Note

WRITTEN CONSENTS—A POWERFUL TOOL IN HOSTILE BATTLES FOR CORPORATE CONTROL

I. INTRODUCTION

A seemingly innocent provision of the Delaware General Corporation Law has generated increased attention recently. Section 228 provides that written consents, executed by stockholders, may be used to effect any action that could be taken by stockholders at a meeting, without actually having a meeting.[1] This provision may be utilized by stockholders to adopt bylaw amendments, elect directors, remove directors, and approve mergers and other transactions. The implications are clear: in the hands of a skilled tactician, the written consent provides an attractive option for effecting a change in corporate control.[2]

This note will discuss several important aspects of the Delaware written consent mechanism. First, a foundation will be set by discussing the statutory language and legislative history of section 228, along with the interplay of the written consent with the other voting mechanisms provided by the Delaware General Corporation Law. Second, the case law that has developed around section 228 will be analyzed with an emphasis on the Delaware Supreme Court decisions in *Datapoint Corp. v. Plaza Securities Co.*[3] and *Allen v. Prime Computer, Inc.*[4] Finally, this note will evaluate an important issue on the horizon,

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1. DEL. CODE ANN. tit. 8, § 228 (Supp. 1988).

2. *See, e.g.*, F. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS 5.03 (2d ed. 1985) (recognizing the use of written consents to approve mergers, consolidations, sale of substantially all corporate assets, dissolution); Greene, Dupler & Matlack, *Structural Defenses: Charter and By-Law Amendments, and Poison Pills* 8, *reprinted in* HOSTILE BATTLES FOR CORPORATE CONTROL 535, 546 (1986) (recognizing use of consents to seize control of corporation); Finkelstein & Varallo, *Action by Written Consent in Control Contests—Strategic and Legal Considerations*, 14 SEC. REG. L.J. 3 (1986); Quinn & Rudoff, *Takeover on Consent: A View from the Inside*, 12 SEC. REG. L.J. 3 (1984); and Lewkow & Austin, *Defensive Charter and By-Law Amendments*, *reprinted in* HOSTILE BATTLES FOR CORPORATE CONTROL 233, 251-57 (1984) (discussing use of written consents in control contests).

3. 496 A.2d 1031 (Del. 1985).

4. 540 A.2d 417 (Del. 1988).

specifically, whether the written consent procedure can be utilized to avoid the rigorous requirements of Delaware's newly-enacted Business Combination Statute.[5]

II. THE FOUNDATION

A. Language of Section 228

The Delaware General Corporation Law provides for certain corporate actions to be taken by stockholders.[6] In the normal scheme of corporate life, the everyday business and affairs of a corporation are conducted by corporate management.[7] The board of directors sets the policies, which are implemented by the officers.[8] The stockholders' role in all of this typically presents itself at the annual meeting of the corporation,[9] where the stockholders vote their shares, in person or by proxy, to elect the board of directors.[10] Obviously, if enough stockholders are disgruntled by the performance of the incumbent board, that board or members of it, will be ousted and replaced by successors with plans to bring an increased level of wealth to the

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5. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988). *See infra* notes 191-229 and accompanying text.

6. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(a) (1983) (amending bylaws); § 242 (1983) (amending certificate of incorporation); § 253 (1983 & Supp. 1988) (approving merger); § 211(b) (1983) (electing directors).

7. DEL. CODE ANN. tit. 8, § 141(a) (1983) (authorizing board of directors to conduct business and affairs of corporation). *See also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985) ("The board has a large reservoir of authority upon which to draw. Its duties and responsibilities proceed from the inherent powers conferred by 8 Del. C. § 141(a), respecting management of the corporation's 'business and affairs.' ") (footnote omitted).

8. *See generally* 2 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 434-504 (powers of officers and agents), §§ 505-48 (perm. ed. 1982) (powers of directors). *See also* F. KEMPIN & J. WIESEN, LEGAL ASPECTS OF THE MANAGEMENT PROCESS 397-444 (2d ed. 1976) (discussing relative roles of directors and officers in corporate governance).

9. *See generally* Sparks, *Conducting the Annual Shareholders' Meeting of a Delaware Corporation, reprinted in* HOSTILE BATTLES FOR CORPORATE CONTROL 613 (1984).

10. *See* DEL. CODE ANN. tit. 8, § 212(b) (1983) which provides:

> (b) Each stockholder entitled to vote at a meeting of stockholders or to express consent or dissent to corporate action in writing without a meeting may authorize another person or persons to act for him by proxy, but no such proxy shall be voted or acted upon after 3 years from its date, unless the proxy provides for a longer period.

corporation. Additionally, at these meetings, other matters are often put to a vote of the stockholders.[11]

While this procedure will remain the norm in the vast majority of situations, section 228 of the Delaware General Corporation Law provides an alternative. Under section 228, any action which may be taken at an annual or special meeting of stockholders may be effected by the written consent of the corporation's stockholders.[12] The action by consent may be taken absent a stockholders' meeting, and without prior notice to the stockholders and without a formal vote.[13]

To be effective, the consents must be in writing, and must indicate the corporate action they purport to authorize.[14] The consents, which must be signed by stockholders as of the record date,[15] typically must total an absolute majority (i.e., fifty percent plus one) of all outstanding shares.[16] Once the consents are obtained, an effective delivery is made to one of three places: the corporation's registered Delaware office; the corporation's principal place of business; or the officer or agent of the corporation having custody of the book containing a record of stockholder meetings.[17] The method of delivery must be by hand or certified or registered mail, return receipt requested.[18] A very important limitation or exception to the consent procedure is that the corporation can opt-out[19] of section 228, by so providing in its certificate of incorporation.[20]

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11. *See* Sparks, *supra* note 9, at 622-23 (noting that voting on stock option plans, appointment of independent auditors, etc. may be conducted at annual meeting).

12. DEL. CODE ANN. tit. 8, § 228(a) (Supp. 1988).

13. *Id.*

14. *Id.*

15. *Id. See also* DEL. CODE ANN. tit. 8, § 213 (1983) (providing that "[i]n order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders . . . , or to express consent to corporate action in writing without a meeting, . . . the board of directors may fix, in advance, a record date"). *See infra* notes 37-42 and accompanying text (discussing record date).

16. *See* DEL. CODE ANN. tit. 8, § 228(a) (Supp. 1988) (providing that it "shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted"). *See infra* note 34 and accompanying text.

17. *See* DEL. CODE ANN. tit. 8, § 228(a) (Supp. 1988).

18. *Id.*

19. *See* C. SMITH & C. FURLOW, GUIDE TO THE TAKEOVER LAW OF DELAWARE 33-38 (1988) (discussing the nature of the Delaware Corporation Law as "opt-out" legislation; particular emphasis on new takeover law).

20. DEL. CODE ANN. tit. 8, § 228(a) (Supp. 1988).

When signing the written consent, the stockholder must indicate the date of signature on the consent.[21] The date of the earliest dated consent delivered to the corporation will trigger a sixty day time period within which the necessary number of consents to take the desired corporate action must be solicited.[22] When less than unanimous consent is obtained, those stockholders who did not consent to the corporate action must be given prompt notification of the action taken.[23] Finally, the statute requires that stockholder action by written consent be so indicated on any necessary filings when the action so taken requires a filing under the Delaware General Corporation Law.[24]

The potential power of the consent procedure should be apparent. Through the consent process stockholders can adopt amendments to the certificate of incorporation[25] or to the corporate bylaws.[26] As previously noted, the consent procedure may also be used to remove directors[27] and elect new directors.[28] Equally significant is the ability to effect mergers and acquisitions through the consent mechanism.[29] Since these are all matters that go to the very core of the corporation's existence, corporate counsel is well-advised to be aware of the "great potential for mischief"[30] associated with section 228.

Perhaps in recognition of the power afforded by section 228, an absolute majority of outstanding stockholders must consent to the

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21. DEL. CODE ANN. tit. 8, § 228(c) (Supp. 1988).

22. *Id. See also* Pabst Brewing Co. v. Jacobs, 549 F. Supp. 1068, 1072 (D. Del. 1982) (termination of consent solicitation period occurs 60 days after the date of delivery of the first consent rather than when majority of outstanding shares have executed consents).

23. DEL. CODE ANN. tit. 8, § 228(d) (Supp. 1988).

24. *Id.* Additionally, § 228(b) provides a procedure for written consent in a nonstock corporation.

25. *See* DEL. CODE ANN. tit. 8, § 242(b)(1) (1983) (amending certificate of incorporation).

26. *See infra* notes 98-110 and accompanying text (discussing use of consents to adopt bylaw amendments).

27. *See infra* notes 111-22 and accompanying text.

28. *Id.*

29. *See infra* notes 191-229 and accompanying text (discussing new takeover law in Delaware).

