whoriskey, *Examining Data Points in Minority Buy-Outs: A Practitioners' Report*, 36 DEL. J. CORP. L. 939, 950 (2011), noting that even after *CNX*, companies involved in going private transactions did not take advantage of the safe harbor, the application of the business judgment rule, because of risks that a majority-of-the-minority provision would give some investors incentives to build a position and threaten to veto the deal. *See also* Leonard Chazen, *Did the Dell Minority-of-the-Majority Clause Go Too Far?*, LAW360 (July 22, 2013, 6:41 PM), http://www.law360.com/articles/459110 (warning on risks of non-

to either side that the bright-line rule does not disqualify from voting, and, on the other hand, the ability of the two contending groups to convince, and attract the votes of, the non-affiliated shareholders, which might ultimately be less a "what would a rational investor do" issue than a PR one.[235] Note that a no-conflict standard, which I address immediately below, could help obviate only the first of those factors, that is, over- or under-inclusiveness based on ownership structure (as it would identify and inhibit ex post only the conflicted votes). The latter problem of unaffiliated shareholders sometimes getting it wrong because they do not believe management's—factually correct—story that the offer is low (or, as the case may be, the bidder's story that the target is grossly mismanaged by the incumbent group) is something no policy solution can fix.

b. No-Conflict Standard

The advantage of this approach is to provide a legal command after the voting conduct has taken place and in light of all the circumstances of the case. If enforcement is good and adjudication costs are low, a standard does a better job at tackling only resolutions that are actually affected by a conflicted vote, while leaving all other resolution out of the law's reach—thus letting the parties freely cast their votes.

However, if well conducted, a conflict analysis for a somewhat bad acquisition (or a somewhat good acquisition) should

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consummation when majority-of-the-minority clauses are drafted in an over-inclusive manner: "[t]he type of majority-of-minority clause used in the Dell agreement, which requires approval by a majority of the outstanding unaffiliated shares, instead of a majority of those voting on the transaction, makes the failure to cast a vote the equivalent of a vote against the deal."); Sharon Terlep, *Dell Buyout Group Calls for Change in Voting Rules*, WALL ST. J. (July 24, 2013, 7:28 PM), http://online.wsj.com/article/SB10001424127887323610704578625550322614778.html.

235. For instance, for targets with a bad track record in terms of governance and sensitivity with shareholder concerns, one would expect institutions to not trust management and to rather side with a bidder, even when rejecting the offer is the efficient thing to do. *See generally* Lee Harris, *The Politics of Shareholder Voting*, 86 N.Y.U. L. REV. 1761, 1763 (2011) ("[T]he process of shareholder voting in corporate elections is not dissimilar to citizen voting in elections for public office.").

result in a judicial valuation of the target that is much closer to the price offered by the bidder: a close call on valuation means a more troubling decision for a judge to make. In other words, the main uncertainty surrounding a standard applied to a "not so easy" case, such as the hypothetical scenario of a somewhat bad acquisition, is how likely a judge would be to identify the conflict and intervene. If the misalignment between bidder and other shareholders is not quite as obvious as in the case of a clearly bad acquisition ($80 offer versus $110 to $130 long term value), then it is legitimate to doubt a judge would be keen on detecting the conflict between the interest of the bidder to pay a low premium and the interests of the other shareholders to capture the long-term value (in the new example, a $100 offer versus $110 to $115 long term value). A similar question would of course arise in the opposite case of a somewhat good acquisition that directors and managers could defeat with their votes. To be sure, lack of intervention would not be the sole issue here—judicial error can, of course, be more likely in close calls.

In sum, while bright-line rules might at times be too rigid and be either over- or under-inclusive, adopting a standard-based approach runs the risk that in non-clear-cut cases the judiciary would at times make valuation mistakes or ultimately take a hands-off approach and not intervene. All this would create uncertainty and more litigation in the M&A market.

c. Unengaged Approach

Not engaging at all to detect a conflicted vote in a somewhat bad or somewhat good acquisition that determines the distorted outcome of the vote and thus of the acquisition is dangerous. Not only is it dangerous because such an approach puts at risk the overall efficiency of the market for corporate control (in all deals that are determined by the pivotal vote of the conflicted party, efficiency would have called for the exact opposite outcome), but it also sends a sobering signal that the legal system, especially *this* legal system whereby the ballot box route is considered the safety valve for the correct functioning of the market for corporate control, is structurally incapable of screening out inefficient outcomes for acquisitions (e.g., a bad acquisition not being defeated and a good acquisition not succeeding). True, the overall effects on society of such an unengaged approach would be less severe than with respect to distorted outcomes in clearly bad or clearly good acquisitions. Nevertheless, since an unengaged approach would affect all deals across the board (that is, also the clear-cut hypotheticals), such a policy would leave conflicted shareholders free to cast their vote on all occasions, thus potentially creating incentives for parties to taint voting outcomes even in the most extreme situations. In other words, with such an approach in place, there may well be more clearly bad acquisitions going through and clearly good acquisitions being rejected than there otherwise would be if the legal system sought to tackle conflicted voting.

5. Relaxing the Assumptions

Tables I and II summarize how the different approaches (and related assumptions) address the four hypotheticals described thus far. Given the stipulated assumptions described below, the expected outcomes for clear-cut cases and for more difficult cases match—this is why I paired the two types of bad acquisitions and good acquisitions.

Table I

Clearly Bad Acquisition
$80 Offer v. $110–30 Target Value under Current Management
Somewhat Bad Acquisition
$100 Offer v. $110–15 Target Value under Current Management

Assumptions: (i) bidder vote is pivotal, (ii) majority of unaffiliated shareholders can identify, and vote according to, best course of action, (iii) trivial enforcement/adjudication costs (judge can determine target value as independent company and hence that bidder is conflicted).

	Bidder Votes/ Vote Counted	*Incumbents Vote/Vote Counted*	*Outcome*	*Efficient*
A1) Bidder Disqualifying Rules	No	Yes	Board and Pill Stay	Yes
A2) Target Disqualifying Rules	Yes	No	Board Ousted and Pill Redeemed	No
A3) Balanced Rules	No	No	Board and Pill Stay	Yes
B) No-conflict Standard	No	Yes	Board and Pill Stay	Yes
C) Unengaged Approach	Yes	Yes	Board Ousted and Pill Redeemed	No

Table II

Clearly Good Acquisition $120 Offer v. $100 Target Value under Current Management **Somewhat Good Acquisition** $120 Offer v. $110–15 Target Value under Current Management Assumptions: (i) incumbents' vote is pivotal, (ii) majority of unaffiliated shareholders can identify, and vote according to, best course of action, (iii) trivial enforcement/adjudication costs (judge can determine target value as independent company and hence that incumbents are conflicted).				
	Bidder Votes / Vote Counted	*Incumbents Vote / Vote Counted*	*Outcome*	*Efficient*
A1) Bidder Disqualifying Rules	No	Yes	Board and Pill Stay	No
A2) Target Disqualifying Rules	Yes	No	Board Ousted and Pill Redeemed	Yes
A3) Balanced Rules	No	No	Board and Pill Stay	No
B) No-conflict Standard	Yes	No	Board Ousted and Pill Redeemed	Yes
C) Unengaged Approach	Yes	Yes	Board and Pill Stay	No

The above tables show how different approaches can determine efficient or inefficient outcomes, based on a set of factual assumptions: (i) the bidder's or the incumbents' vote is pivotal (as the case may be); (ii) a majority of unaffiliated shareholders can identify, and vote according to, the best course of action (that is, towards the efficient outcome); and (iii) enforcement/adjudication costs are trivial. The judge can determine target value as independent company and hence that the bidder or the incumbents, as the case may be, are in fact conflicted.

