Court of Chancery of Delaware,
New Castle County.

BLASIUS INDUSTRIES, INC., William B. Conner, Warren Delano, Jr., Harold H. George, Harold E. Hall, Michael A. Lubin, Arnold W. MacAlonan, Thomas J. Murnick, and William P. Shulevitz, Plaintiffs,
v.
ATLAS CORPORATION, John J. Dwyer, Edward R. Farley, Jr., Michael Bongiovanni, Richard R. Weaver, Walter G. Clinchy, Andrew Davlin, Jr., Edgar M. Masinter, John M. Devaney and Harry J. Winters, Jr., Defendants.

Civ. A. No. 9720.
Submitted: June 6, 1988.
Decided: July 25, 1988.

Shareholders brought actions challenging the validity of directors' decision to add two new members to the board of directors and challenging the counting of votes on a consent solicitation to increase the board from 7 to 15 members and to name a new majority of the board. After the cases were consolidated, the Chancery Court, New Castle County, Allen, Chancellor, held that: (1) the evidence demonstrated that the incumbent directors were not acting out of a self-interested motive when they responded to a shareholder's proposal to increase the size of the board; (2) the deferential business judgment rule did not shield directors' actions from scrutiny; (3) the directors' actions in adding two members to the board was an unintended violation of shareholders' voting right; and **(4) election judges acted reasonably in limiting their count to written "ballots" before them and any errors in the count did not change the outcome of the consent solicitation process, under which the shareholder's proposal failed to garner a majority of the votes.**

Judgment for defendants.

West Headnotes

[1] Corporations and Business Organizations 101 1747(4)

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(B) Election or Appointment, Qualification, and Tenure
101VII(B)1 Directors
101k1734 Election
101k1747 Actions and Proceedings to Determine Right to Office
101k1747(4) k. Evidence. Most Cited Cases
(Formerly 101k283(3))

Evidence established that incumbent board members added two new members to seven-member board in order to prevent holders of majority of corporation's shares from placing majority of new directors on board through consent solicitation in which shareholders proposed to increase board from 7 to 15 members. 8 Del.C. § 228.

[2] Corporations and Business Organizations 101 1747(4)

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(B) Election or Appointment, Qualification, and Tenure
101VII(B)1 Directors
101k1734 Election
101k1747 Actions and Proceedings to Determine Right to Office
101k1747(4) k. Evidence. Most Cited Cases
(Formerly 101k283(3))

Evidence demonstrated that board decided to add two new members to seven-member board not out of any self-interested motive, but rather, with subjective good faith in response to one shareholder's recapitalization proposal that board believed would be injurious to corporation. 8 Del.C. § 228.

[3] Corporations and Business Organizations 101 1842

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(D) Rights, Duties, and Liabilities as to Corporation and Its Shareholders or Members

101k1840 Fiduciary Duties as to Management of Corporate Affairs in General
101k1842 k. Business judgment rule in general. Most Cited Cases
(Formerly 101k310(1))

Deferential business judgment rule did not shield from scrutiny directors' decision to add two new members to board of directors in response to shareholder's proposal to increase board from 7 to 15 members and elect eight new members through consent solicitation, even though directors were acting with subjective good faith to prevent implementation of recapitalization proposal that members reasonably feared would cause great injury to corporation; decision interfered with effectiveness of shareholder consent process. 8 Del.C. § 228.

[4] Corporations and Business Organizations 101 ⚷1733

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(B) Election or Appointment, Qualification, and Tenure
101VII(B)1 Directors
101k1733 k. Number of directors. Most Cited Cases
(Formerly 101k283(1))

Corporations and Business Organizations 101 ⚷1736

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(B) Election or Appointment, Qualification, and Tenure
101VII(B)1 Directors
101k1734 Election
101k1736 k. Requisites and validity in general. Most Cited Cases
(Formerly 101k283(1))

Directors' decision to add two new members to board was not per se invalid, even though actions were taken in response to shareholder's proposal to increase board from 7 to 15 members and elect eight new members through consent solicitation; directors did not act out of self-interested motive, but sought to prevent shareholders from creating majority of new board in order to implement recapitalization that incumbent directors reasonably feared would cause great injury to corporation. 8 Del.C. § 228.

[5] Corporations and Business Organizations 101 ⚷1845

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(D) Rights, Duties, and Liabilities as to Corporation and Its Shareholders or Members
101k1840 Fiduciary Duties as to Management of Corporate Affairs in General
101k1845 k. Loyalty. Most Cited Cases
(Formerly 101k310(1))

Incumbent directors' decision to add two new members to seven-member board was unintended violation of duty of loyalty that members owed to shareholders where directors acted in response to shareholder's proposal to increase board from 7 to 15 members, to name and place majority of newly expanded board, and to recapitalize corporation, even though incumbent directors were acting in good faith; consent solicitation had been issued by nine percent shareholder, not by powerful shareholder acting against interests of distinct shareholder constituency, and recapitalization proposal, although unsound, did not warrant thwarting shareholder vote. 8 Del.C. § 228.

[6] Corporations and Business Organizations 101 ⚷1620

101 Corporations and Business Organizations
101VI Shareholders and Members
101VI(C) Meetings
101k1619 Proxies
101k1620 k. In general. Most Cited Cases
(Formerly 101k198(1))

Law does not inquire into subjective intent of either record owner of shares or beneficial owner of shares in reviewing computation of outcome of proxy fight or consent contest. 8 Del.C. § 225.

