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Corporations—Conditional Supermajority Provisions: Protecting Shareholders' Interests—*Seibert v. Gulton Industries, Inc.*, No. 5631 (Del. Ch. June 21, 1979), *aff'd*, No. 219, 1979 (Del. Jan. 4, 1980).

In *Seibert v. Gulton Industries, Inc.*,[1] the Delaware Supreme Court affirmed the dismissal of a complaint challenging the legality of a conditional supermajority amendment[2] to Gulton Industries' certificate of incorporation. The challenged amendment required the affirmative vote of eighty percent of Gulton's shareholders to approve a proposed takeover[3] of Gulton by any person or entity that had acquired five percent or more of Gulton's shares prior to its proposed takeover.[4] The eighty percent vote was not required if Gulton's directors had approved the proposed takeover prior to the other entity's acquisition of a five percent interest in Gulton. In such cases a simple majority sufficed. Thus, the amendment gave Gulton's directors discretion to invoke the supermajority requirement for takeover attempts they opposed.

The chancellor's decision to dismiss plaintiff's complaint was consistent with the enabling philosophy[5] that permeates the relevant Delaware statutory and case law. Nevertheless, the decision failed to discuss the practical implications of enacting conditional supermajority requirements. Specifically, the chancellor did not consider whether Gulton's conditional supermajority provision would adequately protect sharehold-

1. No. 5631 (Del. Ch. June 21, 1979), *aff'd*, No. 219, 1979 (Del. Jan. 4, 1980).

2. Delaware law ordinarily requires no more than the affirmative vote of a simple majority of shareholders to approve a merger. Supermajority provisions, in contrast, require a higher percent majority vote than is required by state law. Some supermajority provisions, as in *Seibert*, leave to management's discretion the decision whether to invoke the supermajority requirement. Such provisions are often referred to as "discretionary" or "shifting"; this note will hereafter refer to them as "conditional" supermajority provisions.

3. A takeover occurs when an offeror purchases a controlling interest in the stock of another corporation. Takeovers may be effected through public or private offers to purchase securities. Thus, an offeror may publicly announce its intention to purchase during a fixed period all or a portion of a class or classes of securities of a publicly-held corporation at a specified price or upon specified terms for cash or securities. In so doing, the offeror has made a tender offer for the stock of the target corporation. Alternatively, an offeror may effect his purchase of the target corporation's stock privately or on the open market. After completing a takeover, an offeror may vote to merge with the acquired target corporation.

4. A five percent acquisition triggers the disclosure requirements of the Williams Act as amended in 1970, Act of Dec. 22, 1970, Pub. L. No. 91–567, 84 Stat. 1497 (1970), and is the percentage frequently stipulated in defensive voting provisions.

5. According to the proponents of this philosophy, corporate law should merely facilitate the free, private allocation of risks, profit, and control. Latty, *Why Are Business Corporation Laws Largely 'Enabling'?* 50 CORNELL L.Q. 599 (1965). *See generally* Katz, *The Philosophy of Midcentury Corporation Statutes*, 23 L. & CONTEMP. PROB. 177 (1958).

ers' interests to the extent they conflict with management's interests. By dismissing the complaint, the *Seibert* court failed to consider whether the use of conditional supermajority provisions should be circumscribed by the courts in order to make such measures responsive to the needs of shareholders. This note examines alternatives to dismissal of the plaintiff's complaint and recommends that corporate management be required to disclose the purposes and effects of conditional supermajority provisions when proposing them to shareholders for adoption.

I. BACKGROUND

Takeover bids are attempts to acquire control of a corporation through the purchase of its stock on the open market or through a publicized tender offer.[6] The use and success of tender offers increased dramatically in the United States during the 1960's,[7] producing pressure for governmental regulation.[8] In 1968, the Securities Exchange Act of 1934 was amended by the Williams Act[9] to include tender offers. The purpose of the statute was to provide investors with basic substantive protections together with full disclosure of the terms, conditions, and financing of the offer as well as the identity and pertinent background information regarding the offeror.[10] In the late sixties and early seventies, many states also enacted statutes to regulate takeovers; these generally require that offerors disclose certain information to target companies and investors.[11]

6. Smiley, *Do Tender Offers Damage Stockholders?*, in THE ATTACK ON CORPORATE AMERICA 97 (M. Johnson ed. 1978). *See generally* E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL (1973)(hereinafter cited as TENDER OFFERS).