30. 1 E. FOLK, R. WARD & E. WELCH, FOLK ON THE DELAWARE GENERAL CORPORATION LAW 549 (2d ed. 1986) (quoting Empire of Carolina, Inc. v. Deltona Corp., 501 A.2d 1252 (Del. Ch. 1985), *aff'd*, 514 A.2d 1091 (Del. 1986)).

action.[31] This rule is of course more rigorous than the voting rules for a stockholders' meeting, at which only a percentage of the shares present and voting must normally consent to the action.[32] To illustrate, assume a Delaware corporation has one million issued and outstanding shares of voting stock. For a particular corporate action, via the consent process, it would take 500,001 shares to constitute the requisite majority and effect the corporate action. However, if the action were to be voted upon by the stockholders at a normal meeting of the stockholders, and only 700,000 shares were present and voted, only 350,001 votes would be necessary to take the action, provided that a simple majority was required.[33] In other jurisdictions, since action by written consent must be unanimous, all one million shares must consent to the action.[34] Such jurisdictions have made a policy decision favoring the theoretical "give and take" associated with the debate on the issues that are presented at the meeting of stockholders.[35] Recognizing that the debate associated with a stockholders' meeting is in large measure theoretical and essentially nonexistent, section 228 allows for action only by the consent of an absolute majority.[36]

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31. DEL. CODE ANN. tit. 8, § 228(a) (Supp. 1988) (providing that to authorize action by consent the corporation must receive no less than "the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted").

32. FOLK, WARD & WELCH, *supra* note 30, at 548-49. *See also* Sparks, *supra* note 9, at 620 (discussion of quorum).

33. *See* FOLK, WARD & WELCH, *supra* note 30.

34. A sampling of the corporation laws of 25 states indicates that 21 states require unanimous shareholder approval to effectuate action by written consents. ALA. CODE § 10-2A-56 (1975); IDAHO CODE § 30-1-145 (1980); IND. CODE ANN. § 23-1-2-9(i) (Burns 1972); IOWA CODE ANN. § 496A.140 (West 1962); KY. REV. STAT. ANN. § 271A.665 (Michie/Bobbs-Merrill 1981); MD. CORPS. & ASS'NS CODE ANN. § 2-505 (1975); MO. ANN. STAT. § 321.273 (Vernon 1966); MONT. CODE ANN. § 35-1-509 (1982); NEB. REV. STAT. § 21-2028 (1977); N.M. STAT. ANN. § 53-18-8 (1978); N.Y. BUS. CORP. LAW § 615 (McKinney 1963); N.C. GEN. STAT. § 55-63(c) (1982); OHIO REV. CODE ANN. § 1701.54 (Anderson 1978); R.I. GEN. LAWS § 7-1.1-30.3 (1969); TENN. CODE ANN. § 48-17-104 (1955-1988); TEX. BUS. CORP. ACT ANN. art. 9.10 (Vernon 1980); VA. CODE ANN. § 13.1-28 (1978); WASH. REV. CODE ANN. § 23A.08.265 (1988); W. VA. CODE § 31-1-73 (1982); WIS. STAT. ANN. § 180.91 (West 1957); WYO. STAT. § 17-1-1006 (1983). Four states required an absolute majority of all shareholders. CAL. CORP. CODE § 603 (West 1977); FLA. STAT. ANN. § 607.394 (West 1977); ILL. ANN. STAT. ch. 32, para. 157.142 (Smith-Hurd 1954); NEV. REV. STAT. § 78.320 (1979).

35. FOLK, WARD & WELCH, *supra* note 30, at 548-49.

36. *Id.*

As in all stockholder voting situations, section 228 requires the setting of a record date.[37] There are three possibilities for determining the record date, as set out in section 213(b).[38] The board of directors may set the record date, which may not precede the date upon which the resolution setting the record date occurred.[39] The date set by the board also may not be set more than ten days beyond the resolution date.[40] Alternatively, if no record date is established and no prior action by the board is required, the record date must be the earliest date upon which a signed written consent is delivered to the corporation.[41] The final possibility occurs when no record date is fixed by the board and prior action by the board is required by the General Corporation Law. In this situation the record date will be set as the close of business on the day when the board adopts the resolution taking the prior action.[42]

In setting the record date the board may exercise its business judgment.[43] However, once the date has been set by the delivery of

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37. *See* Sparks, *supra* note 9, at 615 (discussion of establishing record date). *See also* FOLK, WARD & WELCH, *supra* note 30, at 428-35 (discussion of § 213).

38. DEL. CODE ANN. tit. 8, § 213(b) (Supp. 1988).

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Empire of Carolina, Inc.*, 514 A.2d at 1097 (board may exercise business judgment but cannot set record date so as to impermissibly manipulate the corporate machinery).

The business judgment rule may protect a board's actions. The business judgment rule is derived from "the fundamental principle, codified in 8 Del. C. § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors." Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)). "The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors." *Id.* The "rule" is not a rule in the true sense of the word but rather "is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. *Aronson*, 473 A.2d at 812. Directors' actions taken in response to a hostile takeover attempt are subject to an "enhanced" or more stringent business judgment rule. *See Unocal Corp.*, 493 A.2d at 955. In a takeover context, in order to avail themselves of the protection of the business judgment rule a board of directors must show first, that "they had reasonable ground for believing that a danger to corporate policy and effectiveness existed," *id.*, and second, that the defensive actions taken by the board were "reasonable in relation to the threat posed." *Id.*

the stockholder consents, that date may not be changed by the board.[44] It is important to note that the authority to set the record date rests with the board of directors in the first instance.[45] The stockholders' power to set the record date only arises if the board has failed to act.[46] Thus, the record date procedure in a consent solicitation situation recognizes the board's primary role in running the affairs of the corporation,[47] but also allows for stockholder manipulation of the record date.

B. Historical Concerns

Prior to 1967, the written consent procedure in Delaware was available only when stockholders unanimously consented to the proposed action.[48] The requirement of unanimous consent reflected the general understanding that the consent procedure was intended for use in small, closely held corporations.[49] The consent mechanism provided speed and flexibility of action by the corporation where stockholder approval was necessary.[50] Instead of having to call a meeting of the corporation's stockholders, which involves time consuming requirements and expense, the written consent procedure allowed the stockholders of a closely held corporation to essentially agree to a particular action over the phone, followed by execution of the consent.

In 1967, the written consent procedure was revised. No longer was unanimous stockholder approval necessary. Under the 1967 revision, if a majority of those entitled to vote gave their written consent, the proposed corporate action could be taken without a meeting.[51] This revision, which marked a significant change in the

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44. *See Empire of Carolina*, 514 A.2d at 1096 n.12 (citing Midway Airlines v. Carlson, 628 F. Supp. 244 (D. Del. 1985)).

45. *See* DEL. CODE ANN. tit. 8, § 213(b) (Supp. 1988).

46. *Id.*

47. *Empire of Carolina*, 514 A.2d at 1097.

48. *See* Folk, *Corporation Law Developments—1969*, 56 VA. L. REV. 755, 782 (1970).

49. *Id.* at 783. The realities of growth and geographical diversity of modern corporate ownership make the gaining of unainmous consent of the shareholders of a large publicly held corporation impracticable. *See, e.g.*, Comment, *Shareholder Democracy: A Description and Critical Analysis of the Proxy System*, 60 N.C.L. REV. 145, 146 (1980).

50. *See* D. DREXLER & A. SPARKS, THE DELAWARE CORPORATION: LEGAL ASPECTS OF ORGANIZATION AND OPERATION A-13 (2d ed. 1988).

51. *See* Folk, *supra* note 48, at 782.

consent procedure, was based on section 271 of the General Corporation Law, which permitted approval of a sale or exchange of all or substantially all of the corporation's assets via the written consents of the holders of a majority of the outstanding shares.[52] Also, under the 1967 provision, the written consent procedure was an opt-in statute.[53] This was changed in 1969, however, when section 228 was amended to be an opt-out statute, providing for majority action by consents for all corporations unless the corporate charter provided otherwise.[54] In 1971, section 228 was further amended to allow for majority stockholder consent in nonprofit corporations.[55]

C. *Voting Mechanisms*

The corporation law of Delaware recognizes the different roles played by management and stockholders. The board of directors is given the power to manage the business and affairs of the corporation.[56] This power, however, must always be exercised with the utmost consideration for the best interests of the corporation and the stockholders of the corporation.[57] The rights attendant to stock ownership manifest themselves in many ways;[58] here the concern is directed towards the right of a stockholder to vote.[59] Voting can be

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52. *Id.* (citing DEL. CODE ANN. tit. 8, § 271(a), *as amended* ch. 148, 57 Del. Laws (2 P-H Corp. (Del.) 492 (July 15, 1969))).

53. *Id.* at 783. That is, unless the certificate of incorporation provided for majority action, unanimity would be required to effect action by consent.

54. *Id.*

55. *See* FOLK, WARD & WELCH, *supra* note 30, at 547.