[7] Corporations and Business Organizations 101 ⚷1617

101 Corporations and Business Organizations
101VI Shareholders and Members
101VI(C) Meetings
101k1616 Right to Vote in General
101k1617 k. In general. Most Cited Cases

(Formerly 101k197)

Investor who chooses to hold stock in some fashion other than his own name thereby assumes the risk that record owner may vote shares contrary to investor's subjective wishes. 8 Del.C. § 225.

[8] Corporations and Business Organizations 101 1747(6)

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(B) Election or Appointment, Qualification, and Tenure
101VII(B)1 Directors
101k1734 Election
101k1747 Actions and Proceedings to Determine Right to Office
101k1747(6) k. Judgment, relief, and costs. Most Cited Cases
(Formerly 101k283(3))

Election judges were entitled to rely on written “ballots” submitted in response to one shareholder's consent solicitation in order to determine whether proposal garnered majority of votes; any errors in counting process resulted from action of record owners or their agents and did not warrant setting aside outcome of consent solicitation. 8 Del.C. § 225.

***652** A. Gilchrist Sparks, III, and Michael Houghton of Morris, Nichols, Arsht & Tunnell, Wilmington, and Greg A. Danilow, M. Nicole Marcey, and Meric Craig Bloch, of Weil, Gotshal & Manges, and Linda C. Goldstein of Kramer, Levin, Nessen, Kamin & Frankel, New York City, for plaintiffs.

Charles F. Richards, Jr., Samuel A. Nolan, and Cynthia D. Kaiser of Richards, Layton & Finger, Wilmington, and Kenneth R. Logan, Joseph F. Tringali, David A. Martland, and Brad N. Friedman of Simpson Thacher & Bartlett, New York City, for defendants.

OPINION

ALLEN, Chancellor.

Two cases pitting the directors of Atlas Corporation against that company's largest (9.1%) shareholder, Blasius Industries, have been consolidated and tried together. Together, these cases ultimately require the court to determine who is entitled to sit on Atlas' board of directors. Each, however, presents discrete and important legal issues.

The first of the cases was filed on December 30, 1987. As amended, it challenges the validity of board action taken at a telephone meeting of December 31, 1987 that added two new members to Atlas' seven member board. That action was taken as an immediate response to the delivery to Atlas by Blasius the previous day of a form of stockholder consent that, if joined in by holders of a majority of Atlas' stock, would have increased the board of Atlas from seven to fifteen members and would have elected eight new members nominated by Blasius.

As I find the facts of this first case, they present the question whether a board acts consistently with its fiduciary duty when it acts, in good faith and with appropriate care, for the primary purpose of preventing or impeding an unaffiliated majority of shareholders from expanding the board and electing a new majority. For the reasons that follow, I conclude that, even though defendants here acted on their view of the corporation's interest and not selfishly, their December 31 action constituted an offense to the relationship between corporate directors and shareholders that has traditionally been protected in courts of equity. As a consequence, I conclude that the board action taken on December 31 was invalid and must be voided. The basis for this opinion is set forth at pages 658-663 below.

The second filed action was commenced on March 9, 1988. It arises out of the consent solicitation itself (or an amended ***653** version of it) and requires the court to determine the outcome of Blasius' consent solicitation, which was warmly and actively contested on both sides. **The vote was, on either view of the facts and law, extremely close. For the reasons set forth at pages 663-670 below, I conclude that the judges of election properly confined their count to the written “ballots” (so to speak) before them; that on that basis, they made several errors, but that correction of those errors does not reverse the result they announced. I therefore conclude that plaintiffs' consent solicitation failed to garner the support of a majority of Atlas shares.**

The facts set forth below represent findings based upon a preponderance of the admissible evidence, as I evaluate it.

I.

Blasius Acquires a 9% Stake in Atlas.

Blasius is a new stockholder of Atlas. It began to accumulate Atlas shares for the first time in July, 1987. On October 29, it filed a Schedule 13D with the Securities Exchange Commission disclosing that, with affiliates, it then owed 9.1% of Atlas' common stock. It stated in that filing that it intended to encourage management of Atlas to consider a restructuring of the Company or other transaction to enhance shareholder values. It also disclosed that Blasius was exploring the feasibility of obtaining control of Atlas, including instituting a tender offer or seeking “appropriate” representation on the Atlas board of directors.

Blasius has recently come under the control of two individuals, Michael Lubin and Warren Delano, who after experience in the commercial banking industry, had, for a short time, run a venture capital operation for a small investment banking firm. Now on their own, they apparently came to control Blasius with the assistance of Drexel Burnham's well noted junk bond mechanism. Since then, they have made several attempts to effect leveraged buyouts, but without success.

In May, 1987, with Drexel Burnham serving as underwriter, Lubin and Delano caused Blasius to raise $60 million through the sale of junk bonds. A portion of these funds were used to acquire a 9% position in Atlas. According to its public filings with the SEC, Blasius' debt service obligations arising out of the sale of the junk bonds are such that it is unable to service those obligations from its income from operations.

The prospect of Messrs. Lubin and Delano involving themselves in Atlas' affairs, was not a development welcomed by Atlas' management. Atlas had a new CEO, defendant Weaver, who had, over the course of the past year or so, overseen a business restructuring of a sort. Atlas had sold three of its five divisions. It had just announced (September 1, 1987) that it would close its once important domestic uranium operation. The goal was to focus the Company on its gold mining business. By October, 1987, the structural changes to do this had been largely accomplished. Mr. Weaver was perhaps thinking that the restructuring that had occurred should be given a chance to produce benefit before another restructuring (such as Blasius had alluded to in its Schedule 13D filing) was attempted, when he wrote in his diary on October 30, 1987:

> 13D by Delano & Lubin came in today. Had long conversation w/MAH & Mark Golden [of Goldman, Sachs] on issue. All agree we must dilute these people down by the acquisition of another Co. w/stock, or merger or something else.