Table III summarizes the interrelations between the various approaches and their underlying assumptions (when present and when relaxed). An explanation and various implications ensue.

Table III

	Vote PIVOTAL (Conflict Is an Issue)	Vote NOT PIVOTAL (Conflict Is Not an Issue)
Both Disinterested Shareholders (DSHs) and Adjudicator *right*	(*All assumptions are met*) Rules and standard work, unengaged approach does not.	All approaches work.
Both DSHs and Adjudicator *wrong*	No approach works, yet rules are either counterproductive (if over-inclusive in the specific) or irrelevant (if all shareholders are wrong).	(*No assumptions are met*) Unengaged approach works, standard does not. Rules are either counterproductive (if over-inclusive in the specific) or irrelevant (if all shareholders are wrong).
DSHs *right* Adjudicator *wrong*	Rules work, standard and unengaged approach do not.	Rules and unengaged approach work, standard does not.
DSHs *wrong* Adjudicator *right*	Standard works, unengaged approach does not. Rules are either counterproductive (if over-inclusive in the specific) or irrelevant (if all shareholders are wrong).	Standards and unengaged approach work. Rules are either counterproductive (if over-inclusive in the specific) or irrelevant (if all shareholders are wrong).

a) When all assumptions are met, the unengaged approach does not work, while all the other approaches (rules and standard) do. More importantly, if *any* of the assumptions under (ii) (disinterested shareholders are right) or (iii) (adjudicator is right) hold, an unengaged approach is never warranted (its only advantage is doing nothing in cases in which nothing needs to be done).

b) When a conflicted vote is pivotal, the unengaged approach never works. When it is not pivotal, the unengaged approach always works because there is no need to intervene; but if the adjudicator is right, also a standard-based approach works because the adjudicator does not intervene when it is not necessary.[236] In any event, the assumption that the conflicted vote is pivotal is based on both the ownership structure of the company on the record date and the voting outcome (that is, how the other shareholders vote). But since there is no reliable way to predict how frequently a conflicted vote might become pivotal (because it is something that can be ascertained only after the resolution takes place),[237] this peculiar strength of the unengaged approach is hard to test. However, it is safe to believe that potentially conflicted votes are more likely to become pivotal when the voting outcome is close.[238]

c) When disinterested shareholders are right, rules always work, irrespective of all other assumptions.[239] When they are wrong, rules are either: (x) counterproductive if, *because* of the

236. If there is no pivotal vote by the potentially conflicted actor, the outcome of the deal is not affected by a conflicted vote. In all such cases, no regime would be necessary because there is no issue to address. When the votes by the potentially conflicted actor are not pivotal, an unengaged approach would actually work: it would not show its typical defect of under-deterrence (because there is nothing to deter here). If the potentially conflicted vote is not pivotal, a no-conflict standard would not even be triggered and therefore would be harmless: in other words, the risk of uncertainty and of excessive litigation that is peculiar of a standard-based regime might not arise whenever the vote cast does not determine the outcome. So an advantage of the unengaged regime could also be an advantage of the no-conflict standard but only to the extent that the potentially conflicted shareholder has not instructed allies to vote in its favor (think of the Deutsche Bank vote in the HP/Compaq merger): because this latter point depends on additional facts, uncertainty and litigation might indeed not disappear with a standard.

237. Even assuming past empirical data were available (currently it is extremely scarce, see *infra* notes 241 and accompanying text), its implications to spot future trends are dubious since such data combines elements deriving from the merits of actual offer on the table and the underlying ownership structure, which are both peculiar to the given deal.

238. *See* Kahan & Rock, *supra* note 90, at 1229 (mentioning a couple of mergers of the mid-2000s (the AXA/MONY and the Transkaryotic mergers) that were "closely fought," with voting outcomes nearing the 50/50 split).

239. However, though easier to grasp and naturally less prone to generate disputes, even rules can carry a litigation risk because of evasion attempts by the relevant players. Shareholders who are disqualified by the bright-line rules might in fact enter into arrangements with complacent allies (who are not formally disqualified) to have the latter cast a vote in their favor. This is of course an enforcement issue, arising out of bright-line rules that are clear to understand and hence easy to avoid. *See supra* note 191.

voting prohibition, a potentially (yet not actually) conflicted vote that is not counted would have determined a different, efficient outcome; or (y) irrelevant, when even without the rules in place, the same inefficient voting outcome would have been reached anyway. In other words, if disinterested shareholders cannot tell whether the offer is good or bad and a majority of their votes are cast against their interests, but a majority of *all* shareholders, thus including the potentially conflicted ones, could have steered towards the efficient outcome, then a balanced disinterested shares regime would be over-inclusive. But note that the likelihood that a potentially conflicted shareholder might correct the error of the disinterested shareholders and determine the efficient outcome depends again on the actual voting outcome and on the underlying ownership structure. The issue therefore boils down to what system we are better off with. Under one, we give a key voice to disinterested shareholders who might make mistakes (but never because of a conflict, which by definition they are not affected by). Under the other, a *potentially* conflicted stockholder may well sometimes fix the error that would otherwise be made by the disinterested stockholder; however, in other circumstances that same shareholder might *actually* be conflicted and skew (inefficient) outcomes in his or her favor (because in a standard he or she would not be automatically disqualified from voting). So the question is, how likely is it that a majority of disinterested shareholders will approve the wrong outcome?

d) When the adjudicator is right, a standard always works, irrespective of all other assumptions (either because it steers the outcome to an efficient one or because it does not intervene when it is not necessary). However, if adjudication does not work properly, a standard-based approach would suffer: a judge might err and alter the outcome of an election if he or she (x) erroneously sanctions a vote that would have otherwise been determinant in reaching an efficient outcome or (y) fails to detect a vote that determines the inefficient one. In the former scenario (x), an unengaged approach (and maybe even a rule-based approach if the assumption that the disinterested shareholders are right holds) would fare better, whereas in the latter (y), only a rule-based approach would (again, provided that the said assumption holds).

C. Policy Remarks

What emerges from the above analysis is that none of the approaches can be expected to work better than the others under all circumstances: each carries positives and negatives.