7. TENDER OFFERS, *supra* note 6, at 64–65 & n.3.

8. Senator Harrison Williams of New Jersey first proposed federal regulation of cash tender offers in October of 1965. Regulation was designed to protect "proud old companies" from raids by "white-collar pirates." 111 CONG. REC. 28256–60 (Oct. 22, 1965)(remarks of Senator Williams on S. 2731).

9. Act of July 29, 1968, Pub. L. No. 90–439, 82 Stat. 454 (codified at 15 U.S.C. §§ 78m(d)–(e), 78n(d)–(f) (1976). For legislative history, see *Hearings on S. 510 Before the Subcomm. on Sec. of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967); *Hearings on H.R. 14475, S. 510, Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. (1968); H.R. REP. No. 1711, 90th Cong., 2d Sess. (1968); S. REP. No. 550, 90th Cong., 1st Sess. (1967).

10. The bill was designed to provide investors with full disclosure without favoring either the tender offerors or the management of the target company. *See* H.R.REP. No. 1711, 90th Cong., 2d Sess. (1968); S. REP. No. 550, 90th Cong., 1st Sess. (1967).

11. *See, e.g.*, N.Y. BUS. CORP. LAW § 1603 (McKinney Supp. 1979–80); PA. STAT. ANN. tit. 70, § 75 (Purdon Supp. 1980–81). In addition, these statutes often require that offers stay open for a minimum period once made, HAWAII REV. STAT. § 417E–2(1) (1976), and that a hearing be held at which state officials review the offer and the offeror's disclosure of statutorily prescribed information, OHIO REV. CODE ANN. § 1707.04.1(B)(4) (Page 1978). Some states also regulate substantive aspects of the offer such as proration of acceptances in the event of oversubscription. VA. CODE § 13.1–530(c) (Supp. 1980); CONN. GEN. STAT. ANN. § 36–463(c) (West Supp. 1980).

Tender offers have continued to succeed despite the extensive legislation, however, and vulnerable corporations have developed an array of defensive measures.[12] For example, a corporation may repurchase its own stock by an open-market purchase or by a tender offer. The target thereby reduces the number of shares available to the potential offeror and increases the price of the target corporation's stock, which may cause the offeror to look elsewhere for a better bargain. Or, a corporation may place its stock in friendly hands to discourage tender offers. Generally, such measures will either discourage future takeover bids or frustrate the success of a bid that is already in progress.[13] Because a conditional supermajority amendment both discourages future offers and frustrates offers that have been made, it is a potent antitakeover measure.

II. THE *SEIBERT* DECISION

In *Seibert*, plaintiff claimed that the amendment adopted by Gulton was illegal because it gave Gulton's directors discretion not authorized by Delaware law.[14] Although it is true that supermajority provisions are not specifically authorized by Delaware laws, several sections of Delaware's General Corporation Law were relevant to plaintiff's claim. Section 251(c) provides that a merger agreement can be approved "[i]f a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement."[15] Section 102(b)(4) allows a certificate of incorporation to include provisions requiring the vote of a larger portion of the stock than is required by the code.[16] Finally, section 102(b)(1) allows a certificate of incorporation to include:

> *Any provision* for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the members of a non-stock corporation; *if such provisions are not contrary to the laws of this State.*[17]

Read together, these provisions allow corporate charters to require the

12. For a thorough discussion of these defensive measures, see TENDER OFFERS, *supra* note 6, at 219–76, and E. ARANOW, H. EINHORN, & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 193–206 (1977).

13. *See* Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, 21 STAN. L. REV. 1104, 1105 (1969).

14. No. 5631 at 3 (Del. Ch. June 21, 1979).

15. DEL. CODE ANN. tit. 8, § 251(c) (1975).

16. *Id.* § 102(b)(4).

17. *Id.* § 102(b)(1)(emphasis added).

vote of more than a simple majority (*i.e.*, a "supermajority") of stockholders for any corporate action, so long as state laws are not violated.