The Blasius Proposal of A Leverage Recapitalization Or Sale.

Immediately after filing its 13D on October 29, Blasius' representatives sought a meeting with the Atlas management. Atlas dragged its feet. A meeting was arranged for December 2, 1987 following the regular meeting of the Atlas board. Attending that meeting were Messrs. Lubin and Delano for Blasius, and, for Atlas, Messrs. Weaver, Devaney (Atlas' CFO), Masinter (legal counsel and director) and Czajkowski (a representative of Atlas' investment banker, Goldman Sachs).

***654** At that meeting, Messrs. Lubin and Delano suggested that Atlas engage in a leveraged restructuring and distribute cash to shareholders. In such a transaction, which is by this date a commonplace form of transaction, a corporation typically raises cash by sale of assets and significant borrowings and makes a large one time cash distribution to shareholders. The shareholders are typically left with cash and an equity interest in a smaller, more highly leveraged enterprise. Lubin and Delano gave the outline of a leveraged recapitalization for Atlas as they saw it.

Immediately following the meeting, the Atlas representatives expressed among themselves an initial reaction that the proposal was infeasible. On December 7, Mr. Lubin sent a letter detailing the proposal. In general, it proposed the following: (1) an initial special cash dividend to Atlas' stockholders in an aggregate amount equal to (a) $35 million, (b) the aggregate proceeds to Atlas from the exercise of option warrants and stock options, and (c) the proceeds from the sale or disposal of all of Atlas' operations that are not related to its continuing minerals operations; and (2) a special non-cash dividend to Atlas' stockholders of an aggregate $125 million principal amount of 7% Secured Subordinated Gold-Indexed Debentures. The funds necessary to pay the initial cash dividend were to principally come from (i) a “gold loan” in the amount of $35,625,000, repayable over a three to five year period and secured by 75,000 ounces of gold at a price of $475 per ounce, (ii) the proceeds from the sale of the discontinued Brockton Sole and Plastics and Ready-Mix Concrete businesses, and (iii) a then expected January, 1988 sale of uranium to the Public Service Electric & Gas Company. (DX H.)

Atlas Asks Its Investment Banker to Study the Proposal.

This written proposal was distributed to the Atlas board on December 9 and Goldman Sachs was directed to review and analyze it.

The proposal met with a cool reception from management. On December 9, Mr. Weaver issued a press release expressing surprise that Blasius would suggest using debt to accomplish what he characterized as a substantial liquidation of Atlas at a time when Atlas' future prospects were promising. He noted that the Blasius proposal recommended that Atlas incur a high debt burden in order to pay a substantial one time dividend consisting of $35 million in cash and $125 million in subordinated debentures. Mr. Weaver also questioned the wisdom of incurring an enormous debt burden amidst the uncertainty in the financial markets that existed in the aftermath of the October crash.

Blasius attempted on December 14 and December 22 to arrange a further meeting with the Atlas management without success. During this period, Atlas provided Goldman Sachs with projections for the Company. Lubin was told that a further meeting would await completion of Goldman's analysis. A meeting after the first of the year was proposed.

The Delivery of Blasius' Consent Statement.

On December 30, 1987, Blasius caused Cede & Co. (the registered owner of its Atlas stock) to deliver to Atlas a signed written consent (1) adopting a precatory resolution recommending that the board develop and implement a restructuring proposal, (2) amending the Atlas bylaws to, among other things, expand the size of the board from seven to fifteen members-the maximum number under Atlas' charter, and (3) electing eight named persons to fill the new directorships. Blasius also filed suit that day in this court seeking a declaration that certain bylaws adopted by the board on September 1, 1987 acted as an unlawful restraint on the shareholders' right, created by Section 228 of our corporation statute, to act through consent without undergoing a meeting.

The reaction was immediate. Mr. Weaver conferred with Mr. Masinter, the Company's outside counsel and a director, who viewed the consent as an attempt to take control of the Company. They decided to call an emergency meeting of the board, even though a regularly scheduled meeting was to occur only one week hence, on January ***655** 6, 1988. The point of the emergency meeting was to act on their conclusion (or to seek to have the board act on their conclusion) “that we should add at least one and probably two directors to the board ...” (Tr. 85, Vol. II). A quorum of directors, however, could not be arranged for a telephone meeting that day. A telephone meeting was held the next day. At that meeting, the board voted to amend the bylaws to increase the size of the board from seven to nine and appointed John M. Devaney and Harry J. Winters, Jr. to fill those newly created positions. Atlas' Certificate of Incorporation creates staggered terms for directors; the terms to which Messrs. Devaney and Winters were appointed would expire in 1988 and 1990, respectively.

The Motivation of the Incumbent Board In Expanding the Board and Appointing New Members.

[1] In increasing the size of Atlas' board by two and filling the newly created positions, the members of the board realized that they were thereby precluding the holders of a majority of the Company's shares from placing a majority of new directors on the board through Blasius' consent solicitation, should they want to do so. Indeed the evidence establishes that that was the principal motivation in so acting.