56. *See* DEL. CODE ANN. tit. 8, § 141(a) (1983) ("business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors"). *See also Unocal Corp.*, 493 A.2d at 953-54.

57. *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (director duty, "affirmatively to protect the interests of the corporation").

58. *See, e.g.*, Aranow, *Overview of Rights of Shareholders* 15 SHAREHOLDER MEETINGS (1984) (summarizing some of the rights attendant to stock ownership, including the right to inspect corporate books and records, solicit proxies, call special stockholder meetings, contest elections and management proposals and bring derivative actions among others).

59. *See* DEL. CODE ANN. tit. 8, § 212 (1983) (setting forth general rule of voting). *See also* Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest. They are limited only by any fiduciary duty owed to other stockholders."); Sparks & Whisenant, *The Elements of Stockholder Control: Voting Rights Under Delaware Law, reprinted in* SHAREHOLDER MEETINGS AND SHAREOWNER CONTROL IN TODAY'S SECURITIES MARKETS 21 (1985) (general discussion of voting rights).

viewed as a means for stockholders to exercise control over directors[60] and have a voice in fundamental corporate matters, such as a merger or consolidation, which directly and substantially affect the stockholders' ownership interest.

While the general rule is that each share of stock is accorded one vote,[61] any class or series of stock "may have such voting powers, full or limited, or no voting powers"[62] as provided in the certificate of incorporation. Delaware law allows for different voting rights for different classes of stock, as well as for shares within a class.[63] As long as the restrictions on the voting rights are contained in the certificate of incorporation, and do not conflict with the other provisions of the General Corporation Law, the restrictions will be valid.[64] A shareholder's right to vote, under Delaware law, is guaranteed by legal ownership.[65]

Section 212 of the General Corporation Law, which details the voting rights of stockholders, provides for three voting mechanisms. First, a stockolder can vote, in person, at an annual or special meeting of stockholders.[66] Second, a stockholder can "express consent or dissent to corporate action in writing without a meeting."[67] Lastly, a stockholder can "authorize another person or persons to act for him by proxy."[68] Typically, due to the nature of investment practices in large corporations,[69] the normal voting mechanism utilized is generally not the in personam vote. Rather, more often than not, votes on corporate action are effected by way of proxy.

The proxy relationship is one of agency.[70] The principal in the relationship is the grantor of the proxy; the proxyholder is the

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60. *See* DEL. CODE ANN. tit. 8, § 211(b) (1983) (vote for directors at annual meeting).

61. DEL. CODE ANN. tit. 8, § 212(a) (1983).

62. DEL. CODE ANN. tit. 8, § 151(a) (1983).

63. *See* FOLK, WARD & WELCH, *supra* note 30, at 401 (citing Providence & Worcester Co. v. Baker, 378 A.2d 121, 122-24 (Del. 1977)).

64. *See id.*

65. *See* Giuricich v. Emtrol Corp., 449 A.2d 232, 239 (Del. 1982).

66. DEL. CODE ANN. tit. 8, § 212(b) (1983).

67. *Id.*

68. *Id.*

69. *See generally* Franco, *Institutional Ownership in the U.S.: An Overview*, SHAREOWNER ACTIVISM 285 (1987) (discussing the nature of stock ownership, street name shareholdings, institutional investors, etc.).

70. FOLK, WARD & WELCH, *supra* note 30, at 406 ("proxy relationship is a 'particular sort of agency'"); 1 F. BALOTTI & J. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 7.15, at 361 (1986) ("a proxy is an agency relationship").

agent.[71] The written proxy itself serves as evidence of this underlying agency relationship.[72] A general proxy confers broad authority upon its holder, allowing him to vote on matters generally attended to at a stockholders' meeting.[73] Proxies may be limited by allowing the proxyholder to vote only on those matters specifically authorized by the principal.[74] Accordingly, votes pursuant to proxy are presumed valid and to "express the will of the stockholders."[75] Under a general proxy, the actions taken by the proxyholder will generally not be capable of subsequent repudiation,[76] unless the proxyholder has perpetrated a fraud.[77] The presumed validity, and difficulty of subsequent repudiation of votes cast by proxy, recognizes the practical concerns of corporate elections,[78] the policy of upholding corporate action taken at stockholder meetings[79] and the policy of avoiding disenfranchisement of stockholders.[80]

While proxies are presumed valid, a stockholder who has granted a prior proxy may revoke it by granting a subsequent proxy.[81] This

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71. *See supra* note 70.

72. Duffy v. Loft, Inc., 151 A. 223, 227-28 (Del. Ch.) *aff'd*, 152 A. 849 (Del. 1930).

73. BALOTTI & FINKELSTEIN, *supra* note 70, at 361.

74. Berlin v. Emerald Partners, No. 136, slip op. at 28-29 (Del. Jan. 12, 1989). After recognizing that the proxyholder in many cases is the broker, who is also very often the record owner, the Delaware Supreme Court stated that:

> [i]n certain instances, the brokers may vote the street name stock in their own discretion. However, with respect to other matters, such as [a] merger proposal presented to . . . stockholders, the brokers must obtain specified instructions from the beneficial owner [the principal], before the broker can vote, or give a proxy, on these nondiscretionary matters.
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> [The] stock exchange rules further provide that where a proxy form contains both discretionary and nondiscretionary proposals, the broker may vote, or give a proxy to vote, in the absence of instructions from the beneficial owner if the broker physically crosses out those portions where it does not have discretion.

Id. (citations omitted).

75. BALOTTI & FINKELSTEIN, *supra* note 70, at 361.

76. *Id.* at 362.

77. *Id.*

78. FOLK, WARD & WELCH, *supra* note 30, at 414.

79. *Id.*

80. *Id.*

81. *See* Hand v. Missouri-Kansas Pipe Line Co., 54 F. Supp. 649, 651 (D. Del. 1944) (proxies revocable absent a coupling with an interest). *See also* Calumet Indus., Inc. v. MacClure, 464 F. Supp. 19 (N.D. Ill. 1978) (applying Delaware law and discussing Delaware law with regard to proxies and written consents, including revocability of both devices). In addition, a stockholder may revoke a proxy orally, by conduct, by appearing at the shareholder meeting, by selling the

feature of a general proxy recognizes the power of the stockholder, as principal, to terminate the agency relationship with the proxyholder. Moreover, it recognizes that the right to vote is vested in the stockholder, not the proxyholder. Section 212(c), however, allows an irrevocable proxy to be granted provided "it is coupled with an interest sufficient in law to support an irrevocable power."[82] While early case law required the interest to be in the stock underlying the proxy, this is no longer the rule.[83] Pursuant to the General Corporation Law, "[a] proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally."[84]

Corporate directors and large stockholders of public corporations are aware of the sparsity of stockholders present at stockholder meetings.[85] These parties generally have much at stake in matters to be voted upon at a meeting—directors are concerned with continued employment and the best interests of the corporation while large stockholders have a substantial monetary investment to protect. Therefore, the proxies of widely dispersed stockholders are often sought by both directors and large stockholders.

The solicitation of proxies is very similar to the solicitation of written consents.[86] At the outset, it is important to note that the solicitation of written consents,[87] like proxy solicitations, requires compliance with the Securities Exchange Act of 1934[88] if a registered corporation is involved. While a detailed account of the requirements of the 1934 Act is beyond the scope of this note, suffice it to say that federal disclosure[89] and antifraud provisions[90] must be considered

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stock, or by giving another proxy. 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2062, at 327 (perm. ed. 1987).

82. DEL. CODE ANN. tit. 8, § 212(c) (1983).

83. *See* BALOTTI & FINKELSTEIN, *supra* note 70, at 364.

84. DEL. CODE ANN. tit. 8, § 212(c) (1983).

85. F. BALOTTI, J. FINKELSTEIN & G. WILLIAMS, MEETINGS OF STOCKHOLDERS 51 (1989).

86. *See, e.g., Calumet Indus.*, 464 F. Supp. at 26 (discussing consent solicitation in contest for corporate control and analogizing to proxy solicitation).

87. *See generally* Finkelstein & Varallo, *supra* note 2, at 7-16 (solicitation process described). *See also* Balotti & Bodnar, *Solicitation of Written Consents*, SHAREOWNER ACTIVISM 177, 186-97 (1987) (solicitation process described).

88. 15 U.S.C. § 78n(c) (1985).

89. *See, e.g.*, 17 C.F.R. § 240.14c-2 (1985) (dissemination of information statement); 15 U.S.C. § 78n(a) (1985) (disclosure requirements). *See* BALOTTI, FINKELSTEIN & WILLIAMS, *supra* note 85, at 234.9 (discussing Securities Exchange Act Requirements in connection with written consents).