The chancellor also noted that Delaware case law had not directly ruled on the validity of supermajority requirements.[18] One recent Delaware case, *Young v. Valhi, Inc.*,[19] involved an attempt to evade the requirements of a supermajority provision. In *Young*, the minority shareholders sued to enjoin a proposed merger of a subsidiary into its parent corporation. The *Young* court held that the proposed merger failed to meet the test of being entirely fair to the minority shareholders of the subsidiary corporation because the majority had "manipulated corporate machinery" (by circumventing Valhi's supermajority provision) in an attempt to "squeeze-out" the minority shareholders of the subsidiary corporation.[20] Although the validity of Valhi's supermajority requirement was not at issue in *Young*, the case approved it by implication.[21] *Young* did not involve a conditional supermajority requirement like that adopted by Gulton.[22]

The chancellor also discussed an older Delaware case, *Sellers v. Joseph Bancroft & Sons Co.*,[23] in which preferred shareholders challenged the validity of an amendment to Bancroft's certificate of incorporation. The amendment, which a majority of Bancroft's shareholders had adopted, lowered the percentage vote needed to change the designations, preferences, and voting powers of the corporation's preferred stock. It was held invalid because it altered contractual preference rights given preferred shareholders in the charter by a fifty percent vote and not by the seventy-five percent vote to which the preferred shareholders were entitled under the charter.[24]

The chancellor considered the decision in *Sellers* significant in relation to *Seibert* because *Sellers* "seem[ed] to approve differing voting require-

18. In his opinion, the chancellor stated that "[t]he research of the parties has revealed no Delaware precedent directly on point." No. 5631 at 4 (Del. Ch. June 21, 1979).

19. 382 A.2d 1372 (Del. Ch. 1978).

20. *Id.* at 1378–79.

21. In *Young*, the chancellor held that a proposed merger, which involved circumventing a charter provision requiring eighty percent of Valhi's stock to be voted in favor of a merger, was unfair to Valhi's minority shareholders. 382 A.2d 1372, 1378–79 (Del. Ch. 1978).

22. The supermajority provision at issue in *Young* is characterized by Black and Smith as a conditional supermajority amendment. *See* Black & Smith, *Antitakeover Charter Provisions: Defending Self-Help for Takeover Targets*, 36 WASH. & LEE L. REV. 699, 722 n.80 (1979). However, Valhi's amendment did not give its directors discretion to decide whether to invoke its supermajority requirement, and therefore is not conditional as that term is used in this note. *See* note 2 *supra*. For an explanation of how Valhi's majority shareholders circumvented the supermajority requirement, see McBride, *Delaware Corporate Law: Judicial Scrutiny of Mergers—The Aftermath of* Singer v. The Magnavox Company, 33 BUS. LAW. 2231, 2243 n.55 (1978).

23. 2 A.2d 108 (Del. Ch. 1938).

24. *Id.* at 110–13.

ments dependent upon the matter being voted upon.''[25] He concluded that Gulton's supermajority amendment also called for a different percentage vote from the same class of shareholders depending upon the subject matter of the vote.[26] Therefore, because the provision in Bancroft's charter was valid under section 102(b)(4), Gulton's was valid also. In reaching this conclusion, the chancellor implicitly reasoned that shareholder approval of a proposed business transaction endorsed by the board concerned a "different subject matter" than shareholder approval of the same type of transaction opposed by the board.[27]

The chancellor concluded that plaintiff had failed to demonstrate that the conditional supermajority amendment violated either Delaware law or public policy.[28] He thus rejected plaintiff's assertion that Gulton's failure to advise its shareholders of the amendment's illegality constituted dissemination of false and misleading proxy information and granted the defendant's motion to dismiss. On appeal, the Delaware Supreme Court affirmed without opinion.[29]

III. ANALYSIS

Like all antitakeover provisions, Gulton's conditional supermajority amendment was enacted to prevent undesirable takeovers.[30] A conditional supermajority provision reduces the incidence of successful takeovers in two ways. First, its presence in a corporation's charter chills offers.[31] Potential offerors will hesitate before tendering an offer for a corporation if an eighty percent vote of its shareholders may be required to approve the transaction. Second, the amendment reduces the likelihood that those offers which are made will succeed, because eighty percent of the shareholders must vote in favor of the subsequent merger.[32]

25. No. 5631 at 6 (Del. Ch. June 21, 1979).

26. *Id.* at 6–7.

27. *Id.* at 7.

28. *Id.* at 8–9.