The conclusion that, in creating two new board positions on December 31 and electing Messrs. Devaney and Winters to fill those positions the board was principally motivated to prevent or delay the shareholders from possibly placing a majority of new members on the board, is critical to my analysis of the central issue posed by the first filed of the two pending cases. If the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, which merely had an incidental impact upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification. *See, e.g., Frantz Manufacturing Company v. EAC Industries,* Del.Supr., 501 A.2d 401, 407 (1985); *Moran v. Household International, Inc.,* Del.Ch., 490 A.2d 1059, 1080, *aff'd,* Del.Supr., 500 A.2d 1346 (1985). The board, as a general matter, is under no fiduciary obligation to suspend its active management of the firm while the consent solicitation process goes forward.

There is testimony in the record to support the proposition that, in acting on December 31, the board was principally motivated simply to implement a plan to expand the Atlas board that preexisted the September, 1987 emergence of Blasius as an active shareholder. I have no doubt that the addition of Mr. Winters, an expert in mining economics, and Mr. Devaney, a financial expert employed by the Company, strengthened the Atlas board and, should anyone ever have reason to review the wisdom of those choices, they would be found to be sensible and prudent. I cannot conclude, however, that the strengthening of the board by the addition of these men was the principal motive for the December 31 action. As I view this factual determination as critical, I will pause to dilate briefly upon the evidence that leads me to this conclusion.

The evidence indicates that CEO Weaver was acquainted with Mr. Winters prior to the time he assumed the presidency of Atlas. When, in the fall of 1986, Mr. Weaver learned of his selection as Atlas' future CEO, he informally approached Mr. Winters about serving on the board of the Company. Winters indicated a willingness to do so and sent to Mr. Weaver a copy of his *curriculum vitae.* Weaver, however, took no action with respect to this matter until he had some informal discussion with other board members on December 2, 1987, the date on which Mr. Lubin orally presented Blasius' restructuring proposal to management. At that time, he mentioned the possibility to other board members.

Then, on December 7, Mr. Weaver called Mr. Winters on the telephone and asked him if he would serve on the board and Mr. Winters again agreed.

On December 24, 1987, Mr. Weaver wrote to other board members, sending them Mr. Winters *curriculum vitae* and notifying them that Mr. Winters would be ***656** proposed for board membership at the forthcoming January 6 meeting. It was also suggested that a dinner meeting be scheduled for January 5, in order to give board members who did not know Mr. Winters an opportunity to meet him prior to acting on that suggestion. The addition of Mr. Devaney to the board was not mentioned in that memo, nor, so far as the record discloses, was it discussed at the December 2 board meeting.

It is difficult to consider the timing of the activation of the interest in adding Mr. Winters to the board in December as simply coincidental with the pressure that Blasius was applying. The connection between the two events, however, becomes unmistakably clear when the later events of December 30 and 31 are focused upon. As noted above, on the 30th, Atlas received the Blasius consent which proposed to shareholders that they expand the board from seven to fifteen and add eight new members identified in the consent. It also proposed the adoption of a precatory resolution encouraging restructuring or sale of the Company. Mr. Weaver immediately met with Mr. Masinter. In addition to receiving the consent, Atlas was informed it had been sued in this court, but it did not yet know the thrust of that action. At that time, Messrs. Weaver and Masinter “discussed a lot of [reactive] strategies and Edgar [Masinter] told me we really got to put a program together to go forward with this consent.... we talked about taking no action. We talked about adding one board member. We talked about adding two board members. We talked about adding eight board members. And we did a lot of looking at other and various and sundry alternatives....” (Weaver Testimony, Tr. I, p. 130). They decided to add two board members and to hold an emergency board meeting that very day to do so. It is clear that the reason that Mr. Masinter advised taking this step immediately rather than waiting for the January 6 meeting was that he feared that the Court of Chancery might issue a temporary restraining order prohibiting the board from increasing its membership, since the consent solicitation had commenced. It is admitted that there was no fear that Blasius would be in a position to complete a public solicitation for consents prior to the January 6 board meeting.

In this setting, I conclude that, while the addition of these qualified men would, under other circumstances, be clearly appropriate as an independent step, such a step was in fact taken in order to impede or preclude a majority of the shareholders from effectively adopting the course proposed by Blasius. Indeed, while defendants never forsake the factual argument that that action was simply a continuation of business as usual, they, in effect, admit from time to time this overriding purpose. For example, everyone concedes that the directors understood on December 31 that the effect of adding two directors would be to preclude stockholders from effectively implementing the Blasius proposal. Mr. Weaver, for example, testifies as follows:

> Q: Was it your view that by electing these two directors, Atlas was preventing Blasius from electing a majority of the board?
>
> A: I think that is a component of my total overview. I think in the short term, yes, it did.

Directors Farley and Bongiovanni admit that the board acted to slow the Blasius proposal down. *See* Tr. T, Vol. I, at pp. 23-24 and 81.

This candor is praiseworthy, but any other statement would be frankly incredible. The timing of these events is, in my opinion, consistent only with the conclusion that Mr. Weaver and Mr. Masinter originated, and the board immediately endorsed, the notion of adding these competent, friendly individuals to the board, not because the board felt an urgent need to get them on the board immediately for reasons relating to the operations of Atlas' business, but because to do so would, for the moment, preclude a majority of shareholders from electing eight new board members selected by Blasius. As explained below, I conclude that, in so acting, the board was not selfishly motivated simply to retain power.