90. *See, e.g.*, 17 C.F.R. § 240.14c-6(a) (1985) (antifraud provisions).

in any solicitation. Additionally, a substantial body of Delaware law has developed regarding the adequacy of disclosures in public statements to stockholders.[91]

One consideration present in mounting a consent solicitation is the establishment of a record date. As previously discussed, section 213 of the General Corporation Law provides the rules for setting a record date.[92] It is important to emphasize that under section 213, if the board of directors does not set the record date prior to the delivery of the consents to the corporation, the board will lose its ability to control the timing of the solicitation.[93] This is because section 228(c) provides for a sixty-day time period for consent solicitations. Thus, in order to maintain some degree of control when faced with a solicitation, directors need to quickly set a record date.

Additionally, there appears to be a distinction between proxies and consents in terms of their respective effectiveness. A proxy solicitation assumes an eventual meeting of stockholders at which the proxies will be voted.[94] Thus, action by proxy will not be effective until the proxies are used to vote upon that action at a meeting of the stockholders.[95] While consents not coupled with an interest are revocable, "any corporate action taken under § 228 is effective only upon delivery of the proper number of valid and unrevoked consents to the corporation."[96] Thus, if a stockholder submits his consent to the corporation's registered Delaware office on day one, the consent will not become effective until the number of consents necessary to take the particular action are received by the corporation.[97]

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91. Delaware imposes a duty upon directors to disclose all facts which are germane or material to a transaction. This requirement derives from the directors' fiduciary duties; all facts which a reasonable stockholder would consider material in his decision relating to his stock must be disclosed. *See, e.g.*, Weinberger v. Rio Grande Indus., 519 A.2d 116, 121 (Del. 1986) (adopting the balancing test of Flynn v. Bass Bros. Enter., 744 F.2d 978, 988 (3d Cir. 1984)); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985).

92. DEL. CODE ANN. tit. 8, § 213(b) (Supp. 1988). *See supra* notes 37-47 and accompanying text (discussing record date).

93. *See supra* notes 45-47.

94. *See* Finkelstein & Varallo, *supra* note 2, at 11-12 (discussing differences between proxies and consents).

95. *Id.*

96. *Prime Computer*, 540 A.2d at 420.

97. If the certificate of incorporation has not been amended to require a higher percentage of consents than the absolute majority requirement imposed by § 228, a particular stockholder's consent will not be "effective" until the registered office receives an absolute majority of stockholder consents.

III. USES OF WRITTEN CONSENTS

A. Bylaw Amendments

The validity of the use of written consents to adopt amendments to a corporation's bylaws was recognized in *Frantz Manufacturing Co. v. EAC Industries*.[98] Having decided to take the company private, the board of directors of Frantz Manufacturing Co. (Frantz) adopted a resolution empowering the proper corporate officers to set up an employee stock option program (ESOP), as part of the privatization plan.[99] Subsequently, EAC Industries (EAC) disclosed its purchase of fifty-one percent of Frantz's outstanding stock.[100] The 13D statement filed by EAC also disclosed the resignation of a Frantz director, his replacement by EAC's president, and certain bylaw changes made pursuant to written consent.[101] The following day, EAC representatives attempted to present their consent package with the bylaw changes to the Frantz Board, but the board refused to see them.[102]

The bylaw amendments, pursuant to the written consents, would have required a quorum of all directors, unanimous director vote for all board action and unanimous approval for committee action ratification.[103] The unanimity requirements, if effective, would have limited any further action by the Frantz Board to that in which EAC's president, presently on the Frantz Board, acquiesced.[104] This would have meant that the ESOP could not have received the treasury shares unless the new Frantz director—EAC's president—approved. Subsequently, the Frantz Board transferred 125,000 of its treasury shares into the ESOP, thereby relegating EAC to less than a majority interest.[105] Additionally, the Frantz Board attempted to adopt a bylaw which retrospectively invalidated the use of written consents.[106]

EAC sought a preliminary injunction declaring the effectiveness of the written consents and negating the validity of the ESOP. Stating

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98. 501 A.2d 401 (Del. 1985).

99. EAC Indus., Inc. v. Frantz Mfg. Co., No. 8003, slip op. at 3 (Del. Ch. June 28, 1985), *reprinted in* 11 DEL. J. CORP. L. 608, 611 (1986).

100. *Id.*, slip op. at 7, *reprinted in* 11 DEL. J. CORP. L. at 613.

101. *Id.*

102. *Id.*, slip op. at 8, *reprinted in* 11 DEL. J. CORP. L. at 614.

103. *Id.*, slip op. at 8, *reprinted in* 11 DEL. J. CORP. L. at 613.

104. *Id.*, slip op. at 8, *reprinted in* 11 DEL. J. CORP. L. at 614.

105. *Id.*, slip op. at 9, *reprinted in* 11 DEL. J. CORP. L. at 614. The new Frantz director, EAC's president, did not acquiesce to the transfer.

106. *Id.*, slip op. at 10, *reprinted in* 11 DEL. J. CORP. L. at 615.

that "[t]his case represents an instance of the adoption by management a [sic] retrospective takeover defense in the face of an acquiror's apparent success in securing majority control," the chancery court granted the injunction.[107]

The Delaware Supreme Court, finding the consent bylaw amendments "not inequitable under the circumstances" affirmed.[108] The court said, "We agree with the Court of Chancery that the EAC bylaw amendments were a permissible part of EAC's attempt to avoid its disenfranchisement as a majority shareholder and hold that the bylaw amendments should be given effect as of the date of the consents."[109] Therefore, the transfer of treasury shares into the ESOP was ineffective; the bylaw amendment, pursuant to written consent, required unanimous director approval and the EAC president, as a rightful member of the Frantz Board, did not approve of the stock transfer.[110]

B. Removal—Replacement of Directors

The *Frantz* case presented a situation in which written consents were used not only to amend bylaws, but also to place a director on a board to fill a vacant position. Consents can also be utilized to remove a corporation's directors and, at the same time, replace them with new directors.[111] This procedure can be carried out by a solicitation calling for the removal of the incumbent directors and also the nomination of a new slate of directors.[112]

The removal-replacement of directors has been recognized as having particular utility in hostile battles for corporate control.[113] To illustrate, consider *Moran v. Household International, Inc.*[114] In *Moran*, the board of directors of Household International adopted a "poison

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107. *Id.*, slip op. at 12, *reprinted in* 11 DEL. J. CORP. L. at 616.
108. *Frantz Mfg. Co.*, 501 A.2d at 409.
109. *Id.* at 407.
110. *Id.*
111. *See, e.g.*, Freeman v. Fabiniak, No. 8035 (Del. Ch. Aug. 15, 1985), *reprinted in* 11 DEL. J. CORP. L. 623 (1986); Cook v. Pumpelly, Nos. 7917, 7930 (Del. Ch. May 24, 1985); Sundlun v. Executive Jet Aviation, Inc., 273 A.2d 282 (Del. Ch. 1970).
112. *See supra* note 111.
113. Finkelstein & Varallo, *supra* note 2, at 5.
114. 500 A.2d 1346 (Del. 1985).

pill'"[115] due to a perceived potential threat of a coercive acquisition. The poison pill, which had substantial antitakeover features, was redeemable by the board.[116] In addressing a concern that the poison pill would prevent any hostile tender offer, the Delaware Supreme Court noted the following potential methods available to acquire Household:

> The evidence at trial also evidenced many methods around the Plan ranging from tendering with a condition that the Board redeem the Rights, tendering with a high minimum condition of shares and Rights, tendering and *soliciting consents to remove the Board* and redeem the Rights, to acquiring 50% of the shares and causing Household to self-tender for the Rights. One could also form a group of up to 19.90% and *solicit proxies for consent to remove the Board* and redeem the Rights.[117]

This technique would facilitate a hostile takeover by giving the acquiror a friendly board of directors to replace the ousted board. Once the friendly board is in place, the poison pill could be redeemed. In light of the new business combination legislation in Delaware, the use of the removal-replacement device may take on increased significance in hostile battles for corporate control.[118]

One potential glitch in the removal-replacement device arises where the board is classified.[119] When a board is classified, members

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115. *See generally* Greene, Dupler & Matlack, *supra* note 2, *reprinted in* HOSTILE BATTLES FOR CORPORATE CONTROL at 556-61 (poison pills are defensive mechanisms whereby a possible target distributes a special type of security to stockholders, converted into common stock of survivor corporation upon a merger). For a general discussion on the common types of poison pills—flip-overs, disproportionate voting, flip-ins, and debt provisions, see D. BLOCK, N. BARTON, & S. RADIN, THE BUSINESS JUDGMENT RULE 130-70 (1987); Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 BUS. LAW. 423 (1987) (summarizing features of, benefits and risks associated with, and actual cases utilizing poison pill defensive measures); Helman & Junewicz, *A Fresh Look at Poison Pills*, 42 BUS. LAW. 771 (1987) (discussing future vitality of poison pill plans).

116. *Moran*, 500 A.2d at 1349. *See* Note, *An Examination of a Board of Directors' Duty to Redeem the Rights Issued Pursuant to a Stockholder Rights Plan*, 14 DEL. J. CORP. L. 537 (1989) (discussing redemption of a poison pill).