29. No. 219, 1979 (Del. Jan. 4, 1980).

30. Gulton's proxy statement of May 23, 1977, in which the conditional supermajority amendment was proposed, stated that the amendment was "designed to provide more effective resistance against any sudden or surprise attempt by an outsider to take control of [Gulton Industries]." Proxy Statement, addendum to Opening Brief of Defendant In Support of Motion to Dismiss at 6, Seibert v. Gulton Indus., Inc., No. 5631 (Del. Ch. June 21, 1979).

31. Although it is impossible to determine the extent of this "chilling effect," antitakeover charter amendments similar to Gulton's have discouraged offers. For example, Harold Simmons of the Valhi case abandoned an attempt to takeover PSA, Inc. after PSA, Inc. adopted several antitakeover charter provisions. Simmons pointed to the charter provisions as a reason for withdrawing the offer. Wall St. J., Feb. 23, 1979, at 14, col. 1.

32. Antitakeover provisions "mak[e] it more difficult for the company making the tender offer . . . to take . . . the second step of merging or otherwise combining with the corporation

Although the degree to which a conditional supermajority provision inhibits takeovers is not measurable,[33] it undoubtedly discourages them.[34] The chancellor failed to discuss the policy reasons for discouraging takeover bids or for supporting such bids. Further, assuming corporations are allowed to take defensive measures against takeover bids, the chancellor did not consider whether some measures better protect shareholders' interests than others. Consideration of these issues is necessary if the courts are to respond intelligently to conditional supermajority provisions.

A. Policy Reasons For and Against Takeover Bids

The decision to takeover a corporation is one of fundamental economics; a takeover will occur if the acquired corporation will provide a return on invested capital, after acquisition costs, equal to or above prevailing rates.[35] The first empirical study of cash tender offers concluded that the corporation most vulnerable to a takeover attempt is one with a poor operating performance, declining dividend payments, and surplus liquid assets.[36] This conclusion suggests that takeovers may benefit shareholders by forcing "inefficient managers out of the system and replac[ing] them with those who can do better."[37] Thus, takeovers arguably encourage efficiency and, hence, benefit shareholders and the economy as a whole.[38]

On the other hand, takeovers may be viewed as "unfair opportunit[ies] created by quirks in the market's valuation of a company or by overall market conditions."[39] Proponents of this theory maintain that ousted managers are not necessarily less competent than their successors and conclude that the benefits commonly associated with takeovers are rarely realized.[40]

whose shares are the object of the offer . . . by having a higher than usual vote required to approve a merger or other combination with a company holding a significant stock interest in the target corporation." Mullaney, *Guarding Against Takeovers—Defensive Charter Provisions*, 25 BUS. LAW. 1441, 1442 (1970).

33. There is no way to know how many tender offers are abandoned in the planning stage when offerors learn that their target's charter contains antitakeover provisions. *See* Black & Smith, *supra* note 22, at 701 n.11.

34. Although "[t]he effectiveness of [antitakeover] provisions is difficult to evaluate," the opposition by offerors to such provisions is "probably the best evidence that they do have some significant effect." Mullaney, *supra* note 32, at 1462. *See also* TENDER OFFERS, *supra* note 6, at 260.

35. TENDER OFFERS, *supra* note 6, at 2.

36. Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 142 (1967).

37. [1979–80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,445, at 82,876.

38. *Id. See also* Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978).

39. [1979–80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,445, at 82,876.

40. One author states that it is "frequently the best run companies, rather than those with inept and inefficient managements, [which] are the most sought after takeover targets." Weiss, *Disclosure and Corporate Accountability*, 34 BUS. LAW. 575, 585 (1979). Another author concludes that

There is support for both views and it remains an open question whether takeovers, on balance, benefit or harm shareholders. Inasmuch as it cannot be said conclusively that takeovers harm shareholders, courts should allow corporations to take defensive measures against them. The conditional supermajority requirement is one available device. Such a requirement presents additional questions that should be considered before the proper response can be framed.