1. The Uneasy Case for an Unengaged Approach

The unengaged approach means no new regulation and no additional litigation. Both can be considered to come at a premium, especially the latter given the ever-litigious M&A world.[240] But this is where its advantages end. The downside of the unengaged approach is that it offers no protection in situations in which a distorted outcome might arise. The gating, overarching policy

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240. M&A activity is already clogged with litigation, see, for example, ROBERT M. DAINES & OLGA KOUMRIAN, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 1 (2013) (noting that ninety-three percent of M&A deals valued over $100 million were the subject of a shareholder challenge), https://www.cornerstone.com/Publications/Reports/2012-Shareholder-Litigation-Involving-M-and-A; Gideon Mark, *Multijurisdictional M&A Litigation*, 40 IOWA J. CORP. L. 291, 292 (2015), stating that:

> In 1999–2000, 11.9% of announced M&A offers with a value of at least $80 million generated litigation. In 2005, approximately 39.3% of deals with a minimum value of $100 million attracted a lawsuit. In 2013, shareholders challenged 97.5% of all M&A transactions with a value greater than $100 million involving U.S. public company targets.

Id. (footnotes omitted); Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2012* 1, 2 (Feb. 1, 2013) (noting continued increase of litigation over takeovers, with lawsuits brought in 92% of all transactions in 2012), http:// papers.ssrn.com/sol3/papers.cfm?abstract_id=2216727; Oesterle & Palmiter, *supra* note 42, at 494. *But see* C.N.V. Krishnan, Ronald W. Masulis, Randall S. Thomas & Robert B. Thompson, *Shareholder Litigation in Mergers and Acquisitions*, 18 J. CORP. FIN. 1248, 1264 (2012) (noting that while M&A deals that are litigated suffer an increased risk of non-completion, the premiums associated with such deals are much higher and offset such a risk); Randall S. Thomas, *What Should We Do About Multijurisdictional Litigation in M&A Deals?*, 66 VAND. L. REV. 1925, 1948 (2013) ("[S]hareholder litigation has an important monitoring function to play in detecting and punishing parties that violate their fiduciary and contractual duties to target company shareholders."); Anabtawi & Stout, *supra* note 151, at 1303–04 (noting that enforcement and adjudication costs in connection with an increased policing of self-dealing "are more than worthwhile, even though the result is more litigation than if there were no such [fiduciary] duties.").

question is thus how many undetected conflicts can yield inefficient acquisitions or block inefficient ones. The answer is that, unfortunately, we do not know. Available data on proxy fights combined with hostile tender offers for Delaware companies is completely inconclusive because of the extremely low number of contested elections that resulted in an actual vote: only seven in the 2003–2015 period.[241] However, this low number should not suggest the overall issue is moot. As I noted elsewhere, a bidder does not necessarily have to launch *and* win a proxy fight to complete a hostile deal: proxy fights can operate "in the shadow."[242] If the ownership structure of the given target is such that its directors can anticipate that they will lose a proxy fight, it is not uncommon that they would let the acquisition go through if a bidder's threat to start a proxy fight and replace the board is credible.[243] The opposite scenario of a bidder launching and withdrawing a proxy fight when it realizes that it has no chance to prevail is also true. This explains the meager number of recent cases in which the proxy contenders ultimately went to a vote count. Needless to say, outcomes (and possibly the overall number of proxy fights) might very well pan out differently if conflicts were policed by any of the above regimes: to make a blatantly simple (and unrealistic) example, if a disinterested share regime restricting only target incumbents were put in place, one can expect more hostile deals, possibly via tender offer combined with a proxy fight. In

241. Out of 60 hostile deals for a Delaware target announced between 2003 and July 2015, while a total of 28 proxy fights were launched, only seven cases ended with an actual vote (a mere 11.6 percent of all hostile deals and 25 percent of deals where a proxy fight was launched). *Fact Set*, SHARKREPELLENT.NET (July 29, 2015) (on file with author).

242. *See* Gatti, *supra* note 14, at 85 n.26.

243. This is, for instance, what happened in 2012 with the GlaxoSmithKline's acquisition of Human Genome Sciences and in the Cypress Semiconductor's acquisition of Ramtron International (for more detail and references, see Gatti, *supra* note 14, at 85 n.26); *see also* Bebchuk, Coates & Subramanian, *supra* note 15, at 927 ("[O]nce a bidder is fairly certain to gain control of the board in an imminent vote, managers might well choose to make a graceful exit, possibly extracting some benefit for themselves, which would not be possible after the vote has occurred."). This is in line with the empirical literature finding that companies and CEOs would rather let go or significantly amend certain deals than face the risk of a defeat at a shareholder meeting. *See* Becht, Polo & Rossi, *supra* note 29.

any event, future research should be addressed to investigate friendly deals, which represent a significantly larger pool, to see what portion of deals are approved with the pivotal votes of the acquirer and the target incumbents.[244] In other words, how many M&A deals would have generated a different outcome had disinterested shareholders alone been pivotal?[245]

But all things considered, doing nothing to address the issue should warrant more skepticism towards the ballot box route as a safety valve for the correct functioning of the market for corporate control. If we do believe in the importance of the shareholders' using "the powers of corporate democracy . . . to turn the board out"[246] and select the preferred outcome (either because it is good policy or because it is what we are left with anyway after takeover defenses eroded the market for corporate control), we should ensure that voting occurs in an orderly way that enables shareholders to express their preferences effectively: that implies the outcome is an aggregation of sincere preferences that are not affected by some particular interests going against the common interest.

Otherwise, if we surrender to the idea that legislating or enforcing conflicts would either be too cumbersome or create too much uncertainty, then we have once and for all accepted that, in a set of circumstances, the ballot box route, which is supposedly keeping the efficiency of the market for corporate control in check, may work in a potentially distorted way (and thus, in some cases, may ultimately not work). True, we cannot know ex ante if the

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244. For an account of a relatively recent merger potentially tainted by a conflicted vote, even though the vote was not cast by an acquirer or a target incumbent, compare the 2014 cash-out merger of Zale Corporation, which was approved by 53.1% of the outstanding shares with the pivotal vote in favor by an allegedly conflicted 23.3% shareholder. However, on that occasion the Chancery Court dismissed the claim that the shareholder was in fact conflicted. *See supra* note 185 and accompanying text.

245. In any event, because of the difficulty in collecting data on the market consensus about the expected value of the target as a standalone entity, we will never know for sure whether voting against a specific deal would in fact have been a better course of action for shareholders.

246. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985).

distortions play in favor of targets or bidders[247] and that is probably why nobody has taken steps to make improvements: as conflicts are circumstantial and depend on whether the vote fosters shareholder wealth maximization or not, this is an issue for which interest groups do not necessarily have a clear agenda because they cannot anticipate the specifics of the conflict situation in a future deal (will they or their adversaries be actually conflicted in such a scenario?). In other words, because it is impossible to anticipate which end of the stick a takeover player will hold on deals, this is not an "us versus them" issue like staggered boards, which always favor incumbents and are opposed by proxy advisors and activists,[248] and so this is not an area in which lobbying efforts are activated to move things in some interest group's favor. But this is precisely why the issue can be considered even thornier than staggered boards. While the (low) likelihood that a company with a staggered board will ever become a target in a hostile deal is already priced into stock and so everyone, from any would-be bidder to market participants, can operate and trade with a given set of expectations (that is, investors will pay less because of the low probability of a battle for control),[249] the direction of whom the conflict is going to favor—whether the bidder or the incumbents—is not predictable ex ante,[250] and conflicted voting can introduce a noisy element in the pricing accuracy a given stock.

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247. As I mentioned earlier (see *supra* note 94 and accompanying text, as well *infra* the examples in Sections IV.B.1, IV.B.2, and IV.B.4.a.), whether a shareholder is in conflict or not with respect to a given acquisition depends entirely on the offer price and the consensus, if any, on the long-term value of the target if it stays independent.

248. *See generally* Lucian Arye Bebchuk, Scott Hirst, & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 HARV. BUS. L. REV. 157 (2013).

249. *Cf.* Marcel Kahan & Edward B. Rock, *Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 U. PA. L. REV. 473, 491 ("Investors need not buy shares of a company in an IPO or secondary market if they do not like the charter. . . . [D]issatisfied shareholders . . . individually . . . can sell their shares, and collectively, such selling can exert pressure for change by depressing the share price. As a result . . . exit imposes . . . significant constraints on managers . . . .").

250. This is because the advantage can be determined only after the offer is presented and the vote takes place.

2. Rules or Standard?

If policymakers decided not to surrender to a system of hostile deals tainted by potential conflicts at the ballot box level, we would have to choose between rules, standards, or, and this is possibly the most promising option, a combination of the two. Consider each of the two approaches in light of their respective appeal and flaws. A system of balanced rules would contain conflicted voting in a series of circumstances, but its potential over-deterrence can put at risk a subset of deals in which the universe of disinterested shareholders might not get it right or might be polarized by some shareholders who, while formally not disallowed to vote, might vote strategically to extract benefits of various sorts: the experience of majority-of-the-minority provisions in freeze-out mergers tells us that deal planners are very wary of putting the deal in jeopardy for the risk of some strategic vetoing by a blocking minority.[251] In addition, applying a disinterested shares regime plain and simple might have quite severe repercussions on certain existing ownership structures.[252] What if, for example, incumbents

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251. *See supra* note 234. Note, however, that the larger pool of shares available in a hostile tender offer for a contestable public company should make these strategic vetoes less problematic for deal planners as compared with how such vetoes play out in the context of a parent/subsidiary merger, in which the size of the float in the market is normally smaller and makes it easier for investors to accumulate stakes that are sufficient to exert veto powers.

252. Another question is whether a disinterested shares regime would, to some extent, create a disincentive to pre-bid accumulation by a bidder if its shares cannot be counted for determining the acquisition outcome at the relevant vote. While exploring the issue is beyond the scope of this article, I would mention that the most obvious observation point is represented by patterns of stake accumulation in CSAS jurisdictions (which already have disinterested shares regimes in place). However, it is unlikely that available data can give us sufficient guidance if we consider the scarcity of hostile deals in such jurisdictions: according to FactSet/SharkRepellent sources, only in seven instances has a shareholder or hostile bidder formally gone through a CSAS referendum process. *Cf. Fact Set*, SHARKREPELLENT.NET (August 5, 2015) (on file with author). For an account that the relevance of CSAS has been de facto absorbed by the advent of poison pills (which call for a joint tender offer and proxy fight, rather than passing the CSASreferendum), see Emiliano Catan & Marcel Kahan, *The Law and Finance of Anti-Takeover Statutes*, 10 n.40 (N.Y.U. Ctr. L. Econ. & Org., Working Paper No. 14-30, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2517594.

held a sizeable stake, say 30% of the voting stock? In the absence of a disinterested shares regime, everyone would assume incumbents can resist future hostile deals and thus no bidder could realistically consider that company up for grabs. However, with a regime in place and incumbents not being able to vote, a bidder could oust the board with a decent offer (whether the bidder could also obtain the majority of the shares in the tender offer, with incumbents already owning 30%, would be more uncertain but definitely possible). In a system with disinterested shares type-rules, sizeable stakes of "interested shares" would count very little, as a bidder can possibly oust a board even when the board has a 30% ownership base by offering some premium (even a low-ball one) and convincing enough shareholders to approve the acquisition. Not only would this potentially harsh byproduct of a one-size-fits-all regime present concerns with respect to the efficiency of voting and acquisitions generally (i.e., the risk that a low-ball bidder takes advantage of the regime and succeeds in a value decreasing transaction), but it can also be considered as politically unattainable if one frames such effects under a public choice lens: Delaware policymakers are wary of the negative consequences for their state's primacy in corporate law of reforms penalizing incumbents and are thus quite reticent to pass them.[253]

None of this would happen in a standard-based regime, as target incumbents would be able to vote and only subsequently would takeover contenders have a dispute over whether the vote was conflicted or not. In other words, rigid bright-line rules may impact ownership structures and assumptions on the market for corporate control, whereas standards would not. However, the complex element in a standard-based approach is establishing the

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253. *See generally* Mark J. Roe, *Takeover Politics*, *in* THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE 321, 340–41, 353 (Margaret M. Blair ed., 1993) (worried about the potential loss of primacy in the market for corporate charters, 1980s Delaware policymakers ruled for targets); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 625–26 (2003) (mentioning the November 1988 Wachtell Lipton client alert memo, which was sent in the wake of the pro-bidder decision in *Interco* and advised its clients to consider reincorporating outside of Delaware should Delaware continue to rule against targets, which in fact did not happen); Romano, *supra* note 31, at 120–22 (hypothesizing that not just target companies but a broader coalition has favored takeover regulation statutes).

inherent long-term value of the target as an independent entity, an exercise that judges seem quite uneasy to perform: if appraisal rights case law is any lesson, valuation never coincides with a point but rather falls within a range of estimates[254] and parties would have a hard time convincing a judge that the other's position is misaligned with the interests of shareholders.

3. Rules and Standard? The Case for a Combined Approach

A more promising way to address this policy dilemma is to *actually combine a rule-based approach with a standard-based one*. The idea is that the system relies on balanced bright-line rules establishing a *rebuttable presumption that both contenders* (i.e., bidder and target incumbents) *are conflicted*: each group would vote, but their shares would not be counted for determining the outcome of the proxy fight/deal. However, *each group can prove that in fact its votes are not conflicted because they are directed to achieve an outcome that maximizes shareholder value*. Thus, instead of having a plaintiff challenge the voting outcome by showing that a pivotal vote was cast in conflict (as in a plain vanilla standard-approach), this policy would initially disregard certain votes but would nonetheless give shareholders the opportunity to prove they should actually be counted in that they are not conflicted.[255]

This combined approach would be a less harsh version of a pure disinterested shares regime, because a group initially labeled as interested could actually demonstrate the opposite and avoid what would otherwise be a false positive: this way, entrenchment-seeking directors and management will have to convince a judge they are casting their votes because rejecting the bid is the best

254. Cede & Co. v. Technicolor, Inc., No. Civ.A. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003) ("The value of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all of the relevant evidence and based on considerations of fairness."); *see supra* note 205.