117. *Moran*, 500 A.2d at 1354 (emphasis added).

118. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988). *See infra* notes 191-229 and accompanying text (discussing Delaware's business combination statute).

119. DEL. CODE ANN. tit. 8, § 141(d) & (k) (1983 & Supp. 1988) (indicating that a board can be divided into 1, 2, or 3 classes with each class standing for election in different years). *See* Finkelstein & Varallo, *supra* note 2, at 17-18 (discussing effect of classified board).

of the board can only be removed for cause.[120] The consent process does not lend itself to "for cause" removal because in such a case, "there must be service of specific charges, adequate notice, and [a] full opportunity for meeting the accusation."[121] It is suggested here that such a process cannot be adequately accomplished through the consent mechanism because the requirements for a "for cause" removal appear to favor the open exchange theoretically present at a stockholder's meeting. Written consents often have more utility in situations where surprise is advantageous.[122]

IV. LIMITATIONS ON WRITTEN CONSENTS

Potentially, the written consent procedure is the hemlock in the incumbent board of director's wine. However, there is an antidote. Section 228, by its terms, is an opt-out statute. Thus, unless the certificate of incorporation provides otherwise, section 228 will apply to that corporation. Many large corporations have already utilized the opt-out procedure by way of a charter amendment.[123] Unlike other forms of antitakeover measures, such amendments typically meet with little stockholder opposition.[124] In light of the potential utilization of the written consent process to bypass the antitakeover effect of the new business combination statute,[125] corporate directors would be well advised to adopt a resolution urging stockholders to opt-out or require a supermajority or unanimous consent solicitation to take action by consent. However, the question arises, short of adopting these charter amendments, what other techniques are available to an incumbent board faced with the potential of having the rug pulled out from under them?

A. Datapoint

In *Datapoint Corp. v. Plaza Securities Co.*,[126] the Supreme Court of Delaware addressed the issue of whether certain bylaw provisions adopted by the Datapoint Board, in response to a takeover bid by

120. *See* DREXLER & SPARKS, *supra* note 50, at A-12. *See also* Finkelstein & Varallo, *supra* note 2, at 17.

121. DREXLER & SPARKS, *supra* note 50, at A-12 to -13.

122. *See* Herzel, Davis & Harris, *Consents to Trouble*, 42 BUS. LAW. 135, 136 (1986) (consents being used in surprise attacks on incumbent directors).

123. *Id.* at 142.

124. *See id.* (lack of opposition from stockholders).

125. *See infra* notes 191-229 and accompanying text.

126. 496 A.2d 1031 (Del. 1985).

corporate raider Asher B. Edelman, conflicted with section 228.[127] Edelman, who beneficially owned ten percent of Datapoint's stock, made an offer to the Datapoint Board to acquire that corporation.[128]

If the offer were rejected, Edelman threatened to solicit stockholder consents to remove the board and replace them with his own candidates.[129] After rejecting his offer, the board responded by adopting a bylaw, which was "'designed to establish a procedure to govern any attempt to take corporate action on Datapoint's behalf by written shareholder consent.'"[130] Edelman withdrew his offer, announced his intention to go forward with his threatened consent solicitation and sued for an injunction against enforcement of the bylaw.[131] Datapoint counterclaimed, seeking declaratory relief that the bylaw was valid and enjoining any violation of it.[132] Subsequently, the bylaw was amended to provide that: no action pursuant to written consent could occur until forty-five days after the record date; a record date would be fixed within fifteen days of the receipt of a stockholder's notice of intent to solicit consents, unless the stockholder requested a date.[133] The amendments also provided for a litigation hold mechanism whereby no action by consent could become effective until all litigation as to the validity of the consents, pursued in good faith, was terminated.[134] After a record date was set, Datapoint filed suit in federal court to invalidate the consents obtained by Edelman, thus triggering the litigation hold.[135]

The Delaware Court of Chancery granted the preliminary injunction enjoining Datapoint from enforcing the bylaw and Datapoint appealed.[136] The basis of the appeal was that section 228 allowed for reasonable regulation of the consent procedure through reasonable bylaw provisions.[137] The Delaware Supreme Court said: "The issue is not whether 228 tolerates any delay in effectuating a shareholder consent action taken thereunder. Nor is the issue whether [section] 228 permits a board of directors to regulate by [sic] bylaw solicitation

127. *Id.* at 1032.
128. *Id.* at 1033.
129. *Id.*
130. *Id.* (referring to chancery court's opinion).
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.* at 1033-34.
135. *Id.* at 1034.
136. *Id.*
137. *Id.*

procedures under [section] 228."[138] Rather, the court chose to confine its ruling to the bylaw in issue.[139] Finding the bylaw to be in conflict with section 228, the court affirmed the chancellor.[140]

In support of this conclusion, the Delaware Supreme Court found that the bylaw imposed an arbitrary delay upon stockholder action by consent.[141] The bylaw afforded Datapoint management a sixty day delay period before the action by consent would become effective.[142] Ostensibly, this time period was necessary for Datapoint's management to determine the validity of the tendered consents. Section 228, however, requires that "action taken [under its authority] is to be effective when sufficient consents are signed."[143] No acceptable reason could be found by the court which would justify why the Datapoint Board should be afforded such a considerable delay in determining the effectiveness of the consents.

In attempting to square the bylaw, both with the court and section 228, the Datapoint directors argued that the delay period was necessary for informed corporate suffrage. By providing that no action by consent could occur until forty-five days after the record date, the Datapoint Board would be able to distribute counter solicitation materials to the stockholders.[144] While the Supreme Court of Delaware found such an attempt at buying time to be unreasonable under section 228,[145] this issue deserves further consideration. At first glance, denial of the delay period seemingly encourages the effectuation of core corporate action through less than totally informed channels. If the actions to be taken by consent parallel those actions which can be taken at a stockholders' meeting, should not the stockholder, presented with a consent solicitation, be afforded the same atmosphere of discussion and exchange of differing views that theoretically exists at the stockholders' meeting? If the "primary consideration in a proxy contest is that there be a free flow of

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138. *Id.* at 1035.
139. *Id.*
140. *Id.*
141. *Id.* at 1036.
142. *Id.*
143. *Id.*
144. *Id.* at 1036 n.5. This argument is apparently based on the statement in Pabst Brewing Co. v. Jacobs, 549 F. Supp. 1068 (D. Del. 1982), that "[t]he Court also recognizes that sufficient time should be given to shareholders to assure that they have the opportunity to receive all material information to make an informed judgment . . . ." *Id.* at 1079.
145. *Datapoint Corp.*, 496 A.2d at 1036.

information so the stockholders can have a reasonable chance of making an informed judgment,"[146] why is it unreasonable for a board of directors to ask for the same in the consent procedure? In fact, in a situation in which a board of directors is aware of a proposed hostile consent solicitation, that board arguably should have a *duty* to respond to the solicitation in a manner that would reveal their side of the story to stockholders, and thus provide an informed voting atmosphere.[147]

The simple answer to these concerns is that section 228, by its terms, does not provide for such a delay period. Whether the underlying reasons for the delay period are viewed as laudable or divisive is immaterial. Further, the alluded to forum of discussion that theoretically occurs at stockholders' meetings is very often just that, theoretical, and does not typify the normal meeting. Additionally, the consent solicitations will be subjected to the materiality requirements associated with proxies indicating that any material misrepresentations by a solicitor will likely result in a lawsuit.[148] However persuasive these arguments may be, the *Datapoint* decision was arguably confined to a bylaw that sought to delay action by consent for a period of forty-five days after the record date, a result which is clearly in conflict with section 228.

Having found this delay bylaw provision unreasonable, the litigation hold provision was "found to be [clearly] 'repugnant to the

146. FOLK, WARD & WELCH, *supra* note 30, at 408 (citation omitted).

147. For example, in a situation in which the incumbent directors are aware that the consent solicitor intends to bust-up the corporation or perhaps to effect some form of transaction that is not in the best interests of the stockholders, the language of Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939), may require the directors to respond as part of their affirmative duty "to protect the interests of the corporation." *Id.* at 510. Additionally, since the protections of the business judgment rule have no application in the context of directorial abdication of functions, Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984), it is suggested that directors will not be protected for any harm devolving upon stockholders pursuant to such a solicitation unless the directors do respond by fully presenting any opposing view they may have. Finally, there may be implications associated with the directors' *Unocal* duties. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Such a consent solicitation could be viewed, quite easily, as a threat "to corporate policy and effectiveness." *Id.* at 955. If this is true, *Unocal* requires that any defensive tactics designed to thwart a potential takeover must be "reasonable in relation to the threat posed." *Id.* Since the law of Delaware is *not* "that a board's response to a takeover threat should be a passive one," *id.* at 955 n.10, the directors must do something. It is suggested here that the least they should do, if time permits, is disseminate any opposing views they may have, and argue their case to the stockholders for what they perceive to be the best interests of the corporation.