There was no discussion at the December 31 meeting of the feasibility or wisdom of the Blasius restructuring proposal. While ***657** several of the directors had an initial impression that the plan was not feasible and, if implemented, would likely result in the eventual liquidation of the Company, they had not yet focused upon and acted on that subject. Goldman Sachs had not yet made its report, which was scheduled to be given January 6.

The January 6 Rejection of the Blasius Proposal.

On January 6, the board convened for its scheduled meeting. At that time, it heard a full report from its financial advisor concerning the feasibility of the Blasius restructuring proposal. The Goldman Sachs presentation included a summary of five year cumulative cash flows measured against a base case and the Blasius proposal, an analysis of Atlas' debt repayment capacity under the Blasius proposal, and pro forma income and cash flow statements for a base case and the Blasius proposal, assuming prices of $375, $475 and $575 per ounce of gold.

After completing that presentation, Goldman Sachs concluded with its view that if Atlas implemented the Blasius restructuring proposal (i) a severe drain on operating cash flow would result, (ii) Atlas would be unable to service its long-term debt and could end up in bankruptcy, (iii) the common stock of Atlas would have little or no value, and (iv) since Atlas would be unable to generate sufficient cash to service its debt, the debentures contemplated to be issued in the proposed restructuring could have a value of only 20% to 30% of their face amount. Goldman Sachs also said that it knew of no financial restructuring that had been undertaken by a company where the company had no chance of repaying its debt, which, in its judgment, would be Atlas' situation if it implemented the Blasius restructuring proposal. Finally, Goldman Sachs noted that if Atlas made a meaningful commercial discovery of gold after implementation of the Blasius restructuring proposal, Atlas would not have the resources to develop the discovery.

The board then voted to reject the Blasius proposal. Blasius was informed of that action. The next day, Blasius caused a second, modified consent to be delivered to Atlas. A contest then ensued between the Company and Blasius for the votes of Atlas' shareholders. The facts relating to that contest, and a determination of its outcome, form the subject of the second filed lawsuit to be now decided. That matter, however, will be deferred for the moment as the facts set forth above are sufficient to frame and decide the principal remaining issue raised by the first filed action: whether the December 31 board action, in increasing the board by two and appointing members to fill those new positions, constituted, in the circumstances, an inequitable interference with the exercise of shareholder rights.

II.

Plaintiff attacks the December 31 board action as a selfishly motivated effort to protect the incumbent board from a perceived threat to its control of Atlas. Their conduct is said to constitute a violation of the principle, applied in such cases as *Schnell v. Chris Craft Industries,* Del.Supr., 285 A.2d 437 (1971), that directors hold legal powers subjected to a supervening duty to exercise such powers in good faith pursuit of what they reasonably believe to be in the corporation's interest. The December 31 action is also said to have been taken in a grossly negligent manner, since it was designed to preclude the recapitalization from being pursued, and the board had no basis at that time to make a prudent determination about the wisdom of that proposal, nor was there any emergency that required it to act in any respect regarding that proposal before putting itself in a position to do so advisedly.

Defendants, of course, contest every aspect of plaintiffs' claims. They claim the formidable protections of the business judgment rule. *See, e.g., Aronson v. Lewis,* Del.Supr., 473 A.2d 805 (1983); *Grobow v. Perot,* Del.Supr., 539 A.2d 180 (1988); *In re J.P. Stevens & Co., Inc. Shareholders Litigation,* Del.Ch., 542 A.2d 770 (1988).

They say that, in creating two new board positions and filling them on December 31, they acted without a conflicting interest ***658** (since the Blasius proposal did not, in any event, challenge *their* places on the board), they acted with due care (since they well knew the persons they put on the board and did not thereby preclude later consideration of the recapitalization), and they acted in good faith (since they were motivated, they say, to protect the shareholders from the threat of having an impractical, indeed a dangerous, recapitalization program foisted upon them). Accordingly, defendants assert there is no basis to conclude that their December 31 action constituted any violation of the duty of the fidelity that a director owes by reason of his office to the corporation and its shareholders.

Moreover, defendants say that their action was fair, measured and appropriate, in light of the circumstances. Therefore, even should the court conclude that some level of substantive review of it is appropriate under a legal test of fairness, or under the intermediate level of review authorized by *Unocal Corp. v. Mesa Petroleum Co.*, Del.Supr., 493 A.2d 946 (1985), defendants assert that the board's decision must be sustained as valid in both law and equity.

III.

[2] One of the principal thrusts of plaintiffs' argument is that, in acting to appoint two additional persons of their own selection, including an officer of the Company, to the board, defendants were motivated not by any view that Atlas' interest (or those of its shareholders) required that action, but rather they were motivated improperly, by selfish concern to maintain their collective control over the Company. That is, plaintiffs say that the evidence shows there was no policy dispute or issue that really motivated this action, but that asserted policy differences were pretexts for entrenchment for selfish reasons. If this were found to be factually true, one would not need to inquire further. The action taken would constitute a breach of duty. *Schnell v. Chris Craft Industries*, Del.Supr., 285 A.2d 437 (1971); *Guiricich v. Emtrol Corp.*, Del.Supr., 449 A.2d 232 (1982).

In support of this view, plaintiffs point to the early diary entry of Mr. Weaver (p. 653, *supra*), to the lack of any consideration at all of the Blasius recapitalization proposal at the December 31 meeting, the lack of any substantial basis for the outside directors to have had any considered view on the subject by that time-not having had any view from Goldman Sachs nor seen the financial data that it regarded as necessary to evaluate the proposal-and upon what it urges is the grievously flawed, slanted analysis that Goldman Sachs finally did present.