255. Obviously, if none of the disregarded votes were pivotal (that is, the outcome of the voting procedure would not change had some or all of the votes been counted), there would be no chance to challenge the resolution.

course of action, while bidders will have to prove their offer is not a "low baller."

One might counter that this policy is no different than having a standard in the first place: after all, parties would end up litigating over value before a judge who would have to pick a figure. I beg to differ.

First and foremost, the potential adjudication flaws would be less severe under this combined approach than in a plain vanilla standard-based regime. In the latter regime, the concern is that judges would be uneasy, if not reluctant, to make a valuation inquiry as to whether the bid price is higher than the target's long-term independent value.[256] In the typical standard-based regime, every vote would be counted and a plaintiff would have to prove that a shareholder (say the bidder) is in conflict: ultimately, a reluctant judge could avoid coming up with any valuation exercise just by saying he or she is not impressed with the pleading record—that way, the voting outcome would be left as is. Conversely, in the combined approach, those votes would be initially disregarded. So in rendering the opinion, a judge who is reluctant to change the outcome of the actual vote would still have to make, at least implicitly, a valuation decision—by rejecting the bidder's pleading, on grounds that there has been a failure to produce enough evidence to warrant a determination that the party is not conflicted, a judge would be implicitly establishing that the offer price is actually lower than the target's long-term independent value. But then it safe to say that, once a judge is placed into that situation, he or she might as well look into the record in more depth, come up with a valuation and actually determine who is and is not conflicted. In other words, the combined approach would compel the judge to conduct a valuation exercise no matter what, whereas under a standard-based approach the burden of proof could help a non-interventionist judge leave the outcome, as it resulted from the initial vote count. True, a combined approach would not cure all enforcement-related problems—the risk of judicial error, a typical problem of any standard-based regime, would not disappear with it—but a judge's reluctance to intervene would be reduced.

Turning to the potential appeal of this policy, not only would this type of reform draw a line and show the legal system is

256. *See supra* notes 205 and 254.

wary of potential conflicts and offer protection in conflicted voting situations, but, more importantly, the expected cost of litigation would generate pressure against undue entrenchment (for target incumbents) and low balling (for bidders).[257] In other words, this system would ex ante help to "keep honest" both the groups involved. First, the aim to avoid the risk of being subject to a disinterested shares regime should induce both groups of potentially conflicted shareholders to "do the right thing." Incumbents will have to be specific as to why the offer is not in the best interests of the shareholders—something akin to "specify[ing] the metric by which their performance going forward should be measured if the offer were defeated."[258] The bidder will have to offer what a ma-

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257. Supporters of an active and vibrant market for corporate control are likely to object that any limitation to a bidder's ability to freely run a proxy contest with the aim to redeem a poison pill would represent an additional restraint in a regulatory landscape that is already quite unsympathetic to buyers, both at the federal (for a pro-bidder critique to the Williams Act, see, for example, Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978)) and state level, see Gilson, *supra* note 3. More constraints to bidders, the argument would go, mean less hostile takeovers at moment in history when this type of deal is not occurring in significant numbers (only 60 in the 2003–2015 period. *See supra* note 241 and accompanying text.

The problem with this objection is that it only focuses on one side of the regulatory intervention, while neglecting the other one. When discussing a rule-based regime, I in fact made it clear that the only way a "disinterested shares" type of reform would work is through balanced rules, that is, rules disqualifying both bidders *and* target directors and management. This type of reform would hardly represent a worsening of the landscape for bidders. Quite the contrary, this would likely tilt the balance in the opposite direction, as one would expect that if the votes of both contending groups were actually neutralized, target incumbents would likely feel more endangered. And, if instead of a rule-based regime, we were to pick a standard-based one, its very own adaptability to the specific circumstances of the given case would sanction a bidder's votes only if such votes were in actual conflict with the other shareholders' interests, that is, only when a bidder is making a low offer: something a system should not encourage. In sum, the objection that a reform would penalize bidders would either (i) mistakenly forget that a disinterested shares regime penalizes both bidders and targets: leaving the last word to disinterested shareholders or (ii) enable conflicts of interests by wrongfully lamenting that bidders cannot vote when they make inefficient offers.

258. Gilson & Gordon, *supra* note 1, at 22–23. In channeling the famous article by Ronald J. Gilson & Reiner Kraakman, *Delaware's Intermediate*

jority of unaffiliated recipients would consider above their reservation price. In other words, low-ball bidders might be dissuaded from not offering what is fair value to the shareholders if they know they cannot count on their votes to get rid of takeover defenses. Second, such pressure would of course be bolstered by each group's interest in avoiding the litigation route to start with.[259] That can be achieved by being extremely convincing with their fellow shareholders in the context of a proxy campaign: because a landslide outcome would make either group's vote not pivotal, there would no need to go to court to have their respective votes counted.

All in all, this suggested approach would utilize procedural tools, such as burden shifting and requiring the parties to factor in expected litigation costs in order to shape their actions in connec-

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Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 BUS. LAW. 247, 268 (1989), Gilson and Gordon explain:

> To make a claim of substantive coercion credible, [Gilson & Kraakman] called for a good deal more than just management's predictable assertion that the market price undervalued the company's shares. The board also would have to state clearly the source of the mispricing and the management's plans for correcting it. The thought was that requiring discipline in demonstrating the presence of substantive coercion would require management to specify the metric by which their performance going forward should be measured if the offer were defeated.

Id. at 22–23, 23 n.49. In their article, Gilson and Kraakman introduced the concept of "substantive coercion" to describe a situation where (i) management actually believes the offer price is inadequate, and (ii) shareholders do not trust management's ability either to assess the circumstances objectively or to deliver on the expected long-term value. Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW 247, 260. Note that, to the authors' dismay, the concept was loosely adopted later on by Delaware judges starting with *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 n.17 (Del. 1989).