148. *See supra* notes 89-90 and accompanying text.

statute.'"[149] Obviously, the effect of the litigation hold could have been to provide the Datapoint Board with the means to perpetually deprive the consenting stockholders of their statutory rights by continually pressing litigation on the validity of the consents. In the words of the court:

> [W]e do not hold that [section] 228 must be construed as barring a board of directors from adopting a bylaw which would impose minimal essential provisions for ministerial review of the validity of the action taken by shareholder consent. However, defendant's bylaw, as adopted, is so pervasive as to intrude upon fundamental stockholder rights guaranteed by statute.[150]

B. Prime Computer

The extent of the authority retained by a board of directors faced with a consent solicitation was also tested in *Allen v. Prime Computer, Inc.*[151] At issue was whether a seemingly reasonable bylaw which regulated the consent solicitation process under section 228 was invalid under *Datapoint*.[152] Chancellor Allen, writing for the court of chancery, had concluded that the bylaw in issue, even though "reasonable in structure and timing and that, if implemented—whether by bylaw or charter amendment—, . . . would serve beneficial corporate purposes," was invalid under the authority of *Datapoint*.[153] On appeal, the Delaware Supreme Court affirmed the decision of the chancery court.[154]

Prime Computer, which controlled two percent of the outstanding common stock of Computervision Corporation, made several failed attempts at instituting a merger of the two Delaware corporations.[155] In response to Prime Computer's overtures, Computervision's directors adopted a poison pill plan which conferred certain

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149. *Datapoint Corp.*, 496 A.2d at 1036 (citing Kerbs v. California E. Airways, 90 A.2d 652 (Del. 1982), *reh'g denied*, 91 A.2d 62 (1982)).

150. *Id.*

151. 540 A.2d 417 (Del. 1988).

152. *Id.* at 418.

153. Prime Computer, Inc. v. Allen, No. 9557, slip op. at 2 (Del. Ch. Jan. 22, 1988) (revised Jan. 25, 1988), *reprinted in* 13 DEL. J. CORP. L. 1198 (1988).

154. *Prime Computer*, 540 A.2d at 418.

155. *Prime Computer*, No. 9557, slip op. at 3, *reprinted in* 13 DEL. J. CORP. L. at 1201.

"purchase rights" upon its stockholders in the event of the merger of Computervision.[156] The purchase right holder had the option, in such a situation, to receive common stock of the acquiror worth twice the exercise price of each right.[157] The poison pill also allowed for redemption of the purchase rights by a new board of directors elected through a proxy or consent solicitation undertaken by an all-shares tender offeror.[158]

Prime Computer commenced an all-shares tender offer for Computervision, conditioned upon the redemption or other satisfactory elimination of the poison pill plan.[159] In its tender offer, Prime Computer notified stockholders of its intent to solicit written consents for the removal of the Computervision Board of Directors if they failed to meet this condition to the offer.[160] In response to this threat to their job security, the Computervision Board adopted certain bylaw provisions. Under one bylaw, section 12, corporate action was purportedly prevented from being taken by written consent until "'at least twenty (20) days from the date of commencement of a solicitation . . . of consents.'"[161] Not applying to consent solicitations by ten persons or less, the purpose of section 12 was to allow "the corporation's stockholders to have an opportunity to receive and consider the information germane to an informed judgment as to whether to give a written consent . . . ."[162] Thus, section 12 delayed the effectiveness of consents until at least twenty days after commencement of a solicitation, allowing stockholders to revoke their consents within that period.

Under another amendment to the bylaws, section 13, a reviewing procedure of the validity of consents and revocations delivered to the corporation was established.[163] It required Computervision to retain independent inspectors within three business days of the earliest dated consent.[164] Further, the "[c]onsents and revocations [were to be] delivered to the inspectors upon receipt by the corporation," for

156. *Id.*
157. *Id.*
158. *Id.*, slip op. at 3-4, *reprinted in* 13 DEL. J. CORP. L. at 1201-02.
159. *Id.*, slip op. at 4-5, *reprinted in* 13 DEL. J. CORP. L. at 1202.
160. *Id.*, slip op. at 5, *reprinted in* 13 DEL. J. CORP. L. at 1202.
161. *Id.*, slip op. at 6, *reprinted in* 13 DEL. J. CORP. L. at 1203.
162. *Prime Computer*, 540 A.2d at 421 (bylaws are reprinted in appendix). *See also supra* notes 88-90 (disclosure under Delaware law) and 120-25 (discussing need to inform stockholders during a consent solicitation).
163. *Prime Computer*, 540 A.2d at 422.
164. *Id.*

immediate review as to their validity.[165] After the twenty day period set out in section 12, the inspectors, upon the request of Computervision or the soliciting stockholders, were to report whether a sufficient number of valid consents had been received.[166] Finally, section 13 provided a forty-eight hour period for Computervision and the soliciting stockholders to review the findings of the inspectors and decide whether to challenge the findings or not.[167] If challenged, the inspectors were to promptly arrange for a challenge session to be followed by a final report as to the number of valid consents.[168]

The validity of the bylaw provisions at issue was controlled by the language of section 228 and the *Datapoint* decision. The chancery court read section 228 as "creat[ing] a right in shareholders to act independently of directors upon whom they may be dependent to call a meeting."[169] The chancery court also pointed out that *Datapoint* requires "an evaluation of both the purposes sought to be served by the bylaw (in light of the purposes of section 228) and the timing impact upon the effective exercise of the power to act through written consent."[170] Before addressing the issue of whether a bylaw, providing a delay period for the effectiveness of action pursuant to written consent, is permissible under section 228, the court addressed the reasonableness and balance of the bylaw provisions.[171]

First, the bylaws only applied to action by consent taken by more than ten consenting stockholders.[172] This indicated, according to the court, that the bylaws were intended to remedy the potential problems of solicitations of widely held companies and not to thwart direct exercises of control by a majority stockholder or small group.[173] Second, unlike the *Datapoint* bylaw, there was no litigation hold present in this case.[174] Third, the review provisions of section 13 did not strike the court as unreasonable, nor unduly elaborate.[175] While reasonable minds may differ as to whether section 13 provides "'min-

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165. *Id.*
166. *Id.* at 422-23.
167. *Id.* at 422.
168. *Id.*
169. *Prime Computer*, No. 9557, slip op. at 10, *reprinted in* 13 DEL. J. CORP. L. at 1205.
170. *Id.*
171. *Id.*, slip op. at 11, *reprinted in* 13 DEL. J. CORP. L. at 1205.
172. *Id.*
173. *Id.*
174. *Id.*, slip op. at 11, *reprinted in* 13 DEL. J. CORP. L. at 1206.
175. *Id.*, slip op. at 11-12, *reprinted in* 13 DEL. J. CORP. L. at 1206.

imal essential provisions for ministerial review,'" Chancellor Allen was of the opinion that it was the burden of the challenging party to prove the bylaws were not reasonable.[176] Finally, the court considered the twenty day period outlined in section 12 to be reasonable for consent and revocation solicitations.[177] This recognized reasonableness was, however, contingent upon whether section 228 allows for a bylaw enumerated delay period to solicit revocations.[178]

Relying on *Datapoint,* the chancery court held that the twenty day delay provision was invalid.[179] The court felt compelled to reach this decision while repeatedly implying that *Datapoint* may have been wrongly decided. Chancellor Allen pointed out that the twenty day period, which allowed the directors time to solicit revocations, would afford stockholders "an opportunity to maturely consider the decision and, indeed, to change their minds."[180] The opinion implies that such a procedure would be favorable, and if not constrained by *Datapoint's* proscription against bylaws "'giv[ing] time to seek to defeat the shareholder action'—a 'ground not relating to the legal sufficiency of the consents obtained,'" a different result might have followed.[181] The court also invalidated the section 13 bylaw because, even though it probably was a satisfactory ministerial review bylaw under *Datapoint,* it was too interwoven with section 12 to stand alone.[182]

On an expedited basis, the Delaware Supreme Court affirmed the decision of the chancery court.[183] In addressing the validity of the Computervision bylaw, Justice Moore, writing for the court, set forth several relevant factors to use "[i]n evaluating the reasonableness of a bylaw, which purports to establish ministerial review of the validity of consents . . . ."[184]

> First, a court must determine the purpose sought to be served. A bylaw whose real purpose is delay of shareholder action is per se unreasonable. Second, the court should consider the impact of the bylaw upon the effective exercise

176. *Id.*, slip op. at 12-13, *reprinted in* 13 DEL. J. CORP. L. at 1206.
177. *Id.*, slip op. at 13, *reprinted in* 13 DEL. J. CORP. L. at 1206-07.
178. *Id.*
179. *Id.*, slip op. at 19, *reprinted in* 13 DEL. J. CORP. L. at 1209.
180. *Id.*, slip op. at 14, *reprinted in* 13 DEL. J. CORP. L. at 1207.
181. *Id.*, slip op. at 15, *reprinted in* 13 DEL. J. CORP. L. at 1208.
182. *Id.*, slip op. at 17, *reprinted in* 13 DEL. J. CORP. L. at 1209.
183. *Prime Computer,* 540 A.2d at 418.
184. *Id.* at 420.