While I am satisfied that the evidence is powerful, indeed compelling, that the board was chiefly motivated on December 31 to forestall or preclude the possibility that a majority of shareholders might place on the Atlas board eight new members sympathetic to the Blasius proposal, it is less clear with respect to the more subtle motivational question: whether the existing members of the board did so because they held a good faith belief that such shareholder action would be self-injurious and shareholders needed to be protected from their own judgment.

On balance, I cannot conclude that the board was acting out of a self-interested motive in any important respect on December 31. I conclude rather that the board saw the “threat” of the Blasius recapitalization proposal as posing vital policy differences between itself and Blasius. It acted, I conclude, in a good faith effort to protect its incumbency, not selfishly, but in order to thwart implementation of the recapitalization that it feared, reasonably, would cause great injury to the Company.

The real question the case presents, to my mind, is whether, in these circumstances, the board, even if it *is* acting with subjective good faith (which will typically, if not always, be a contestable or debatable judicial conclusion), may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. The question thus posed is not one of intentional wrong (or even negligence), but one of authority *as between the fiduciary and the beneficiary* (not simply ***659** legal authority, *i.e.*, as between the fiduciary and the world at large).

IV.

It is established in our law that a board may take certain steps-such as the purchase by the corporation of its own stock-that have the effect of defeating a threatened change in corporate control, when those steps are taken advisedly, in good faith pursuit of a corporate interest, and are reasonable in relation to a threat to legitimate corporate interests posed by the proposed change in control. *See* *Unocal Corp. v. Mesa Petroleum Co.*, Del.Supr., 493 A.2d 946 (1985); *Kors v. Carey*, Del.Ch., 158 A.2d 136 (1960); *Cheff v. Mathes*, Del.Supr., 199 A.2d 548 (1964); *Kaplan v. Goldsamt*, Del.Ch., 380 A.2d 556 (1977). Does this rule-that the reasonable exercise of good faith and due care generally validates, in equity, the exercise of legal authority even if the act has an entrenchment effect-apply to action designed for the primary purpose of interfering with the effectiveness of a stockholder vote? Our authorities, as well as sound principles, suggest that the central importance of the franchise to the scheme of corporate governance, requires that, in this setting, that rule not be applied and that closer scrutiny be accorded to such transaction.

1. *Why the deferential business judgment rule does not apply to board acts taken for the primary purpose of interfering with a stockholder's vote, even if taken advisedly and in good faith.*

A. *The question of legitimacy.*

The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests. Generally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance), or they may vote to replace incumbent board members.

It has, for a long time, been conventional to dismiss the stockholder vote as a vestige or ritual of little practical importance.[FN1] It may be that we are now witnessing the emergence of new institutional voices and arrangements that will make the stockholder vote a less predictable affair than it has been. Be that as it may, however, whether the vote is seen functionally as an unimportant formalism, or as an important tool of discipline, it is clear that it is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own. Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power.

FN1. *See, e.g.,* E. Rostow, To Whom and For What Ends Is Corporate Management Responsible, in *The Corporation in Modern Society* (E.S. Mason ed.1959). The late Professor A.A. Berle once dismissed the shareholders' meeting as a "kind of ancient, meaningless ritual like some of the ceremonies that go with the mace in the House of Lords." Berle, Economic Power and the Free Society (1957), *quoted in* Balotti, Finkelstein, Williams, Meetings of Shareholders (1987) at 2.

B. *Questions of this type raise issues of the allocation of authority as between the board and the shareholders.*

[3] The distinctive nature of the shareholder franchise context also appears when the matter is viewed from a less generalized, doctrinal point of view. From this point of view, as well, it appears that the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context.[FN2] That is, a decision by the ***660** board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance. That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation, but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority. A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation. This need not be the case with respect to other forms of corporate action that may have an entrenchment effect-such as the stock buybacks present in *Unocal, Cheff* or *Kors v. Carey.* Action designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and a shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not, in my opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment.[FN3]

FN2. Delaware courts have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights. This concern suffuses our law, manifesting itself in various settings. For example, the perceived importance of the franchise explains the cases that hold that a director's fiduciary duty requires disclosure to shareholders asked to authorize a transaction of all material information in the corporation's possession, even if the transaction is not a self-dealing one. *See, e.g., Smith v. Van Gorkom,* Del.Supr., 488 A.2d 858 (1985); *In re Anderson Clayton Shareholders' Litigation,* Del.Ch., 519 A.2d 669, 675 (1986).

A similar concern, for credible corporate democracy, underlies those cases that strike down board action that sets or moves an annual meeting date upon a finding that such action was intended to thwart a shareholder group from effectively mounting an election campaign. *See, e.g., Schnell v. Chris Craft, supra; Lerman v. Diagnostic Data, Inc.*, Del.Ch., 421 A.2d 906 (1980); *Aprahamian v. HBO*, Del.Ch., 531 A.2d 1204 (1987).

The cases invalidating stock issued for the primary purpose of diluting the voting power of a control block also reflect the law's concern that a credible form of corporate democracy be maintained. *See Canada Southern Oils, Ltd. v. Manabi Exploration Co., Inc.*, Del.Ch., 96 A.2d 810 (1953); *Condec Corporation v. Lunkenheimer Company*, Del.Ch., 230 A.2d 769 (1967); *Phillips v. Insituform of North America, Inc.*, Del.Ch., C.A. No. 9173, Allen, C., 1987 WL 16285 (August 27, 1987).