259. As a stick to avoid abuses of the litigation avenue, it should be considered to prohibit the company from reimbursing any losing party in the related litigation: this would represent a disincentive system to push incumbents to litigate only if they believe they are in a position to prove the bidder is effectively low-balling (and, conversely, a bidder will litigate only if it can prove its offer is truly value-maximizing). This suggestion follows the spirit of the sanctions system set forth in the Federal Rules of Civil Procedure. *See* FED. R. CIV. P. 11(c).

tion with the underlying M&A transaction and thus help achieve the substantive policy goal of curbing conflicted voting to avoid suboptimal deals and promote desirable ones.[260]

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260. It is common to use procedural tools for purposes of shaping substantive policy in corporate law: the rules on burden shifting in the context of corporate freeze-outs are clearly a case in point. *See supra* note 84. The pendulum between the standards of review under the duty of care and duty of loyalty is another. *See* Allen, Jacobs & Strine, *supra* note 38, at 874–78. Takeover law itself uses burden shifting abundantly. *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995) (noting that in order to fail the second prong under *Unocal*, that is, the proportionality test, directors must prove their actions are not "draconian, by being either preclusive or coercive[,]" and, if the "[response is] not draconian, the Court must then determine whether it [falls] within a range of reasonable responses to the threat . . . posed," at which point it is the plaintiff who has to prove unreasonableness); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994). The Court in *Paramount Communications* discussed the scope of enhanced judicial scrutiny under *Revlon*:

> The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.

Id; see also Blasius Indus. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (stating that if the board acts "for the primary purpose of impeding the exercise of stockholder voting power[,] . . . . the board bears the heavy burden of demonstrating a compelling justification for such action"); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (stating that directors have to prove there are "reasonable grounds for believing that a danger or a threat to corporate policy and effectiveness exists" and the response taken by the company is "reasonable in relation to the threat posed"; if they satisfy such a burden, the transaction is then reviewed under the deferential business judgment review, but if directors are unable to satisfy the enhanced scrutiny under Unocal, the defenses measures are not valid unless directors can show that the transaction was entirely fair). On burden shifting, see generally Louis Kaplow, *Burden of Proof*, 121 YALE L.J. 738 (2012) and, with respect to corporate law, Charles M. Yablon, *On the Allocation of Burdens of Proof in Corporate Law: An Essay on Fairness and Fuzzy Sets*, 13 CARDOZO L. REV. 497 (1991).

V. CONCLUSION

In this article, I have identified conflicted voting by shareholders of Delaware companies as a worrisome factor that can negatively distort voting and acquisitions outcomes, something that prior analysis in the takeover field has not satisfactorily explored. While conceding there is no easy policy fix, this article analyzes different approaches to minimize the efficiency costs of such distorted outcomes. This article does not necessarily call for a reform. Rather, it illustrates the implications of embracing one or more of the policy avenues that I have analyzed on the current Delaware system. Crucially, if the issue is dismissed, there is no way to reconcile the policy behind introducing proxy fights as a safety valve for the efficient functioning of the market for corporate control.[261] Future theoretical and empirical research is necessary to better understand the phenomenon and evaluate additional, complex policy dilemmas, such as whether a mandatory or an optional regime is better suited, whether friendly deals require a different solution, as well as the repercussions that policing conflicted voting might have on empty voting and shareholder activism.

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261. Virtually all jurisdictions that vested shareholder referendums with the power to determine the outcome of hostile acquisitions have dealt with the issue and adopted a disinterested shares regime.

APPENDIX I

There are currently twenty-five states that somehow restrict the voting power of an acquirer via a control share acquisition statute.[i] These restriction statutes are the default option in twenty-four of the twenty-five states,[ii] with a possibility for companies to opt out of the statute, subject to the certain procedures under the relevant statute.[iii]

These control share acquisition statutes have two main characteristics: the type of restriction which is placed upon the acquirer's voting rights and the manner in which the acquirer is able to regain the affected voting rights. Within these twenty-five control share acquisition statutes, there are six different methods whereby acquirer's voting rights may be affected. The majority of control share acquisition states (eighteen) provide that an acquirer has no voting rights, unless a specific resolution has been passed by the applicable majority (this varies as to if the acquirers shares are entitled to vote on the resolution or not, as discussed below).[iv] Two states[v] allow an entity making a control share acquisition vote for directors but not on any other matters without a shareholder resolution authorizing the voting rights of the acquirer. Hawaii denies the voting rights of an acquirer for one year should the acquisition not be approved by a majority of disinterested shares.[vi] Two states disallow an acquirer to vote in shareholder matters if the acquirer has more than 20% percent of the voting rights.[vii] Wisconsin restricts the voting power of an acquirer, which holds over 20% of the voting power to one-tenth of the acquirer's shares (thus a 20% percent stake will have only 2% of the voting power, or one vote for every ten shares).[viii] Finally, Ohio does not specifically mention voting restrictions or restoration of voting rights; however, it requires a majority of the uninterested shares to approve any acquisition.[ix]

Among control share acquisition state statutes, there are primarily four separate methods used by the various states in which an acquirer can either have their voting rights restored or acquisition approved. A slight majority of the control acquisition states (thirteen of twenty-five) require a majority of the outstanding disinterested shares approve a resolution of acquisition or restoration of voting rights.[x] The second most popular regime (nine of twenty-five States) requires both a majority of outstanding disinterested shares, as well as a majority of all outstanding shares to approve a resolution.[xi] Next, two states (Idaho and Maryland) require a two-third majority of outstanding disinterested shares to approve a resolution of acquisition or restoration of voting rights.[xii] Finally, Wisconsin requires a majority of the adjusted shares (i.e. where any 20% or greater voting power is reduced to one-tenth of the power), which are voted at the meeting to approve a restoration of voting rights or approval of an acquisition.[xiii]