> of the power conferred under [section] 228. Finally, the bylaw should contain only the minimal requisites for a reliable and prompt ministerial review to ensure the orderly function of corporate democracy. Such ministerial review must not be unduly elaborate, should contain reasonable time periods only necessary to the circumstances, and should be one which, when administered in good faith, is reasonable and balanced.[185]

The first and second factors represent a purpose and effect inquiry. The first of these factors essentially recognizes the statutory right conferred upon stockholders to exercise their franchise via the written consent mechanism. As the court stated, "[b]ecause [section] 228 clearly and unambiguously permits a majority of the stockholders of a corporation to act immediately and without prior notice to the minority, the statute must be given its plain meaning."[186] Since, in the takeover context, incumbent directors may be faced with the potential of losing "their" corporation, they will often seek to prolong a hostile contest as long as possible with the hope of winning a war of attrition. *Prime Computer* establishes that an express or implied purpose to delay stockholder action by consent, through the use of bylaw amendments, will not be tolerated by the Delaware courts. Recognizing that a similar delay may arise in the absence of a finding of delay purpose, prong two of the *Prime Computer* inquiry questions the effect of a bylaw upon the stockholders' section 228 power. The effect of delaying action by written consent will not be tolerated, even if couched in terms of minimal ministerial review provisions.

In this case, the directors of Computervision adopted the bylaw amendments as a vehicle to buy time to solicit consent revocations.[187] Clearly, this is a forbidden purpose under the purpose inquiry prong of *Prime Computer*. The effect of the bylaw amendment at issue was to delay the effectiveness of stockholder action by consent for a minimum of twenty days. While in some instances twenty days may be necessary to properly review the consents, the effect of the bylaw would be to delay consent action for twenty days. Such a per se effect is not tolerable under prong two of *Prime Computer*.

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185. *Id.*
186. *Id.*
187. *See supra* note 162 and accompanying text.

The third prong of *Prime Computer* recognizes the court's prior approval of ministerial review bylaws.[188] The suggestion by the court is that depending upon the circumstances of the consent solicitation, the depth of, and amount of time necessary for the ministerial review will vary. For example, the Computervision bylaw provided for the passage of a minimum time period of twenty days before which a nationally recognized independent inspector of elections could issue a report on the consents validity. Under the bylaw, this procedure would take place regardless of whether eleven stockholders, who owned ninety-nine percent of the corporation's stock, or 100 billion individuals each owning one share of stock exercised their franchise by consent. Surely there would be no need to follow the provisions of the bylaw in the case of the eleven ninety-nine percent stockholders. However, exactly that was required by the bylaws. While it is possible that in some instances the provisions of the bylaw may be useful, and reasonable, the fact that the bylaws set forth rigid, inflexible restraints, regardless of the circumstances, rendered them invalid.[189]

In attempting to adopt bylaw provisions which will survive *Prime Computer* and *Datapoint*, corporate counsel should analyze the Computervision bylaws appended to the Delaware Supreme Court opinion in *Prime Computer*. As the court said, "[T]he form of ministerial review, were it not coupled with the twenty day period, would probably be reasonable under *Datapoint*."[190] *Prime Computer* clearly indicates that attempts to frustrate the immediacy of the consent process will meet with failure, despite any arguments that directors should be given time to solicit revocations. Thus, in order to avoid the potentially harsh results of a consent solicitation, directors are well-advised to adopt a resolution encouraging an amendment to the corporation's bylaws opting-out of section 228's reach. This is especially pertinent when the Delaware business combination statute is considered.

V. CONSENT TO A BUSINESS COMBINATION?

In the wake of the United States Supreme Court's affirmation of Indiana's second generation takeover statute in *CTS Corp. v. Dynamics Corp.*,[191] Delaware enacted its own business combination

188. *See supra* text accompanying note 150 (*Datapoint* quote).
189. *Prime Computer*, 540 A.2d at 421.
190. *Id.* at 421.
191. 107 S. Ct. 1637 (1987).

statute.[192] This rather detailed and lengthy statute can be synopsized, for present purposes, as follows:

> Section 203 is intended to strike a balance between the benefits of an unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics. To achieve this end, the statue [sic] will delay for three years business combinations with acquirors not approved by the board unless the acquiror is able to obtain in his offer 85% of the stock as defined in the statue [sic]. This provision is intended to encourage a full and fair offer.[193]

Since the Delaware Act has been held to be "most likely constitutional," consideration of its effect upon written consents is appropriate.[194]

The statute provides that "a corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder."[195] There are several exceptions, one of which allows the business combination to be effective if the incumbent board of directors approves it and it is authorized by at least two-thirds of the outstanding voting stock not owned by the interested stockholder at an annual or special meeting.[196] Stockholder authorization, however, may not be effected through written consents.[197] Thus, the business combination statute serves to limit the reach of section 228. While the debate on the wisdom and propriety of the statute is still brewing, section 203 does not appear to foreclose all uses of the written consent. In fact, it is quite likely that section 203 will result in the increased use of written consents in the takeover context.

Section 203 prohibits business combinations involving "interested stockholders."[198] Essentially, any person who owns fifteen per-

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192. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988).

193. 5 F. BALOTTI & J. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS 178.7 (1988 Special Supp.). *See* Note, *The North Carolina Shareholder Protection Act*, 66 N.C.L. REV. 1146, 1151 n.45 (1988).

194. BNS Inc. v. Koopers Co., 683 F. Supp. 458 (D. Del. 1988) (detailed discussion of new Delaware statute).

195. DEL. CODE ANN. tit. 8, § 203(a) (Supp. 1988).

196. DEL. CODE ANN. tit. 8, § 203(a)(3) (Supp. 1988).

197. *Id.*

198. *See* DEL. CODE ANN. tit. 8, § 203(c)(5) (Supp. 1988) (definition of interested stockholder).

cent or more of the target corporation's outstanding voting stock is an interested stockholder.[199] Additionally, any person who is an affiliate or associate of the corporation and owned fifteen percent or more of the outstanding voting stock, within the three years prior to the determination of whether such person is an interested stockholder, will be deemed an interested stockholder.[200] Expressly defined as not an interested stockholder are those who owned in excess of the fifteen percent limitation prior to December 23, 1987.[201] The statute further provides "that a person shall not be deemed the owner of any stock because of such person's right to vote such stock if the [right] to vote such stock arises solely from a . . . consent given in response to a . . . consent solicitation made to 10 or more persons . . . ."[202] While the full text of the statute should always be consulted when confronted with a particular set of facts, there are potential circumstances in which a party may escape characterization as an interested stockholder. Obviously, in such a situation, the restrictions of section 203 would not apply, allowing the use of consents to effect a merger or other business combination. Additionally, merely having solicited consents does not cause the solicitor to be deemed an owner of the underlying stock. Thus, there is no danger in soliciting consents of exceeding the fifteen percent ownership level.

The first exception to the prohibition on business combinations, found in section 203(a)(1), provides an opportunity to utilize written consents to bypass the three-year waiting period. Section 203(a)(1) prohibits business combinations between the corporation and an interested stockholder for three years following the date the stockholder became an interested stockholder, "unless: (1) Prior to such date the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder . . . ."[203] By the use of written consents, the potential acquiror, prior to becoming an interested stockholder, may be able to successfully solicit consents authorizing the removal of an incumbent hostile board and replacement with a friendly board.[204] Once the friendly board is in office,

199. *Id.*
200. *Id.*
201. *Id.* § 203(c)(5)(x)(A).
202. *Id.* § 203(c)(8)(ii)(B) (section defining "owner").
203. *Id.* § 203(a)(1).
204. *See supra* notes 113-22 and accompanying text (describing replacement-removal of directors).

approval of the "business combination or the transaction which resulted in the stockholder becoming an interested stockholder,"[205] will be assured. Thereafter, the three-year prohibition may be bypassed.

A possibly useful technique may be to couple the removal-replacement of directors with a tender offer for fifty-one percent of the corporation's shares.[206] Once the appropriate number of consents is received, and the new board is in place, the tender offer can be approved by the board.[207] It is essential, however, under section 203(a)(1) that the consent process precede the actual takedown date of the tender offer, to assure the proper board approval.[208] A similar technique may potentially be utilized in other forms of acquisition.

It is interesting to speculate on the applicability of the business judgment rule to such a transaction.[209] The above described consent coupled with a tender offer situation might be challenged as being an interested transaction since the new board may be characterized as interested or otherwise subservient to the acquiror.[210] It should be obvious that the new directors were nominated to the board to provide approval for the transaction. The directors also appear to have a direct personal interest in the transaction; if they do not approve the transaction they will likely lose the support of the would-be acquiror, as well as any further business arrangements with him.