B. Special Policy Questions Presented by Conditional Supermajority Requirements

A conditional supermajority provision differs substantially from a fixed[41] supermajority requirement in that the former gives discretion to the directors to decide whether to invoke the supermajority vote requirement. Leaving this discretion with the directors creates a potential conflict of interest between them and the shareholders each time a takeover bid is made. A fixed supermajority requirement presents such a conflict only once, namely, when the amendment is proposed in the proxy solicitation. Once a fixed supermajority requirement is adopted, the decision whether to merge rests largely with shareholders. A conditional supermajority amendment, however, raises the possibility of self-dealing by the directors with each proposed takeover.[42] For example, the directors may approve offers friendly to them, thereby increasing the likelihood that such offers will succeed, even when they know that such offers will harm shareholders. Moreover directors are likely to disapprove any offer that threatens their positions in the corporation,[43] irrespective of whether such an offer would benefit shareholders.

On the other hand, the discretion inherent in a conditional superma-

"[e]xperience does not prove that the shareholders of the target are better off if the target accepts a takeover bid." Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 108 (1979).

41. A "fixed" supermajority requirement simply requires that a designated supermajority of the corporation's shareholders vote to approve certain transactions. Fixed supermajority requirements are less common today than they were several years ago, as managers prefer the flexibility given them by recently developed, more sophisticated antitakeover devices such as Gulton's conditional supermajority amendment. For a discussion of various types of supermajority provisions, see Black & Smith, *supra* note 22, at 713–15.

42. The Chairman of the Securities and Exchange Commission alluded to this potential problem in a speech delivered Jan. 17, 1980 to the Seventh Annual Securities Institute. In discussing the discretionary feature of Gulton's amendment, he stated "[w]hether such apparent flexibility will result in abuses—such as its use as a bargaining chip to enhance incumbent management's interests at the expense of shareholders—will be a subject of continuing concern." [1979–80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,445, at 82,882.

43. Managers fear losing their jobs, and have a "natural desire to remain in control" of the corporations that employ them. Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 363, 230 A.2d 769, 776 (1967).

jority requirement may benefit shareholders if it is used properly. For example, the directors may refuse to approve a pending offer if they think that acquisition by the particular offeror will not benefit the corporation. Withholding approval will trigger the supermajority requirement, decreasing the likelihood of the offeror's success.[44] Or, the directors may condition their approval on an increase in the offeror's offered price per share. This will pressure the offeror either to increase the price, which will benefit shareholders, or to forego managerial approval and risk not receiving the required supermajority vote.

Given the potential for a conflict of interest, the chancellor in *Seibert* should have considered whether a meaningful remedy exists for shareholders who allege that the directors have abused their discretion to require a supermajority.

The only remedy the chancellor's decision left the shareholders is a cause of action against corporate directors for abuse of discretion. Delaware courts have long held that corporate management stands in a fiduciary relation to shareholders and has a duty to deal with them "fairly and justly."[45] It is questionable whether applying this standard produces a meaningful remedy, however, because Delaware courts readily defer to corporate management's[46] business decisions and presume that they have been made in good faith in the absence of evidence to the contrary.[47] If directors were sued for abuse of discretion in invoking or not invoking the conditional supermajority provision, it is likely that they could satisfy Delaware courts that they had a "business purpose" sufficient to justify their decision to approve or oppose a tender offer.[48] Therefore, until Delaware courts are willing to heighten their scrutiny of asserted "business purposes,"[49] it will remain difficult for a shareholder to demonstrate that an abuse of discretion has occurred.

44. *See* note 37 *supra*. *But cf.* Black & Smith, *supra* note 22, at 701 & n.11 (questioning whether antitakeover provisions impede tender offers).

45. *Id.* at 363, 230 A.2d at 775 (quoting Yasik v. Wachtel, 25 Del. Ch. 247, 256, 17 A.2d 309, 313 (1941)).

46. "Judicial decisions in Delaware illustrate that the courts have undertaken to . . . create a 'favorable climate' for management." Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663, 670 (1974).

47. For example, in Allaun v. Consol. Oil Co., 147 A. 257 (Del. Ch. 1929), a minority shareholder alleged that a proposed sale of Consolidated's assets to Huff Oil Co. was fraudulent in that the consideration to be paid was grossly inadequate. The court dismissed the complaint, and held that the directors' judgment in setting the terms of the sale was presumed to have been exercised honestly and in good faith. *Id.* at 263.

48. For example, they could argue that the price offered was too low or that the proposed offer was not in the corporation's best interests.