State	Voting Restrictions as Default	Company may change Default	Acquirer may vote in director elections without shareholder resolution	Acquirer may vote only if allowed by resolution	Denied Voting Rights for 1 Year	More than 20% is disallowed a vote	More than 20% of voting power is limited to 10% of voting power	No discussion of voting restrictions, only matters which may be voted on, (not director votes)	Needs Majority of disinterested shares to allow acquirer to vote	Needs Both Majority of Disinterested and Majority of all outstanding	Needs 2/3 of Disinterested Shares	Needs Majority of adjusted shares present at meeting	Defines Interested Shareholder as Acquirer, Officer or Inside Director of target	Defines Interested Shareholder otherwise (see footnotes)
Arizona	Yes[xiv]	Yes[xv]	X[xvi]						X[xvii]					X[xviii]
Florida	Yes[xix]	Yes[xx]		X[xxi]					X[xxii]				X[xxiii]	
Hawaii	Yes[xxiv]	Yes[xxv]			X[xxvi]				X[xxvii]					X[xxviii]
Idaho	Yes[xxix]	Yes[xxx]		X[xxxi]							X[xxxii]			X[xxxiii]
Indiana	Yes[xxxiv]	Yes[xxxv]		X[xxxvi]						X[xxxvii]			X[xxxviii]	
Kansas	Yes[xxxix]	Yes[xl]		X[xli]						X[xlii]			X[xliii]	
Maryland	Yes[xliv]	Yes[xlv]		X[xlvi]							X[xlvii]		X[xlviii]	
Massachusetts	Yes[xlix]	Yes[l]		X[li]					X[lii]				X[liii]	
Minnesota	Yes[liv]	Yes[lv]		X[lvi]						X[lvii]			X[lviii]	
Mississippi	Yes[lix]	Yes[lx]				X[lxi]			X[lxii]				X[lxiii]	
Missouri	Yes[lxiv]	Yes[lxv]		X[lxvi]						X[lxvii]			X[lxviii]	
Nebraska	Yes[lxix]	Yes[lxx]	X[lxxi]						X[lxxii]					X[lxxiii]
Nevada	Yes[lxxiv]	Yes[lxxv]		X[lxxvi]					X[lxxvii]					X[lxxviii]
North Carolina	Yes[lxxix]	Yes[lxxx]		X[lxxxi]					X[lxxxii]				X[lxxxiii]	
Ohio	Yes[lxxxiv]	Yes[lxxxv]						X[lxxxvi]	X[lxxxvii]					X[lxxxviii]
Oklahoma	Yes[lxxxix]	Yes[xc]				X[xci]			X[xcii]				X[xciii]	
Oregon	Yes[xciv]	Yes[xcv]		X[xcvi]						X[xcvii]			X[xcviii]	
Pennsylvania	Yes[xcix]	Yes[c]		X[ci]						X[cii]				X[ciii]
South Carolina	Yes[civ]	Yes[cv]		X[cvi]					X[cvii]				X[cviii]	
South Dakota	Yes[cix]	Yes[cx]		X[cxi]						X[cxii]			X[cxiii]	
Tennessee	No[cxiv]	Yes[cxv]		X[cxvi]					X[cxvii]				X[cxviii]	
Utah	Yes[cxix]	Yes[cxx]		X[cxxi]					X[cxxii]				X[cxxiii]	
Virginia	Yes[cxxiv]	Yes[cxxv]		X[cxxvi]					X[cxxvii]				X[cxxviii]	
Wisconsin	Yes[cxxix]	Yes[cxxx]					X[cxxxi]					X[cxxxii]		X[cxxxiii]
Wyoming	Yes[cxxxiv]	Yes[cxxxv]		X[cxxxvi]						X[cxxxvii]			X[cxxxviii]	

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i. Louisiana and Michigan repealed their controlled share acquisition statutes. *See infra* Chart.

ii. Tennessee is the exception. *See* TENN. CODE ANN. § 48-103-310(a) (2002) ("This part shall be applicable to any corporation as defined in § 48-103-302 whose charter or bylaws contain an express declaration that control share acquisitions respecting the shares of the corporation are governed by and subject to the provisions of this part.").

iii. *See infra* Chart.

iv. *See id.*; *see also, e.g.*, KAN. STAT. ANN. § 17-1294(a) (2007) ("Control shares acquired in a control share acquisition have the same voting rights as were accorded the shares before the control share acquisition only to the extent granted by resolution approved by the shareholders of the issuing public corporation."); VA. CODE ANN. § 13.1-728.3(A) (2011). This provision states:

> Notwithstanding any contrary provision of this chapter, shares acquired in a control share acquisition have no voting rights unless voting rights are granted by resolution adopted by the shareholders of the public corporation. If such a resolution is adopted, such shares shall thereafter have the voting rights they would have had in the absence of this article.

Id.

v. *See* Chart. For example, see ARIZ. REV. STAT. § 10-2725(A) (2013), which states:

> Shares of an issuing public corporation that are acquired by an acquiring person in a control share acquisition and that exceed the threshold of voting power of any of the ranges prescribed in section 10-2722, subsection A, paragraph 4 have the same voting rights as other shares of the same class or series for all elections of directors but do not have the right to vote on other matters unless approved by a resolution of shareholders of the issuing public corporation at a special or annual meeting of shareholders pursuant to section 10-2723.

Id. For another example, see NEB. REV. STAT. § 21-2451 (2012), which states:

> Shares acquired in a control-share acquisition shall have the same voting rights as other shares of the same class or series in all elections of directors but shall have voting rights on all other matters only if approved by a vote of shareholders of the issuing public corporation at a special or annual meeting of shareholders pursuant to the Shareholders Protection Act and, to the extent so approved, shall have the same voting rights as other shares of the same class or series.

Id.

vi. HAW. REV. STAT. § 414E-2(b) (LexisNexis 2008) ("All shares acquired by an acquiring person in violation of subsection (e) shall be denied voting rights for one year after acquisition.").

vii. *See* Chart. For an example, see MISS. CODE ANN. § 79-27-7(2)–(3) (2013), which reads:

> (2) Subject to subsections (3) through (5) of this section, the voting power of control shares having voting power of one-

> fifth (1/5) or more of all voting power is reduced to zero unless the shareholders of the issuing public corporation approve a resolution pursuant to the procedure set forth in Section 79-27-9 according the shares the same voting rights as they had before they became control shares.
> (3) Except as provided in Section 79-27-9(6), the voting power of control shares representing voting power of less than one-fifth (1/5) of all voting power is not affected by this chapter.

Id. For another example, see OKLA. STAT. ANN. § 18-1149(1)–(2) (West 2012), which states:

> (1) Subject to the provisions of paragraphs 2 through 4 of this section, the voting power of control shares having voting power of one-fifth (1/5) or more of all voting power is reduced to zero unless the shareholders of the issuing public corporation approve a resolution pursuant to the procedure set forth in Section 1153 of this title according the shares the same voting rights as they had before they became control shares.
> (2) Except as provided in subsection A of Section 1153 of this title, the voting power of control shares representing voting power of less than one-fifth (1/5) of all voting power is not affected by Sections 1145 through 1155 of this title.

Id.

viii. WIS. STAT. § 180.1150(2) (Westlaw through 2015 Act 392) ("Unless otherwise provided in the articles of incorporation of a resident domestic corporation or otherwise specified by the board of directors of the resident domestic corporation in accordance with s. 180.0824(3), and except as provided in sub. (3) or as restored under sub. (5), the voting power of shares of a resident domestic corporation held by any person, including shares issuable upon conversion of convertible securities or upon exercise of options or warrants, in excess of 20% of the voting power in the election of directors shall be limited to 10% of the full voting power of those shares.").

ix. OHIO REV. CODE ANN. § 1701.831(E)(1) (LexisNexis 2009) ("The shareholders of the issuing public corporation who hold shares as of the record date of such corporation entitling them to vote in the election of directors authorize the acquisition at the special meeting held for that purpose at which a quorum is present by an affirmative vote of a majority of the voting power of such corporation in the election of directors represented at the meeting in person or by proxy, and a majority of the portion of the voting power excluding the voting power of interested shares represented at the meeting in person or by proxy. A quorum shall be deemed to be present at the special meeting if at least a majority of the voting power of the issuing public corporation in the election of directors is represented at the meeting in person or by proxy.").

x. *See infra* Chart.

xi. *See id*.

xii. *See id*.

xiii. WIS. STAT. § 180.1150(5)(c) (Westlaw through 2015 Act 392) ("Regular voting power is restored if at the meeting called under par. (a) at which a quorum is present a majority of the voting power of shares represented at the meeting and entitled to vote on the subject matter approve the resolution.").

xiv. ARIZ. REV. STAT. ANN. § 10-2721 (2013).