Similarly, a concern for corporate democracy is reflected (1) in our statutory requirement of annual meetings (8 *Del.C.* § 211), and in the cases that aggressively and summarily enforce that right. *See, e.g., Coaxial Communications, Inc. v. CNA Financial Corp.*, Del.Supr., 367 A.2d 994 (1976); *Speiser v. Baker*, Del.Ch., 525 A.2d 1001 (1987), and (2) in our consent statute (8 *Del. C.* § 228) and the interpretation it has been accorded. *See Datapoint Corp. v. Plaza Securities Co.*, Del.Supr., 496 A.2d 1031 (1985) (order); *Allen v. Prime Computer, Inc.*, Del.Supr., No. 26, 1988 [538 A.2d 1113 (table)] (Jan. 26, 1988); *Frantz Manufacturing Company v. EAC Industries*, Del.Supr., 501 A.2d 401 (1985).

FN3. I thus am unable to be guided by the somewhat different view expressed in the unreported case *American Rent-A-Car, Inc. v. Cross*, Del.Ch., C.A. No. 7583, 1984 WL 8204 (May 9, 1984).

2. *What rule does apply: per se invalidity of corporate acts intended primarily to thwart effective exercise of the franchise or is there an intermediate standard?*

[4] Plaintiff argues for a rule of *per se* invalidity once a plaintiff has established that a board has acted for the primary purpose of thwarting the exercise of a shareholder vote. Our opinions in *Canada Southern Oils, Ltd. v. Manabi Exploration Co.*, Del.Ch., 96 A.2d 810 (1953) and *Condec Corporation v. Lunkenheimer Company*, Del.Ch., 230 A.2d 769 (1967) could be read as support for such a rule of *per se* invalidity. *Condec* is informative.

There, plaintiff had recently closed a tender offer for 51% of defendants' stock. It had announced no intention to do a follow-up merger. The incumbent board had earlier refused plaintiffs' offer to merge and, in response to its tender offer, sought alternative deals. It found and negotiated a proposed sale of all of defendants' assets for stock in the buyer, to be followed up by an exchange offer to the seller's shareholders. The stock of the buyer was publicly traded in the New York Stock Exchange, so that the deal, in effect, offered cash to the target's shareholders. As a condition precedent to the sale of assets, an exchange ***661** of authorized but unissued shares of the seller (constituting about 15% of the total issued and outstanding shares after issuance) was to occur. Such issuance would, of course, negate the effective veto that plaintiffs' 51% stockholding would give it over a transaction that would require shareholder approval. Plaintiff sued to invalidate the stock issuance.

The court concluded, as a factual matter, that: "... the primary purpose of the issuance of such shares was to prevent control of Lunkenheimer from passing to Condec...." 230 A.2d at 775. The court then implied that not even a good faith dispute over corporate policy could justify a board in acting for the primary purpose of reducing the voting power of a control shareholder:

> Nonetheless, I am persuaded on the basis of the evidence adduced at trial that the transaction here attacked unlike the situation involving the purchase of stock with corporate funds [the court having just cited *Bennett v. Propp*, Del.Supr., 187 A.2d 405, 409 (1962), and *Cheff v. Mathes*, Del.Supr., 199 A.2d 548 (1964)] was clearly unwarranted because it unjustifiably strikes at the very heart of corporate representation by causing a stockholder with an equitable right to a majority of corporate stock to have his right to a proportionate voice and influence in corporate affairs to be diminished by the simple act of an exchange of stock which brought no money into the Lunkenheimer treasury, was not connected with a stock option plan or other proper corporate purpose, and which was obviously designed for the primary purpose of reducing Condec's stockholdings in Lunkenheimer below a majority.

Id. at 777. A *per se* rule that would strike down, in equity, any board action taken for the primary purpose of interfering with the effectiveness of a corporate vote would have the advantage of relative clarity and predictability. FN4 It also has the advantage of most vigorously enforcing the concept of corporate democracy. The disadvantage it brings along is, of course, the disadvantage a *per se* rule always has: it may sweep too broadly.

FN4. While it must be admitted that any rule that requires for its invocation the finding of a subjective mental state (*i.e.*, a primary purpose) necessarily will lead to controversy concerning whether it applies or not, nevertheless, once it is determined to apply, this *per se* rule would be clearer than the alternative discussed below.

In two recent cases dealing with shareholder votes, this court struck down board acts done for the primary purpose of impeding the exercise of stockholder voting power. In doing so, a *per se* rule was not applied. Rather, it was said that, in such a case, the board bears the heavy burden of demonstrating a compelling justification for such action.

In *Aprahamian v. HBO & Company*, Del.Ch., 531 A.2d 1204 (1987), the incumbent board had moved the date of the annual meeting on the eve of that meeting when it learned that a dissident stockholder group had or appeared to have in hand proxies representing a majority of the outstanding shares. The court restrained that action and compelled the meeting to occur as noticed, even though the board stated that it had good business reasons to move the meeting date forward, and that that action was recommended by a special committee. The court concluded as follows:

> The corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates. In the interests of corporate democracy, those in charge of the election machinery of a corporation must be held to the highest standards of providing for and conducting corporate elections. The business judgment rule therefore does not confer any presumption of propriety on the acts of directors in postponing the annual meeting. Quite to the contrary. When the election machinery appears, at least facially, to have been manipulated those in charge of the election have the burden of persuasion to justify their actions.

Aprahamian, 531 A.2d at 1206-07.