49. Recently, the Delaware Supreme Court did increase its scrutiny of business purposes in "going private" transactions. *See* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

C. *Possible Judicial Responses to a Conditional Supermajority Requirement*

The chancellor's decision to validate Gulton's amendment was not compelled[50] by Delaware law and gave Gulton's directors a discretion unduly susceptible to abuse. For these reasons, the chancellor should have explored alternatives to dismissal of plaintiff's complaint in determining the best remedy.

1. *State Imposed Disclosure*

One alternative is to require corporate management to disclose the purpose and effects of conditional supermajority provisions when proposing them to shareholders for adoption.

A duty to disclose could be imposed through existing Delaware precedent.[51] Enforcement of the duty would require after-the-fact judgments on the fairness and adequacy of management's disclosure. Several cases have applied a fairness test[52] to determine whether the terms of proposed mergers sufficiently protected the interests of minority shareholders. A similar fairness test could be applied to a conditional supermajority amendment to determine whether management's disclosure sufficiently protected shareholders' interests.

Disclosure would benefit shareholders by informing them of the advantages and disadvantages of a proposed antitakeover measure. Disclosure leaves shareholders free to choose for themselves whether an antitakeover measure is desirable. Undercutting the advantages of disclosure, however, is the fact that it would be difficult for a court to decide whether disclosure was adequate in a given situation. Delaware courts often defer to corporate management's invocation of the "business judgment"

50. *See* note 18 *supra*. *Young* and *Sellers* had implicitly approved supermajority requirements, but neither case involved a conditional supermajority requirement. *See* note 21 *supra* for a discussion of the *Young* case. *See* text accompanying notes 23 & 24 *supra* for a discussion of the *Sellers* case.

Section 102 of the Delaware General Corporation Law authorizes "fixed" supermajority requirements, but is silent on the question whether conditional supermajority requirements are authorized by Delaware law. DEL. CODE ANN. tit. 8, § 102 (1975).

51. Delaware courts could require that management fully reveal to shareholders the potential advantages and disadvantages of such provisions as a part of its general fiduciary duty to deal fairly with them. *See* Yasik v. Wachtel, 25 Del. Ch. 247, 17 A.2d 309, 313 (1941) ("[i]t is fundamental that directors stand in a fiduciary relation to the corporation and its shareholders, and that their primary duty is to deal fairly and justly").

52. In Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952), the court held that in an "interested merger," such as a merger between a parent and a subsidiary corporation, the test to be applied is intrinsic fairness and that the defendant corporation has the burden of establishing that the merger terms are fair to all parties. The court continued to apply this doctrine in Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977).

rule,[53] and the effectiveness of the duty to disclose would depend in large part upon whether Delaware courts were willing to look beyond the form of disclosure to scrutinize its contents.[54] Even assuming courts would not defer to management's judgment, applying the fairness test to disclosure would be difficult. Deciding whether events occurring subsequent to the adoption of a supermajority charter provision were so reasonably foreseeable that management should have described the possibility of such a contingency to shareholders would not be easy.

2. *SEC Imposed Disclosure*

A duty to disclose could also be imposed on management through rule-making by the Securities and Exchange Commission. On October 13, 1978, the SEC issued Exchange Act Release No. 15230 (Release),[55] in which the SEC's Division of Corporate Finance made public its concern over the adequacy of disclosure with respect to antitakeover provisions.[56] Although the Release states that its instructions are "merely for the guidance of [its] staff,"[57] it is clearly "designed to put issuers on formal notice that in the Division's view antitakeover proposals are inherently suspect and will be scrutinized accordingly for completeness of disclosure."[58]

The Release contains special recommendations regarding disclosure of supermajority provisions.[59] The Division recommends that issuers disclose whether the supermajority provisions will, under any circumstances, give management a veto power over the transaction being voted upon, despite the fact that a majority of the corporation's shareholders want to approve the deal. Furthermore, if the supermajority provision would give a minority of shareholders power to veto a merger that had been approved by management or a majority of the shareholders, that feature should be disclosed. Lastly, disclosure should be made with respect

53. *See generally,* Cary, *supra* note 46, especially 680–81.

54. In the past, Delaware courts have not been willing to do this. *See* note 46 and accompanying text *supra*.

55. SEC Exchange Act Release No. 15230, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,748 (Oct. 13, 1978) [hereinafter cited as Release].