xv. *Id.*

xvi. *Id.* § 10-2725.

xvii. *Id.*

xviii. *Id.* § 10-2725(B) (excluding shares owned by any director, not a director which is also an employee).

xix. FLA. STAT. § 607.0902(5) (2016).

xx. *Id.*

xxi. *Id.* § 607.0902(5)(a).

xxii. *Id.* § 607.0902(9)(b).

xxiii. *Id.* § 607.0902(3).

xxiv. HAW. REV. STAT. ANN. § 414E-2 (LexisNexis 2008).

xxv. *Id.*

xxvi. *Id.* § 414E-2(b).

xxvii. *Id.* § 414E-2(e).

xxviii. *Id.* § (stating that only the acquirers' shares are considered interested).

xxix. IDAHO CODE § 30-1603 (2013).

xxx. *Id.*

xxxi. *Id.* § 30-1607.

xxxii. *Id.*

xxxiii. *Id.* § 30-1601(11) (excluding shares owned by any director, not a director which is also an employee).

xxxiv. IND. CODE ANN. § 23-1-42-5 (LexisNexis 2010).

xxxv. *Id.*

xxxvi. *Id.* § 23-1-42-9.

xxxvii. *Id.*

xxxviii. *Id.* § 23-1-42-3.

xxxix. KAN. STAT. ANN. § 17-1290 (2007).

xl. *Id.*

xli. *Id.* § 17-1294.

xlii. *Id.*

xliii. *Id.* § 17-1288.

xliv. MD. CODE ANN., CORPS. & ASS'NS § 3-702 (Westlaw through all legislation from the 2016 Regular Session of the General Assembly).

xlv. *Id.*

xlvi. *Id.*

xlvii. *Id.*

xlviii. *Id.* § 3-701(g) (Westlaw).

xlix. MASS. GEN. LAWS ANN. ch.110D, § 2 (West 2011).

l. *Id.*

li. *Id.* § 5.
lii. *Id.*
liii. *Id.* § 1(d).
liv. MINN. STAT. ANN. § 302A.671 (West 2011).
lv. *Id.*
lvi. *Id.*
lvii. *Id.*
lviii. *Id.* § 302A.011(42).
lix. MISS. CODE ANN. § 79-27-7 (2013).
lx. *Id.*
lxi. *Id.* § 79-27-9.
lxii. *Id.*
lxiii. *Id.* § 79-27-5(f).
lxiv. MO. REV. STAT. § 351.407.1 (2001).
lxv. *Id.*
lxvi. *Id.* § 351.407.5.
lxvii. *Id.*
lxviii. *Id.* § 351.015(9).
lxix. NEB. REV. STAT. § 21-2453 (2012).
lxx. *Id.*
lxxi. *Id.* § 21-2451.
lxxii. *Id.*
lxxiii. *Id.* § 21-2441 ("Interested shares shall mean the voting stock of an issuing public corporation owned by an acquiring person.").
lxxiv. NEV. REV. STAT. ANN. § 78.378 (LexisNexis 2010).
lxxv. *Id.*
lxxvi. *Id.* § 78.379.
lxxvii. *Id.* § 78.3791.
lxxviii. *Id.* § 78.3787 (including an acquirer, an officer or director, or an employee of the target).
lxxix. N.C. GEN. STAT. ANN. § 55-9A-09 (West, Westlaw through Chapters 93, 95 to 101 of the 2016 Regular Session of the General Assembly, pending changes received from the Revisor of Statutes).
lxxx. *Id.*
lxxxi. *Id.* § 55-9A-05 (Westlaw).
lxxxii. *Id.*
lxxxiii. *Id.* § 55-9A-01(b)(4) (Westlaw).
lxxxiv. OHIO REV. CODE ANN. § 1701.831 (LexisNexis 2009).
lxxxv. *Id.*
lxxxvi. *Id.*
lxxxvii. *Id.*
lxxxviii. Only the acquirers' shares are considered interested. *See id.* § 1701.831(E)(2).
lxxxix. OKLA. STAT. ANN. tit. 18, § 1148 (West 2012).
xc. *Id.*
xci. *Id.* tit. 18, § 1149.

xcii. *Id.* tit. 18, § 1153.
xciii. *Id.* tit. 18, § 1147.
xciv. OR. REV. STAT. § 60.804 (2011).
xcv. *Id.*
xcvi. *Id.* § 60.807.
xcvii. *Id.*
xcviii. *Id.* § 60.801(7).
xcix. 15 PA. STAT. AND CONS. STAT. ANN. § 2561(a) (West 2013).
c. *Id.* § 2561(b).
ci. *Id.* § 2564(a).
cii. *Id.* § 2564.
ciii. See id. §§ 2562, 2564(a) (allowing only disinterested shares to vote).
civ. S.C. CODE ANN. § 35-2-105 (West, Westlaw through 2016 session, subject to technical revisions by the Code Commissioner as authorized by law before official publication).
cv. *Id.*
cvi. *Id.* § 35-2-109(a) (Westlaw).
cvii. *Id.* § 35-2-109(b)(2) (Westlaw).
cviii. *Id.* § 35-2-103(A) (Westlaw).
cix. S.D. CODIFIED LAWS § 47-33-17 (2007).
cx. *Id.* § 47-33-19(1)(a).
cxi. *Id.* § 47-33-12.
cxii. *Id.*
cxiii. *Id.* § 47-33-3(1)(r).
cxiv. TENN. CODE ANN. § 48-103-310 (2002).
cxv. *Id.*
cxvi. *Id.* § 48-103-303.
cxvii. *Id.* § 48-103-307.
cxviii. *Id.* § 48-103-302(6).
cxix. UTAH CODE ANN. §§ 61-6-6, -10 (West, Westlaw through 2016 Third Special Session).
cxx. *Id.* § 61-6-6 (Westlaw).
cxxi. *Id.* § 61-6-10 (Westlaw).
cxxii. *Id.*
cxxiii. *Id.* § 61-6-4 (Westlaw).
cxxiv. VA. CODE ANN. § 13.1-728.2 (2011).
cxxv. *Id.*
cxxvi. *Id.* § 13.1-728.3.
cxxvii. *Id.*
cxxviii. *Id.* § 13.1-728.1 (referring specifically to the definition of "interested shares").
cxxix. WIS. STAT. ANN. § 180.1150(2) (West, Westlaw through 2015 Act 392, published 4/27/2016).
cxxx. *Id.*
cxxxi. *Id.*
cxxxii. *Id.* § 180.1150(5)(c) (Westlaw).

cxxxiii. *Id.* § 180.1150(2) (Westlaw).
cxxxiv. WYO. STAT. ANN. § 17-18-309(a) (2013).
cxxxv. *Id.* § 17-18-309(b).
cxxxvi. *Id.* §§ 17-18-302(a), -306.
cxxxvii. *Id.* § 17-18-306(b).
cxxxviii. *Id.* § 17-18-301(a)(iv).