Consider the likely situation where, in soliciting consents to remove-replace directors, the solicitor also discloses to the stockholders his intent to commence a two-tier tender offer subject to the new board's approval.[211] Further assume that based on this solicitation, the new directors are elected and "rubber stamp" the proposed tender offer. If the business judgment rule is "a presumption that in making a business decision the directors of a corporation acted

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205. DEL. CODE ANN. tit. 8, § 203(a)(1) (Supp. 1988).

206. *See* SMITH & FURLOW, *supra* note 19, at 86-89 (discussing the particular utility and some problems associated with this technique).

207. DEL. CODE ANN. tit. 8, § 203(a)(1) (Supp. 1988).

208. *See* SMITH & FURLOW, *supra* note 19, at 86.

209. *See supra* note 43 (explaining business judgment rule). *See generally* BLOCK, BARTON & RADIN, *supra* note 115 (exhaustive text on business judgment rule).

210. Director interest has been described, in terms of the application of the business judgment rule, this way: "From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Aronson*, 473 A.2d at 812.

211. *See* SMITH & FURLOW, *supra* note 19, at 87.

on an informed basis, in good faith and in the honest belief that the action was in the best interests of the company,"[212] the business judgment rule arguably should not be applicable. Such a transaction may be subject to the entire or intrinsic fairness test.[213]

First, it has been suggested that since the stockholders elected the new board with full disclosure of the two-tiered tender offer, that such stockholder action may constitute ratification of the transaction by the stockholders, thereby insulating the directors from liability.[214] In such a scenario, however, is it not equally arguable that since the directors only rubber stamped the transaction, there was no director action, hence the business judgment rule should not apply?[215] It does not seem appropriate to foreclose stockholders not consenting to the election of the new directors from pursuing legal remedies. Second, by merely serving as a rubber stamp to the transaction, the directors cannot reasonably argue that they acted on an informed basis.[216] As the Delaware Supreme Court cautioned in *Smith v. Van Gorkom*:[217]

> Under the business judgment rule there is no protection for directors who have made "an unintelligent or unadvised judgment." . . . Since a director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing. But fulfillment of the fiduciary function requires more than the mere absence of

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212. *Aronson*, 473 A.2d at 812.

213. Intrinsic or entire fairness has two basic components: fair dealing and fair price. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983). Fair dealing involves questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to directors, and how approvals of the directors and shareholders were obtained. *Id.* at 711. Fair price relates to the economic and financial considerations behind the merger including factors such as assets, market value, earnings, future prospects, and any other elements that affect the inherent value of the company. *Id.* The test for fairness is not a bifurcated one between fair dealing and price, but rather all aspects of the issue must be examined since the question is one of *entire* fairness. *Id. See also* Summa Corp. v. Trans World Airlines, 540 A.2d 403 (Del. 1988) (intrinsic fairness test applied to majority shareholder who acted against minority interests).

214. *See* SMITH & FURLOW, *supra* note 19, at 87.

215. *See Aronson*, 473 A.2d at 813 (business judgment rule inapplicable where directors failed to act).

216. *See* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

217. *Id.*

> bad faith or fraud. Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information . . . .[218]

Another problem involves the potential application of the *Revlon* duty.[219] As the Delaware Supreme Court said, when the directors have determined that "the breakup of the company was inevitable [and] that the company was for sale [the directors become] auctioneers charged with getting the best price for the stockholders at a sale of the company."[220] *Revlon*, of course, involved the actions of incumbent directors who implemented defensive tactics to fend off a hostile acquisition and ended the bidding by granting a lock-up option to a white knight.[221] In the consent coupled with tender offer situation, the imposition of the *Revlon* duty may arise at the time when the new directors are elected, but prior to their approval of the transaction conferring the solicitor with "interested" status. Imposing the *Revlon* duty on the new directors would potentially chill the effectiveness of the consents coupled with tender offer transaction. It would, however, serve to assure that the directors are not abdicating their responsibilities to the desires of a potential acquiror.[222] Is it not appropriate to demand from the new directors the same level of good faith, informed decision making and attention to the best interests of the stockholders (here, price maximization) as would be demanded of any other director in a similar situation?[223]

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218. *Id.* at 872.

219. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

220. *Id.* at 182.

221. A white knight refers to a friendly third party corporation which a target corporation will turn to, to acquire all or part of the target corporation, thus fending off a hostile acquiror. The white knight ploy is among the host of defensive measures employed in takeover situations receiving judicial sanction whereby the object is to deter or defeat the takeover. *Unocal Corp.*, 493 A.2d at 957. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (white knight utilized in a "lock-up" strategy). *See also* BLOCK, BARTON & RADIN, *supra* note 115 (discussing the sale of companies to white knights).

222. This recognizes that a director's role in a takeover context, in Delaware, is not a passive one. *See supra* note 147.

223. When enacted, the restrictive provisions of § 203 allowed for amendments to the corporation's bylaws in order to opt-out of the statute. Therefore, if a stockholder, interested or not, would be able to solicit sufficient consents for the "removal-replacement" of directors, the new friendly directors could adopt such a bylaw amendment. *See supra* notes 98-110 (bylaw amendments), 111-22 (removal-

An opt-out amendment in the corporation's bylaws or certificate of incorporation may be enacted by the affirmative vote of a majority of the corporation's shares entitled to vote.[224] Written consents could be solicited to accomplish this goal. An opt-out amendment pursuant to stockholder vote will not be effective for twelve months.[225] Further, only stockholders who became interested stockholders after the adoption of such amendment can take advantage of the shortened waiting period.[226] Thus, if a noninterested stockholder could muster sufficient consents to opt-out of section 203, that stockholder would be able to effect a business combination after the passage of twelve months. Clearly, this is one procedure that may only be viable for the long-range planner.[227]

The business combination legislation limits, but does not foreclose the use of written consents to effect immediate stockholder action. The discussion has already outlined several potential means to either bypass, or relax, the rigidity of section 203. By utilizing written consents to take these actions, a potential acquiror could develop a friendly environment from an otherwise hostile situation.[228] The business combination statute, with its potentially chilling effect on hostile acquisitions, may likely lead to an increased use of the written consent process, the implications of which will be facing the courts of Delaware in the near future.[229] In order to avoid the

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replacement of directors) and accompanying text. One major problem is presented with this scenario. This action must be accomplished within ninety days of the effective date of § 203. Therefore, directors had to have availed themselves of this provision by May 3, 1988. *See BNS*, 683 F. Supp. at 466.

224. DEL. CODE ANN. tit. 8, § 203(b)(3) (Supp. 1988). *See also* DEL. CODE ANN. tit. 8, § 242(b)(1) (1983) (board adopts resolution to amend certificate of incorporation for stockholder vote).

225. DEL. CODE ANN. tit. 8, § 203(b)(3) (Supp. 1988).

226. *Id.*

227. *See generally* V. BRUDNEY & M. CHIRELSTEIN, CORPORATE FINANCE 825-32 (1987) (discussing concerns associated with tender offers such as timing and economics).

228. *See supra* notes 111-22 and accompanying text (by removal-replacement of directors, a friendly environment is created).

229. Before the new antitakeover law more than half the Fortune 500 companies were incorporated in Delaware. A recent newspaper article reports that over "100 major companies," including Zenith Electronics Corp., Beaumont Financial Ltd. and Gibson Musical Instruments, Inc., have "moved their charters to Delaware as of April 4." While these may not all be due to the new antitakeover legislation, there does seem to be a trend of more corporations moving to Delaware. News-Journal (Wilmington), Apr. 13, 1988, at B10, cols. 2-5. More corporations mean that the use of the written consent mechanism to effect a business combination, as well as the incidence of attempts to opt-out of the provisions of § 228, will be on the rise.

inevitable, directors should adopt a resolution urging stockholders to opt-out of section 228's reach.

VI. CONCLUSION

Section 228 is a provision of the Delaware Corporation Law which, when drafted, was never envisioned to be as significant in battles for corporate control as it has presently become. The written consent mechanism is available for such actions as amending bylaws and removing and replacing directors. Action taken by consent is effective immediately upon the presentation of a sufficient number of consents to the corporation. Limitations on the effectiveness of action by consent, imposed by directors through bylaw amendments, will not be tolerated by the Delaware courts. However, by so providing in the articles of incorporation, the potentially harsh results of section 228 can be completely avoided by opting-out. In light of the potential use of written consents to avoid the protections afforded by the Delaware Business Combination legislation, and the restrictions imposed on director action by *Datapoint* and *Prime Computer*, directors should take immediate action to effect an opt-out of section 228. If such action is not taken by directors, they may have missed one of their best chances to avoid a hostile battle.

Daniel J. DeFranceschi