56. *Id.* The Release recommends that disclosure of antitakeover provisions be set forth prominently and in one place in the proxy materials that are mailed to shareholders. *Id.* at ¶ 80,986. It also recommends that disclosure include the reasons why management is proposing to amend the charter. In addition, the requirement's effect, its advantages and disadvantages, and its mode of operation should be stated. *Id.* at ¶ 80,986–87.

57. *Id.* at ¶ 80,984.

58. Black & Smith, *supra* note 22, at 702.

59. Release, *supra* note 55, at ¶ 80,987.

to whether a supermajority vote is needed to adopt or repeal the provision.[60]

The Release and any rule that may be promulgated pursuant to it can be enforced under SEC Rule 14a–9(a), which prohibits solicitation of votes by a proxy statement that is false or misleading with respect to a material fact or that omits to state a material fact needed to make other statements therein not false or misleading.[61] The SEC, a solicited shareholder,[62] or the corporation may bring suit to enforce 14a–9(a). Possible remedies include enjoining any further solicitations with the defective materials, enjoining the voting of proxies received through solicitation with the defective materials, or rescinding any action taken on the basis of the proxies so acquired. The current standard used to determine the adequacy of disclosure under 14a–9(a) is "[f]air accuracy, not perfection."[63] Federal courts are available to enforce the Release and any rules that may follow it.

Similar to state-imposed disclosure, SEC-imposed disclosure of the effects of antitakeover proposals benefits shareholders by allowing them to decide for themselves whether to enact such proposals. The Release contains recommendations to issuers that will help them determine what information should be disclosed. The Release has been criticized as shortsighted, however, in that it requires too much disclosure, which may make it difficult for management to convince shareholders that there are valid reasons for enacting antitakeover proposals. Additionally, it will be difficult for courts to decide whether the Release's disclosure requirements were met when reviewing solicitation statements whose adequacy has been challenged.

3. *Banning Conditional Supermajority Requirements*

The other alternative to the chancellor's decision is to ban conditional supermajority provisions. This option would preclude managerial self-dealing that may be present when conditional supermajority provisions are allowed. Banning conditional supermajority provisions would also spare corporate managements and courts the task of deciding what is "fair" disclosure in a given situation.

Banning such amendments, however, presents two problems. First, it

60. *Id.*

61. *See* Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195, 1199 (2d. Cir. 1978).

62. The Supreme Court has upheld the right of private litigants to bring an action in their own name or to bring a derivative suit on behalf of the corporation to enforce the proxy rules of 14(a). J. I. Case Co. v. Borak Co., 377 U.S. 426 (1964).

63. *See* Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195, 1200 (2d. Cir. 1978).

is a paternalistic response; it deprives shareholders of the opportunity to approve such measures if they so desire.[64] Second, banning conditional supermajority provisions is an extreme measure, unwarranted in the absence of strong evidence that such provisions rarely serve the interests of a corporation's shareholders. Such evidence has not been adduced.[65]

D. Recommendation & Conclusion

There is no ideal solution to the conflict of interest problem presented when an antitakeover provision, such as Gulton's supermajority amendment, is proposed by management to shareholders for adoption. Of the available solutions, however, disclosure is preferable because it informs shareholders and leaves them free to decide for themselves whether to adopt antitakeover provisions. Because Delaware courts defer readily to corporate management, it is unlikely that they will fashion a duty to disclose from existing precedent. Thus, SEC-imposed disclosure is the more promising solution. At present, Rule 14a–9(a) requires full and fair disclosure in proxy solicitations[66] and thus, could be used to challenge the adequacy of disclosure when antitakeover proposals are made. The SEC is currently deciding whether to promulgate rules requiring disclosure of antitakeover proposals. SEC rules could benefit both shareholders and management if they are carefully drafted, keeping the interests of shareholders, management, and the corporation itself in mind.

Constance M. Crawley

64. Shareholders may conclude that corporate management is better qualified than they are to judge the desirability of potential offers. For that reason, they may wish to give management discretion to invoke the supermajority requirement for offers they deem undesirable.

65. Black & Smith, *supra* note 22, at 731, conclude that "there is a glaring lack of evidence that the antitakeover provisions now being adopted . . . unfairly interfere with stockholder's rights."

66. *See* Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195, 1199 (2d. Cir. 1978).