In *Phillips v. Insituform of North America, Inc.*, Del.Ch., C.A. No. 9173, Allen, ***662** C. (Aug. 27, 1987), the court enjoined the voting of certain stock issued for the primary purpose of diluting the voting power of certain control shares. The facts were complex. After discussing *Canada Southern* and *Condec* in light of the more recent, important Supreme Court opinion in *Unocal Corp. v. Mesa Petroleum Company*, it was there concluded as follows:

> One may read *Canada Southern* as creating a black-letter rule prohibiting the issuance of shares for the purpose of diluting a large stockholder's voting power, but one need not do so. It may, as well, be read as a case in which no compelling corporate purpose was presented that might otherwise justify such an unusual course. Such a reading is, in my opinion, somewhat more consistent with the recent *Unocal* case.
>
> In applying the teachings of these cases, I conclude that no justification has been shown that would arguably make the extraordinary step of issuance of stock for the admitted purpose of impeding the exercise of stockholder rights reasonable in light of the corporate benefit, if any, sought to be obtained. Thus, whether our law creates an unyielding prohibition to the issuance of stock for the primary purpose of depriving a controlling shareholder of control or whether, as *Unocal* suggests to my mind, such an extraordinary step might be justified in some circumstances, the issuance of the Leopold shares was, in my opinion, an unjustified and invalid corporate act.

Phillips v. Insituform of North America, Inc., supra at 23-24. Thus, in *Insituform,* it was unnecessary to decide whether a *per se* rule pertained or not.

In my view, our inability to foresee now all of the future settings in which a board might, in good faith, paternalistically seek to thwart a shareholder vote, counsels against the adoption of a *per se* rule invalidating, in equity, every board action taken for the sole or primary purpose of thwarting a shareholder vote, even though I recognize the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance. It may be that some set of facts would justify such extreme action.FN5 This, however, is not such a case.

FN5. Imagine the facts of *Condec* changed very slightly and coming up in today's world of corporate control transactions. Assume an acquiring company buys 25% of the target's stock in a small number of privately negotiated transactions. It then commences a public tender offer for 26% of the company stock at a cash price that the board, in good faith, believes is inadequate. Moreover, the acquiring corporation announces that it may or may not do a second-step merger, but if it does one, the consideration will be junk bonds that will have a value, when issued, in the opinion of its own investment banker, of no more than the cash being offered in the tender offer. In the face of such an offer, the board may have a duty to seek to protect the company's shareholders from the coercive effects of this inadequate offer. Assume, for purposes of the hypothetical, that neither newly amended Section 203, nor any defensive device available to the target specifically, offers protection. Assume that the target's board turns to the market for corporate control to attempt to locate a more fairly priced alternative that would be available to all shareholders. And assume that just as the tender offer is closing, the board locates an all cash deal for all shares at a price materially higher than that offered by the acquiring corporation. Would the board of the target corporation be justified in issuing sufficient shares to the second acquiring corporation to dilute the 51% stockholder down so that it no longer had a practical veto over the merger or sale of assets that the target board had arranged for the benefit of all shares? It is not necessary to now hazard an opinion on that abstraction. The case is clearly close enough, however, despite the existence of the *Condec* precedent, to demonstrate, to my mind at least, the utility of a rule that permits, in some extreme circumstances, an incumbent board to act in good faith for the purpose of interfering with the outcome of a contemplated vote. *See also American International Rent-A-Car, Inc. v. Cross, supra*, n. 3.

3. *Defendants have demonstrated no sufficient justification for the action of December 31 which was intended to prevent an unaffiliated majority of shareholders from effectively exercising their right to elect eight new directors.*

[5] The board was not faced with a coercive action taken by a powerful shareholder against the interests of a distinct shareholder constituency (such as a public minority). It was presented with a consent ***663** solicitation by a 9% shareholder. Moreover, here it had time (and understood that it had time) to inform the shareholders of its views on the merits of the proposal subject to stockholder vote. The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors. The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters. It may be that the Blasius restructuring proposal was or is unrealistic and would lead to injury to the corporation and its shareholders if pursued. Having heard the evidence, I am inclined to think it was not a sound proposal. The board certainly viewed it that way, and that view, held in good faith, entitled the board to take certain steps to evade the risk it perceived. It could, for example, expend corporate funds to inform shareholders and seek to bring them to a similar point of view. *See, e.g. Hall v. Trans-Lux Daylight Picture Screen Corporation*, Del.Ch., 171 A. 226, 227 (1934); *Hibbert v. Hollywood Park, Inc.*, Del.Supr., 457 A.2d 339 (1982). But there is a vast difference between expending corporate funds to inform the electorate and exercising power for the primary purpose of foreclosing effective shareholder action. A majority of the shareholders, who were not dominated in any respect, could view the matter differently than did the board. If they do, or did, they are entitled to employ the mechanisms provided by the corporation law and the Atlas certificate of incorporation to advance that view. They are also entitled, in my opinion, to restrain their agents, the board, from acting for the principal purpose of thwarting that action.

I therefore conclude that, even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders. I note parenthetically that the concept of an unintended breach of the duty of loyalty is unusual but not novel. *See Lerman v. Diagnostic Data, supra; AC Acquisitions Corp. v. Anderson, Clayton & Co.*, Del.Ch., 519 A.2d 103 (1986). That action will, therefore, be set aside by order of this court.

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Judgment will be entered in favor of defendants. An appropriate form of order may be submitted on notice.

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